Insurance Solvency Supervision

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

– to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
– to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
– to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The original Member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became Members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973), Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996), Korea (12th December 1996) and the Slovak Republic (14th December 2000). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

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FOREWORD

With a view to meeting its members' growing disquiet concerning the question of insurance solvency - a concern accentuated by recent cases of insolvency and the increased role of insurance companies in the economy, for example in the fields of life insurance and private pensions and also as institutional investors - the OECD Insurance Committee decided in early 1993 to set up a Group of Governmental Experts on Insurance Solvency. According to its mandate, the Group's primary task was to survey and analyse the regulatory and supervisory systems and techniques existing in Member countries concerning the solvency of insurance companies, the issues raised in this field and measures and practices that were being or might be used to address them.

As the starting point of their work, Member country experts began by drafting summary reports on the supervision of solvency in their own countries. The experts were asked to focus on the following points in particular:

- regulations concerning the supervision of solvency;
- practical organisation of supervision;
- recovery measures when difficulties arise.

These national reports were combined in a single publication in 1995.

Since then, solvency supervision has evolved in response to the new environment surrounding the insurance business. The increasing liberalisation of markets has resulted in most *prior* supervision of products and tariffs being relinquished in favour of *ex post* supervision; the concentration and internationalisation of insurance companies has necessitated greater mutual understanding and closer co-operation between supervisory authorities in the different countries. Moreover, the supervisory authorities have had to meet the challenge represented by increased convergence between the different financial sectors - banks, insurance, securities and pensions - by drawing up solvency rules for insurance groups and financial conglomerates and co-operating closely or even merging with other financial sectors' supervisory authorities. Finally, the new emerging risks have had to be taken into account and the protection of the insured has in some instances been increased, by introducing an additional level of cover, i.e. general funds for the protection of policyholders.

The time had come to update the publication. Readers will find updated versions of the 25 national contributions included in the 1995 publication, and also reports from the five countries that have joined the OECD since that time. In addition, they will find a comparative analysis of the different systems of solvency supervision in the OECD countries.

The information contained in the present report is up-to-date as at 1 January 2001. At that point in time, a number of Member countries were considering introducing changes of varying magnitude in their solvency supervision systems.

This publication was prepared by the Financial Affairs Division of the Directorate for Financial, Fiscal and Enterprise Affairs (co-ordinated by Ms Viviane Leflaive). It was approved by the Insurance Committee at its 67th Session in June 2001 and is published on the responsibility of the Secretary-General of the OECD.

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COMPARATIVE ANALYSIS

Viviane Leflaive

I Introduction

The insurance business is characterised by a reversal of the conventional operating cycle: insurance companies take in premiums, i.e. remuneration for insurance services rendered, before paying out any benefits in respect of claims. When they invest the funds thus collected, insurers run certain risks in respect of depreciation, liquidity, interest rates, matching (i.e., mismatching assets and liabilities), credit, etc. In addition to these risks, which are common to all financial institutions, there are risks unique to the insurance industry - insufficient premiums, miscalculation of technical provisions, adverse change in loss frequency, catastrophic losses, reinsurance risk, etc. Lastly, like any business, an insurance company is subject to risks of a more general nature, such as incompetent or dishonest management or poorly managed growth.

The primary function of an insurer is to manage all these risks in such a way as to be able at all times (or at least in the vast majority of circumstances) to meet its commitments to policyholders and beneficiaries. It is this capability of an insurer to meet its commitments that is known as "solvency".

Nonetheless, because of the structure, size and complexity of the insurance industry, it is fairly difficult for policyholders or beneficiaries themselves to check their insurer’s solvency. It is therefore for the primary purpose of protecting consumers that countries have instituted systems for supervising the solvency of insurance companies. Such supervision also makes it possible to guarantee the insurance industry’s financial soundness and thus to enhance public confidence, which is vital to the industry’s development.

This study is based essentially on the national reports on the supervision of insurance solvency in the OECD countries that are compiled in this publication. However, it also draws on other work carried out at the OECD, such as that of the Group of Governmental Experts on Insurance Solvency, and at other forums, including the Conference of Insurance Supervisory Authorities of the Member States of the European Union and the International Association of Insurance Supervisors.

Like the national reports, our study will focus on the following major issues:

- Regulations governing the supervision of insurance solvency (regulatory scope and typology of solvency supervision systems);
- Incorporation of the various risks into solvency supervision (concerning capital adequacy requirements, technical provisions and investments, risks specific to groups and financial conglomerates, and other risks);
- Practical organisation of supervision (status and main missions of the supervisory authorities and resources at their disposal, integrated or separate financial supervision authority, the role of auditors and actuaries within companies);
- Managing financial difficulties and cases of insolvency (intervention thresholds, rehabilitation measures, protection of policyholders in the event of liquidation).

II Regulations governing the supervision of insurance solvency

A. Introductory remarks

The complexity of the insurance industry, and thus the great difficulty for consumers themselves to gauge the solvency of their insurers, have prompted the governments of all of the OECD countries to institute systems of varying scope to supervise the insurance business.

A virtual lack of regulation in New Zealand

In this regard, **New Zealand** is a very special case in that regulation of the insurance business is extremely limited.

No solvency or capital adequacy requirements are in fact imposed on life insurance companies, apart from the placement of a NZ$ 500 000 (about EUR 235 000) security deposit with a public administrator and the filing of accounts and the actuary's annual report with the Secretary to the Government Actuary. The Government Actuary may then require additional information and request that a company be placed under court supervision if he deems that its financial position appears fragile.

In non-life insurance, the sole regulatory requirement is that companies submit each year to review by one of the approved rating agencies[1], that they register the rating obtained with the Companies Office and that they disclose this rating at the conclusion of each new contract and at each renewal. However, members of the Insurance Council, a trade association of New Zealand non-life insurers, pledge to abide by the recommendations of the Fair Insurance Code and to maintain a solvency margin (the ratio of capital and reserves to net premiums) of at least 20 per cent.

It could therefore be said that the insurance market is largely self-regulated in New Zealand.

Regulatory harmonisation in Europe

The solvency rules in force in the European Union were introduced by the first non-life directive in 1973 and the first life insurance directive in 1979. These directives were subsequently amended, and insurance sector regulations in the European Union are now based essentially on the third-generation directives from 1992. In 1998, these directives were supplemented by a directive on insurance groups, and a proposed directive on insurance intermediaries is currently being negotiated. Lastly, an update of prudential standards has also been planned[2].

These regulations obviously apply to the fifteen Member States of the **European Union**[3], but the three other members of the European Economic Area (**Iceland**, **Liechtenstein** and **Norway**) have subscribed to them as well. In addition, this regulatory framework has also been instituted in **Switzerland** following agreements on insurance concluded between it and the European Union—in 1993 for non-life and in 1994 for life insurance. Lastly, the countries taking part in the European Union's accession programme are gradually amending their legislation to bring it in line with the European directives. Amongst OECD Member countries, the **Czech Republic**, **Hungary, Poland** and the **Slovak Republic** belong to that programme.

The regulation of insurance supervision is therefore largely harmonised throughout the continent of Europe, even if in certain areas the directives leave considerable latitude for application.

Regulation of insurance solvency in Canada and the United States

In some federal countries, the supervision of insurance solvency has the peculiarity of being regulated not only at the federal level, but at the State or provincial level as well.

In **Canada**, for example, the Office of the Superintendent of Financial Institutions (OSFI) supervises and regulates insurance companies that have been constituted or licensed under federal law, along with the activity of Canadian branches of foreign companies. In contrast, review and interpretation of insurance contracts, licensing and supervision of agents, and supervision of the solvency of insurance companies that have been constituted or licensed under provincial law (5 per cent of Canadian insurers) are prerogatives of the provincial authorities. Moreover, a Canadian or foreign insurer registered at federal level must also have been approved in all provinces and territories[4] in which it wishes to do business.

In the **United States**, each State is responsible for regulating and supervising insurance within its own jurisdiction. Each possesses its own Department of Insurance, which is placed under the responsibility of an appointed or elected Commissioner. These Commissioners meet within the National Association of Insurance Commissioners (NAIC), a body created in 1871 to co-ordinate the supervision of companies doing business in more than one state. The NAIC co-ordinates the States' efforts in the area of solvency in various ways, such as maintaining databases on insurer finances, the financial assets they hold and relevant regulatory measures, drafting model legislation and co-ordinating regulatory policy on important issues. For example, in 1989 the NAIC adopted Financial Regulation Standards, under which 47 States are now accredited, and its risk-based capital adequacy standards have been applicable since 1992 for life insurance and since 1993 for non-life.

Hereinafter, unless otherwise stated, references to the rules on solvency supervision in these two countries will be to federal regulations.

B. The scope of supervision of insurance solvency

The notion of insurance

Companies that write direct insurance are subject to regulation and supervision in all of the OECD Member countries (with the aforementioned restrictions in **New Zealand**). As a rule, it is the regulatory or supervisory authorities who decide which entities fall under the heading of insurance. In some countries, such as the **Netherlands**, **Poland** and the **United States**, the notion of the insurance industry is defined by law. In others, it is the notion of insurance operations that is defined: such is the case, for example, with the Member States of the **European Union**, where an exhaustive list of these operations is set forth in an annex to the insurance directives. Other countries rely on practice or case law to determine the scope of insurance. It should be noted that the OECD has also established a classification of insurance operations, which is listed in an annex to the Code of Liberalisation of Current Invisible Operations.

Entities subject to supervision

Theoretically, all entities engaged in the direct insurance business as defined above are subject to supervision. However, in some OECD countries (including **Australia**, **Germany**, **Luxembourg**, the **Netherlands**, **Norway**, **Portugal**, **Sweden** and **Switzerland**), certain entities are exempted from supervision even though they conduct insurance operations. The entities concerned are small ones having a very narrow scope of activity, such as trade unions that pay out compensation during strikes, small mutual companies that insure livestock, small local farm funds, companies that insure export credits with government guarantees, etc.

Prudential regulations theoretically apply equally to all businesses. Even so, exceptions can be granted to small firms or companies having a particular legal form (generally companies set up as mutual insurers). Such exceptions are justified by the economic, but also the social, role played by these companies. Thus, the **European Union** directives give Member States the option of allowing mutual insurers to reduce their minimum guarantee fund by 25 per cent. However, provisions like this are being increasingly contested because of the distortions of competition they might engender. In **Australia**, for example, the regulations applied to "friendly societies" are being harmonised with the rules applicable to conventional insurers. Similarly, **Japan**’s regulations on the liquidation of insurance companies with share capital are gradually being extended to mutual societies. Lastly, the aforementioned provision of the European directives in favour of the mutual societies is now being called into question by a majority of Member countries.

Moreover, in many cases additional rules apply to companies that belong to an insurance group or financial conglomerate (see below).

Supervision of reinsurance

Supervision of the reinsurance business comprises two distinct aspects: supervising the solvency of direct insurers that enter into reinsurance contracts (ceded reinsurance); and supervising the solvency of reinsurers that accept such contracts (accepted reinsurance).

Ceded reinsurance is supervised to ensure that the cedant’s risk exposure is properly limited by adequate reinsurance treaties. In this respect, it is part and parcel of the supervision of the direct insurer’s solvency, and the relevant regulatory measures will be outlined in the paragraph on the supervision of technical risks.

Accepted reinsurance is supervised differently, depending on whether the accepting company also writes direct insurance or, on the contrary, is a professional reinsurer. In the first case, the reinsurance business is subject to supervision similar to that of other direct insurance activities in a majority of OECD countries, insofar as any losses on that activity would directly diminish the funds that must also guarantee commitments to direct insured. In the second case, however, while some countries impose supervisory rules similar to those for direct insurers (e.g., **Canada**, the **Czech Republic**, **Denmark**, **Sweden**, **Turkey** and the **United Kingdom**), others impose more limited supervision. In **France** and **Germany**, for example, there is no licensing procedure for professional reinsurers, although reinsurers are subject to financial supervision. Lastly, countries such as **Belgium**, the **Netherlands** and the **Slovak Republic** subject such reinsurers to neither licensing procedures nor supervision, on the grounds that professional reinsurers deal only with clients that have the capability of assessing the solvency of the firms with which they do business.

It should be noted that the supervision of a reinsurer' s solvency is an issue that also arises in the assessment of the credit risk incurred by direct insurers by virtue of their claims on reinsurers. This topic is covered in the paragraph on reinsurance risk.

C. Systems of insurance solvency supervision: typology

Prior supervision and ex post *supervision*

An insurance company's solvency is supervised at various stages in the firm's business cycle. The licensing procedure, and particularly the imposition of capital adequacy requirements and close review of the firm's business plan, constitutes the first step. A thorough review of licensing conditions is beyond the scope of this study, however. Throughout a firm's lifetime *ex post* solvency supervision[5] continues, until all of its commitments are met, even during the run-off period or during a liquidation procedure.

While a firm is in business, some countries deem it incumbent upon the supervisory authorities to conduct prior checks of regulatory compliance, and of the quality of products put on the market, and to ensure that these products are adequately priced. This "prior control" approach, is recommended by the OECD in its *Twenty Insurance Guidelines for Economies in Transition*. It is stipulated, however, that "Supervision of tariffs and products should however be adapted to the particular situation of each country and reassessed at a later stage according to the development and progress of the market." Only a handful of OECD Member countries engage in prior control of pricing and products: **Hungary**, **Korea** (only in respect of products considered sensitive) and the **United States**. In **Mexico**, new products may be offered for sale as soon as they are registered, but the supervisory authority may decide to ban products for the 30 days following their registration. Lastly, prior control of pricing is still in effect in **Switzerland** for a number of special risks, but an upcoming reform is expected to put an end to it. The **Slovak Republic** requires insurance company to submit every changes of scheme of operation since licensing procedure.

In the other OECD countries, a more liberal approach, initially advocated by a number of countries such as **Australia**, the **Netherlands** and the **United Kingdom**, has gradually taken hold. The principle of exclusively *ex post* control was adopted by all of the Member States of the **European Union** in the third generation of insurance directives[6], and **Japan** instituted a risk-based solvency supervision system after pricing and product controls were abolished in 1997. The goal is to encourage insurance companies to innovate with new products, while at the same time ensuring, later on (through on-site audits or document checks), that these products do in fact meet regulatory standards, and that their pricing does not put the firm's financial position in jeopardy. In this area, **Belgium** is particularly vigilant, since each category of product is subject to an *ex post* review of profitability, after which the supervisory authority can require a premium increase or call for any other measure likely to restore financial equilibrium to that product category (such as amending certain contract clauses, changing selection policy, etc.). As regards new life assurance policies the same applies to the **Netherlands** where each company has to be submitted to a profit test. This, however, does not include that such product are subject to prior approval. It should be noted that the principle of *ex post* control does not prevent national supervisory authorities from requiring insurance companies to submit information on new products (e.g., main characteristics, technical interest rates, etc.) before marketing them; it means only that these data are not subject to prior approval.

The retrospective approach and the prospective approach

There can be two approaches to *ex post* supervision of insurance company solvency:

- The retrospective approach, which uses historical data to calculate an insurer's solvency requirements;
- The prospective approach, which calculates these requirements by applying theoretical models that incorporate historical data but also factor in assumptions as to future trends in corporate or market data.

The retrospective approach is applied in all of the OECD countries. Among the various types of retrospective models, a distinction is generally made between fixed-ratio models and risk-based models, which are also referred to as "risk-based capital" (RBC). The two types of models differ in the number of factors taken into account and the complexity of the formulae that are used.

Fixed-ratio models

In fixed-ratio models, solvency requirements are established as a fixed percentage of the value of a given variable that is assumed to be strongly correlated with a company's degree of risk exposure. This variable generally involves a simple function of one or more items on the balance sheet or profit and loss account. Such models are used in all of the Member States of the **European Union**, but also in **Australia** (for non-life insurance), the **Czech Republic**, **Korea**, **Mexico**, **Poland**, the **Slovak Republic**, **Switzerland** and **Turkey**[7].

The main advantage of these models is that they are simple to apply. Nevertheless, because of their very simplicity, it is difficult to tailor them to a particular insurer's risk profile, and they are very sensitive to the choice of variable used as the basis for the ratio. Moreover, they can sometimes lead to illogical requirements: for instance, if the ratio is based on technical provisions, a company having a prudent method of provisioning will have to produce a much greater solvency margin than a company that tends to under-provision.

But this drawback can be lessened by using and comparing a number of different ratios. For instance, a premium-based ratio favourable to companies that undercharge is offset by a claims-based ratio in the **European Union**.

"Risk-based" models

In the **United States**, the National Association of Insurance Commissioners (NAIC) in 1992 adopted risk-based capital adequacy standards applicable to the life and health insurance sectors. The objective of this "risk-based" model is to address the drawbacks of fixed-ratio methods by incorporating not just one or two factors, but all of the risks confronting an insurance undertaking (or at least what is considered to be all the risks confronting an insurance undertaking)—technical risks (involving inadequate pricing or technical provisioning, liquidation, etc.), but also investment risks (interest rate risk, credit risk, the risk of depreciation, etc.) and other risks (such as commercial risk and management risk). In addition, an effort is made to factor in the correlation between risks: values corresponding to each risk are not simply added together but are plugged into a more complex formula designed to reflect the correlation or independence of the various risks. It is considered, for example, that on average the value of the RBC ratio adopted in 1993 for non-life insurance in the **United States** is about a third lower than it would be if computed by addition alone.

More recently, models of this type were also adopted in **Canada** and **Japan**. For its part, **Norway** has adopted a dual system that combines the fixed-ratio model of European Union directives and a "risk-based" model based on banking regulations (the BIS model).

"Risk-based" models have the drawback of being more difficult to apply. In addition, it must be ensured that any new variables that are introduced do in fact lead to a more accurate estimation of the risks incurred. It is necessary to strike a balance between the number of component factors, the complexity of the formula and ease of application.

Prospective models

Fixed-ratio and "risk-based" models both share the drawback of being purely retrospective. But for some firms, and particularly those that are growing fast or have decided to alter their strategies, the incorporation of assumptions about future trends in corporate or market data can significantly alter one's perception of a firm's medium-term solvency.

So-called "prospective models" are theoretical ones that calculate solvency requirements using historical data but also factor in assumptions about changes in a company's profile (rates of policy renewal rates, overheads, etc.) and the market (future returns on investments, volatility of losses, and so on). Such an approach is used in **Australia** to test capital adequacy in life insurance. This test differs from the "risk-based" solvency test, which is used as well, in that it factors in business plan assumptions, and especially growth projections over a three-year time frame. A test of this type has also been instituted in **Finland**.

The value of prospective models is linked directly to the relevance of their architecture. The results obtained will be valid only if the model adequately reflects actual company and market trends. But business cycles, the effects of legislative changes and the impact of a rare event are difficult to model and to quantify. In addition, to apply such models often entails substantial data processing resources: as a result, the cost of legislative compliance can be high if such models are adopted.

Nonetheless, because they do a better job of taking a company's future development, and especially its growth, into account, they are probably bound to develop. In **France**, for example, a 1999 law requires companies to file a report that includes an analysis of medium and long term solvency. Some people see this as a desire to supplement existing requirements with a prospective assessment of solvency.

A complementary approach: survival models

If solvency requirements are calculated by "survival" models, known also as "dynamic solvency analysis" models, insurance companies must undergo a test based on assumptions of adverse changes to their assets or liabilities (e.g., asset depreciation or upward adjustment of technical provisions). Such models may be classified as either retrospective or prospective, depending on whether the scenarios are based exclusively on historical data or if they also include assumptions about new business.

"Survival" models were first developed in the **United States**, where some States are currently testing dynamic models based on changes in cash flows, and **Canada**. The solvency test used for life insurers in **Australia** alongside the aforementioned capital adequacy test is another example of a "survival" test based on a projection of unfavourable changes in liabilities (this test being supplemented by additional requirements incorporating asset-side risks). Lastly, the resilience test applied in the **United Kingdom** may be placed in this family of tests, even though it does not determine a solvency requirement, but rather the amount of the "resilience reserve".

The main difficulty in implementing these models lies in the definition of the scenarios tested: all risk factors need to be taken into account, and risk levels need to be chosen carefully to strike the proper balance between prudence and efficiency.

III Incorporating the various risks into solvency supervision

The solvency tests introduced in connection with fixed-ratio or risk-based models seek to quantify an insurance company's exposure, risk by risk, and then to plug the values obtained into an overall formula, the results of which—known as the minimum or regulatory margin—will be compared with the selected amount of capital effectively available in the firm (allowable equity). It should be noted that this regulatory margin represents only a lower limit, below which the supervisory authorities intervene automatically. Supervisory authorities may, however, take action even if an insurer still has a sufficient margin, and as a rule they are empowered to require an insurer to maintain a margin greater than this minimum amount if the circumstances so warrant.

A. *Equity requirements*

Minimum amount of equity (guarantee fund)

As soon as an insurance company files a licensing application, an initial solvency requirement is imposed on it in the form of a minimum level of equity, which is sometimes referred to as a minimum guarantee fund. Subsequently, equity that is allowable for constituting the solvency margin must always exceed both the minimum regulatory margin, calculated as a function of the risks to which the insurer is exposed, and this guarantee fund.

The amount of the minimum guarantee fund is not risk-based, but is set rather in an absolute manner. In point of fact, the fund plays a real role only in the case of new companies or those that do only a low volume of business, since for all other firms the risk-based margin would be greater. But for new firms, the only parameters available to estimate risks are assumptions regarding the business plan, and for that reason the results obtained are not necessarily very reliable. They are not reliable for small firms either, because the quantities in question are not large enough for the application of statistical rules to provide a sufficiently precise estimation.

The minimum amount of the guarantee fund may be modulated depending on the line of business: the amount stipulated for life insurance is generally greater than the requirement for non-life, except in **Canada**, **Japan**, **Korea**, **Norway** and **Turkey**, where the amounts are identical. **European Union** directives, as well as the **Czech Republic**, **Hungary**, **Poland**, the **Slovak Republic** and **Switzerland**, also require different amounts, in respect of non-life insurance, between liability and casualty business. Lastly, **Switzerland** is the only country to require different amounts for different classes of life insurance. In **Korea**, the level of the guarantee fund does not depend on the nature, but rather the number, of classes written: the amount required of a single-line insurer is one- or two-thirds less than the standard amount.

The amounts required differ sharply from one country to another. For non-life insurance, the range extends from EUR 200 000 for legal protection insurance in the **European Union** to 30 billion won (more than EUR 25 million) for a Korean multi-line insurer; for life insurance, it ranges from EUR 800 000 in the **European Union** to 30 billion won in **Korea**, A$10 million in **Australia** and C$10 million in **Canada**. In the **United States**, the amounts are set by each State. The relatively low guarantee funds imposed by **European** directives are due to the fact that amounts were set in absolute value in the first-generation directives; a substantial increase, which would at least account for subsequent inflation, is on the agenda, and there are plans to review the amounts regularly thereafter. **Norway** and **Mexico** resolve this problem by indexing the amount of the guarantee fund to inflation. Lastly, it should be borne in mind that the fund is only a floor, and that in most cases the supervisory authorities may require a company to carry a greater amount of equity: this is described as being commonplace in **Canada**, and even as constituting the rule in **Sweden** (where the minimum required capital is set by the authorities on a case by case basis, depending on the line of business, projected volume and other criteria).

Components of allowable equity (free capital)

The definitions adopted for allowable equity to cover regulatory margin requirements (free capital) do not differ substantially from one country to another. Theoretically, it consists of the company's assets, free of any foreseeable commitments, less any intangible items. When the assets represent a commitment, they can be included in the allowable equity if the corresponding commitment is subordinated to any other commitment. It therefore consists primarily of: share capital for joint stock companies or initial capital for mutual societies, a portion of the unpaid-in fraction of this capital, reserves free of all commitments, retained earnings, subordinated debt (in some countries only) and reserves related to potential adjustment of invested assets (in countries in which investments are carried at cost).

B. Technical risks

The main risks taken into account when determining minimum regulatory solvency margins are technical risks (insurance risks) and investment risks. While other risks can in fact also have highly adverse repercussions on an insurance company's solvency, they are harder to quantify. This does not mean that such risks are not subject to regulatory supervision, but only that the relevant provisions are generally qualitative measures imposed in addition to solvency margin requirements.

Risks of miscalculating premiums and technical provisions

These two items account for the bulk of technical risks. According to an A.M. Best study on the primary reasons for the failure of American insurance companies between 1969 and 1998, they constitute by far the leading causes of insolvency in the United States (being at fault in 22 per cent of the 683 cases studied).

Premium risk, or the risk of under-pricing, is defined as the risk that the premiums charged will be too low to cover the corresponding commitments. It has two components: pure premium assessment risk, which is fairly similar to the risk of miscalculating technical provisions; and the risk of underestimating operating expenses. It should be noted that if the under-pricing is voluntary—e.g., if premiums are deliberately set too low in order to attract customers—the risk is not one of assessment but rather "commercial" or "management" risk (see below).

The risk of miscalculating technical provisions, or "provisioning risk", corresponds to the risk that technical provisions will prove inadequate to meet all of the commitments arising from insurance contracts. It takes fairly different forms for life and non-life insurance, and, in respect of non-life insurance, between classes involving short-tail risks (such as casualty insurance) and those involving long-tail risks (such as various classes of liability). Liquidation risk, which is relatively negligible in the case of short-tail risks, in fact becomes relatively substantial as the time frame of the risks insured gets longer.

Lastly, a distinction is sometimes made between valuation risk that is due to an accidental miscalculation or misinterpretation of available data and a risk that stems from a subsequent change in risk factors; in this case, the risk is one of adverse change. This latter risk is by definition inevitable, save for recourse to reinsurance, but the former (i.e., an error in calculation) can be limited by regulations governing the process for setting premiums and technical provisions and/or by requiring that the tasks involved be performed by a qualified person—in most cases an actuary. Such provisions are found in all of the OECD countries in respect of life insurance; in contrast, only half of the OECD countries require non-life companies to use actuaries[8], and provisions governing the valuation process are frequently far more lax, except for compulsory classes of insurance, to which in many cases strict provisions apply.

In non-life insurance

Two accounting items can be seen as natural indicators of a company's level of exposure to valuation risks: the amount of premiums and the amount of provisions for future claims. The amount of premiums (premiums written, earned premiums or the higher of the two) is in fact a very natural basis for the risk of under-pricing and risk related to premium collection costs, but it also provides a thoroughly acceptable approximation for the risk of inadequate technical provisions in short-tail classes. In contrast, for classes involving long-tail risks, a ratio based on provisions for future claims is preferable for estimating the risk of under-provisioning and the risk involving claims management expenses.

To date, **European Union** directives have called for the use of a premium-based ratio to be supplemented by that of a ratio based not on the amount of provisions for future claims, but on the amount of claims (average, over the three or seven previous years depending on the class of risk, of the amount of claims paid and the variation of the amount of reserves for outstanding claims). The advantage of taking into account the amount of claims paid is that it does not set a lower solvency requirement for a company that has calculated its technical provisions too narrowly than would be imposed on a company having a more prudent provisioning policy. On the other hand, this index does not factor in the particularly substantial liquidation risk that characterises transactions involving a very lengthy time frame. It is for this reason that a large majority of Member countries would like to add, alongside a premium index and a claims index, a third parameter—a provisions index—that would be based on provisions for future claims.

If the term "claims-based ratio" is taken to encompass ratios based on provisions for claims and ratios based on past claims (of the European sort), it could be said that all of the OECD countries use both a premium-based ratio and a claims-based ratio. Except for the **United States**, where they are used cumulatively (according to a formula that is more complex than addition alone), only the higher of the two ratios is used in the final calculation of the solvency requirement (alternative method). **Canada**, however, is considering a reform of its non-life solvency system that would shift to a risk-based system in which technical risk would be factored in via a ratio involving unearned premiums and one involving unpaid claims, used cumulatively.

The percentages used to construct ratios are generally not applied uniformly, yet methods of refinement differ from country to country. The first method consists in setting different rates for different classes of insurance: in **Mexico**, for example, the percentage applied to total premiums varies from 13.87 per cent for health and accident insurance lines to 113.62 per cent for credit insurance, which is deemed far riskier (the percentage applied to claims varies in similar proportions). This method of refinement is used in the **United States** as well. **Canada** is also considering varying the percentage applied to claims, depending on the class of insurance. In contrast, the method is not applied in Europe, and it did not receive majority support in the reform of **European Union** directives. The reasoning given was that such a distinction would require an indisputable classification of risks by class of insurance (to prevent risks from being apportioned in an opportunistic manner) and would make the solvency margin more complicated to calculate. Moreover, the introduction of a provisions index, which factors in the high liquidation risks inherent in long-tail risks, implicitly entails a modulation (since the provisions index would effectively determine the solvency requirement only if the provision for future claims exceeded a given percentage of premiums).

Another method of refinement seeks to incorporate reduction of risk through improved risk diversification. In the RBC system implemented in the **United States**, a reduction of the provisions risk is granted in respect of portfolios that are adequately diversified (the degree of diversification being calculated from the respective proportion of total provisions of each class: for a portfolio equitably apportioned among the 15 classes, the factor is cut to 72 per cent of the initial amount). The difference between the percentages applied below and above the EUR10 and 7 million thresholds applicable respectively to the premium index and the claims index in the **European Union** can also be explained by the incorporation of risk compensation (which is easier to achieve in a large firm). But these thresholds also reflect a desire to take economies of scale into account. Be that as it may, this differentiation does not appear to have been sufficiently convincing, since the proposed reform would do away with it.

The percentages can also be altered to reflect the particular characteristics of a firm in relation to the market average, the lower liquidation risk for accepted reinsurance contracts, the absence of subsequent claims risk for contracts covering only those risks that are reported during the period of cover, and so on.

In life insurance

In respect of life insurance, health insurance that is managed in a similar fashion, and certain accident classes, the setting of premiums and technical provisions is heavily regulated in all of the OECD countries. In particular, regulations call for the use of mortality or morbidity tables and a prudent technical interest rate. The **Slovak Republic** does not regulate technical interest rate; the supervisory authority recommends using of prudent technical interest rate and modification of mortality/morbidity tables in the cases that authority finds them insufficient. Depending on the country, tables can be imposed by the supervisory authorities or established by the insurance companies on the basis of the observed loss frequency of their own portfolios, and then approved. Ceilings on technical interest rates are set either absolutely (e.g., 8 per cent for contracts denominated in national currency in **Mexico**) or in relative terms (60 per cent of the rate on government bonds in the currency in which a contract is denominated in the **European Union**[9]). Moreover, apart from **France** and **Switzerland**, all OECD countries require that life insurance companies retain the services of an actuary[10]. In view of these measures, the primary technical risk in life insurance is that of an unexpected and adverse change in mortality or morbidity[11]. Depending on the type of life insurance in question, two balance sheet items provide a natural basis for estimating the risk. A ratio based on the amount of mathematical provisions is in fact relevant for estimating annuity risks (risk of underestimating annuitants' life expectancy). In contrast, for contracts that provide death benefits, a ratio based on capital at risk and the difference between the amount of the benefit and the mathematical provisions constituted, is more appropriate.

All of the OECD countries use a ratio based on capital at risk except **Mexico**, where solvency requirements for life insurance other than pensions are based on the aggregate amount insured (mathematical provisions and capital at risk). The special case of annuity contracts is treated differently only in **Canada**, where a ratio of 1 per cent of mathematical provisions is applied alternatively to contracts involving a survival risk, and in **Mexico**, where a ratio of 4 per cent of mathematical provisions is applied to all pension contracts. **European Union** directives also call for a ratio based on mathematical provisions; this is not, however, in order to allow for the risk of a change in mortality but for the risk involving operating expenses[12]; this is why this ratio, logically, is used in conjunction with the one involving capital at risk. This choice of ratio assumes that the bulk of operating expenses consist of the costs of tracking policies and managing investments; if, on the contrary, it is premium collection and new contract preparation expenses that dominate, then a ratio based on gross premiums would be more appropriate. Lastly, it should be noted that special ratios are applied in respect of entities that do not administer life insurance using the conventional capitalisation method (e.g., a ratio based on the assets of the association for tontines, a ratio based on net premiums for associations of Lloyd's subscribers).

As for non-life insurance, the percentages used to define ratios can be modulated in a variety of ways. In the **United States**, loss simulations for portfolios of differing size have shown that firms with the largest portfolios have a relatively smaller risk of change. The percentage applied is therefore modulated, from 1.5‰ for the first layer of capital at risk to 0.6% in excess of $25 billion. **Canada** also makes a refinement based on portfolio size: the required margin is multiplied by a factor ranging from 1.25 for the smallest portfolios to 0.6 for the largest.

Another method of refinement seeks to take account of the fact that shorter-term insurance contracts involve lesser risks of change. In the **European Union**, solvency requirements—3% of capital at risk—are divided by three for temporary contracts of less than three years' duration and are halved for contracts spanning three to five years. A similar distinction is made in **Canada**, but there the relevant time frame is the residual guarantee period—the requirement being divided by four for contracts of less than one year and halved for those with between one and five years left to go.

Lastly, solvency requirements can also depend on contract characteristics: **Canada**, for example, applies different percentages for contracts not involving survival risks, depending on whether they constitute group or individual insurance, do or do not include bonuses, and are or are not adjustable.

Growth risk

An insurance company's growth entails special risks if it is excessive or poorly co-ordinated, if risk selection or pricing is not done with all the necessary care, and if financial resources are insufficient to cover the risk. Growth *per se* does not constitute a separate risk, but rather a delicate period in a company's lifetime, during which the probability that other risks—especially the risks of under-pricing and operating cost overruns—will come to bear increases significantly.

The aforementioned A.M. Best study contended that excessive—or in any event ill-controlled—growth was the cause of 13 per cent of the insurance company failures in the **United States** between 1969 and 1998. For its part, the Conference of Insurance Supervisory Authorities of the Member States of the **European Union** deems in its report on the *Solvency of Insurance Undertakings* that "On the basis of past experience, the risk of excessive and uncoordinated growth ... was generally regarded as significant."

This risk is only factored in explicitly by the RBC system set up in the **United States**. For non-life insurance, if premiums grow by more than 10 per cent an excessive-growth increase of 45 per cent is applied to the RBC coefficient representing provisioning risk (a ratio based on technical provisions) and to the coefficient for subscription risk (a premium-based ratio). Moreover, average growth in excess of 10 per cent over the past five years is deemed to aggravate risk and is incorporated into the ratio corresponding to extraordinary risks related to the balance sheet. For life insurance, a coefficient of 2 per cent of life insurance premiums and 0.5 per cent of health insurance premiums is used to cover general business risk[13]. This factor is not limited to growth risk, but also encompasses all risks not included in other categories, such as risks arising from competition, excessively rapid development, poor management, an adverse economic climate or operating expense overruns.

In all of the other countries, growth risk is taken into account only through regulatory measures other than solvency tests. One of them is the requirement that all newly licensed undertakings writing a given line of business prove that they have the financial resources to cover the set-up costs of their administrative services and production networks (by establishing an organisational fund) or to meet the high risk of adverse change involved in the distribution of new products. This measure is recommended in the IAIS standard on licensing. The amount of such a fund is not spelt out in the regulations because the supervisory authorities must be able to determine it on the basis of a company's particular circumstances.

Adequate recourse to reinsurance, and proportional reinsurance in particular, is also a good way for an insurance company to control its growth[14]. It is in this sense that the control measures of a reinsurance programme can be considered to somehow contain growth risk. But the best way of limiting this risk is still to conduct on-site inspections of fast-growing insurance companies at shorter-than-average intervals.

Reinsurance

Reinsurance cessions are incorporated into solvency supervision in two distinct ways. First, a reinsurance programme can limit risks, and especially the risks of large or accumulated losses. A first set of provisions therefore seeks to ensure that a firm has adequate reinsurance cover. However, unlike the situation under co-insurance contracts, a reinsured insurer still bears sole legal liability vis-à-vis the insured. An insurer must therefore bear the risk of its reinsurer's potential default. A second set of measures was therefore instituted to take this risk—which is also known as credit risk (arising from reinsurance)—into account.

These two risks constitute a significant component of the risk incurred by an insurance company: the risk of catastrophic losses was the cause of 6 per cent, and default by reinsurers of 3 per cent, of insurance company failures in the **United States** between 1969 and 1998.

The risks of large and accumulated losses

The risk of large losses corresponds to the danger that a non-life insurance undertaking will incur excessively large losses, in terms of the number and/or value of claims. The main response to this risk is supervision of the reinsurance programme. Such supervision is carried out by all of the OECD countries, and it starts with the licensing procedure. In some countries, it is supplemented by more specific measures limiting the amount of risk an insurer can retain. Regulators impose retention ceilings by risk in **Australia** (5 per cent of net assets[15]), **Canada** (2 per cent of free capital, in non-life), **Poland** (25 per cent of net provisions and capital) and the **United States** (10 per cent of capital plus surplus). In **Australia**, insurance companies are also required to possess net assets equal to or exceeding the value of their maximum retention per event. The objective of this measure is to limit the risk of accumulated, or "catastrophic", losses involving a succession of claims triggered by a single event (such as an earthquake or a storm). Lastly, in **Norway** an insurance company's by-laws must stipulate a limit on risk retention: the clause most frequently adopted sets maximum retention per risk at 10 per cent of the company's capital and retention per event at 20 per cent.

Another very common measure is to require constitution of a particular type of technical provision—a provision for equalisation. Except for **Australia**, **Mexico**, **Turkey** and the **United States**, all of the OECD countries report the existence of such a provision. In contrast, the number and nature of the classes concerned vary from country to country. While the **United Kingdom** extends the principle of the equalisation provision to all property insurance, maritime and aviation risks and non-proportional reinsurance and **Spain** extends it to all long-tail risks, the scope of application may be limited to a very small number of classes, usually including natural disasters.

Lastly, catastrophic risk may be added directly to the list of risks that are factored into solvency requirements: such is the case in **Japan**, where catastrophic risk is one of the five factors composing the overall RBC ratio.

Credit risk arising from reinsurance

Regulators can take a number of steps to limit the risk of default by a reinsurer. The most common one is to allow only partial deduction of the reinsurers' share from the amount of technical provisions used to compute solvency requirements, or to make the deduction subject to certain conditions. **European Union** directives stipulate that if a Member State allows technical provisions to be covered by claims on reinsurers, it shall set the allowable percentage. Countries may therefore choose to allow such claims in computing the solvency margin only if assets are deposited to guarantee them. Moreover, ceded reinsurance is incorporated into the solvency margin calculation only up to a certain threshold. For the moment, that threshold is set uniformly (50 per cent for non-life insurance and capital at risk; 15 per cent for mathematical provisions); however, future directives may empower the supervisory authorities, in certain cases, to set lower deductions, i.e. at a rate lower than 50 per cent, if there is any doubt as to the quality of the reinsurance provisions, the reinsurer's solvency or the stability of the reinsurance links[16]. A number of OECD countries already apply criteria that hinge upon the quality of reinsurers.

In the **United States**, for example, claims on reinsurers may be partially deducted from gross provisions; the deduction, which is generally limited to the amount of the assets on deposit, is greatest if the reinsurer has been licensed by the State in which the insurer does business. In **Canada**, claims on a reinsurer are fully deductible if the reinsurer is registered in Canada or is subject to supervision by an OECD Member country; otherwise, the deduction is limited to the amount of the guarantee deposit. **Mexico** incorporates reinsurance into the regulatory margin calculation in a highly unique way, insofar as the deduction of claims on reinsurers licensed in Mexico (any others are excluded) is limited to the average cession rate for the class in question and the resultant figure is corrected if the reinsurer has not been given a satisfactory rating by an international rating agency. Of all the OECD countries, only **Australia** computes the regulatory margin solely on the basis of premiums net of reinsurance; the reason for this is the supervisory authority's prior control of the reinsurance programme, with the quality of reinsurers being one of the parameters taken into consideration. In **Poland**, the margin requirement is computed using rules laid down in European directives, but for the time being claims on reinsurers are fully eligible to cover regulated commitments (although a reform is in the works).

Alongside partial adjustment of provisions for reinsurance, the credit risk arising from reinsurance may be integrated directly into the list of technical risks used to compute the margin. In the **United States**, for example, credit risk is taken into consideration, for non-life insurance, via a 10 per cent coefficient applied to aggregate reinsurance claims. For life insurance, reinsurance risk is one of the components of investment risk[17]. In **Japan**, "investment risk" also comprises a component called "credit risk arising from reinsurance", but it comprises both the risk that a reinsurer will default on a claim payment and the risk that a cedant will default on a premium payment if the company being examined also has a reinsurance business. The resultant ratio is then factored into the total RBC formula.

Lastly, other, more qualitative, measures can be implemented. For example, a reinforcement of indirect supervision of reinsurance undertakings by the competent oversight authorities can reduce the potential risks of reinsurance operations. The OECD project to establish a system to exchange information on the financial soundness of reinsurers among the various countries is an important step in this direction. Mandatory recourse to a variety of different reinsurers is another option, but in that case steps should be taken to ensure that this does not prompt an insurer to diversify by doing business with less reliable reinsurers.

C. Investment risks

After technical risks, investment risks are the second major risk category taken into account in solvency supervision. According to the European Conference of Insurance Supervisory Services, they are also the second most important cause of insurance companies' financial difficulties, after the management risk and ahead of the technical provision risk. In the **United States**, investments have also been identified as a major risk factor: 6 per cent of bankruptcies are attributable to overvaluation of assets.

Investment regulation: points for consideration

Cross-sector harmonisation of investment regulation

A harmonisation of investment regulation could be thought of between life and non-life insurance. Indeed, whereas technical risks are unequally divided between the life and non-life sectors, the investment and other risks are equally present in both. Though investment risks have widely different impacts depending on the duration of the risks insured. This last element, along with the fact that some life insurance companies guarantee a minimum rate of liability to their policyholders, explains why investment regulations sometimes differ as between life and non-life business.

Another argument sometimes put forward to justify a reform of investment regulation is that it is necessary to align the constraints applying to insurance companies, particularly in the life sector, with those applying to pension funds, so as to avoid a distortion of competition. However, given that the two areas are very different, the cogency of this argument may be doubted[18].

Quantitative restrictions and "prudent person rules"

Two different regulatory approaches are used in applying the investment risk to solvency supervision. The first, known as the quantitative approach, is to set quantitative limits on the investments of an insurance company. The limits may be set by category of assets or by issuer (rules of diversification), by currency (currency matching rule), or by location of assets (e.g. in the country where business is transacted). The main advantage of this approach is its ease of application; it is easy for the supervisory authorities to ascertain whether a company is complying with these rules and to justify their intervention if it is not. But the quantitative approach also has negative aspects. It may lead to an inefficient allocation of capital, especially if managers tend to hold in a given category a proportion of assets well below the prescribed ceilings so as not to exceed these when markets perform well. Also, quantitative limits are not flexible and cannot be rapidly adjusted in response to economic developments or structural changes in securities markets. These objections are partially removed if the thresholds are high enough to enable different asset management options.

With the prudent person approach, on the other hand, the requirement is simply that investments must be such that they may be regarded as being managed prudently, in the way a good father would manage the family assets. This type of regulation rests principally on scrutiny of managerial behaviour, for example through monitoring of the corporate governance and internal control procedures set in place by the company. The prudent person approach has the advantage of allowing the insurance company’s management much more scope. In this respect it is more consistent with the rationale of solvency supervision, which is to protect policyholders and beneficiaries with minimum interference in the management of the company. On the other hand, it is much more difficult for the supervisory authorities to make sure that the requirement of financial security is being met and to determine at what point intervention is necessary.

No country’s system of investment regulation rests solely on one or other of these two approaches. In the **United States**, for example, regulation essentially uses the prudent person approach, but a quantitative restriction of 3 per cent to 5 per cent per issuer[19] is also applied, while other quantitative limits are imposed by some individual States. Similarly, the EU Third life and non-life Directives set quantitative limits by asset category and issuer but also impose a general requirement as to maximum diversification and profitability. Rather than classify countries according to whether they follow one or other of the approaches, it is more appropriate to place them on a progressive scale between the two extremes of purely quantitative regulation and sole application of prudent person rules.

The main investment risks: depreciation risk and liquidity risk

The depreciation risk is the general risk of an investment's losing value. The credit risk is a particular case since it involves a loss of value due to the weakening financial position or default of a debtor. If, on the other hand, investment depreciation results from financial market developments, it is appropriate to speak of market risk. A company also runs the risk of being unable to convert its investments in liquid assets in time and sufficiently to meet commitments falling due: this is the liquidity risk.

The principles of diversification, dispersion and localisation

The basic approach to containing the depreciation risk and the liquidity risk is to apply the principles of diversification—spreading the investment portfolio over several major asset categories or different issuers—and dispersion—share of a specific asset in a category of assets.

The countries applying quantitative regulation for the different classes of investment (most of the OECD area) generally authorise the same type of investment, but with ceilings that are more constraining in some countries than in others. Assets representing the technical provisions may be held in:

- bonds: ceilings between 2 per cent (**Turkey** for corporate bonds) or 5 per cent (**Poland**) and 100 per cent;
- shares: ceilings between 10 per cent (**Slovak Republic)** and 100 per cent;
- mortgage-backed securities (except in **Turkey**);
- real estate: from 10 per cent in the **Netherlands** to 100 per cent;
- loans: all OECD countries except **Poland** and the **Slovak Republic**;
- liquidity: all OECD countries except **Mexico**; and
- advances on life insurance contracts (except **Japan** and the **United Kingdom**).

The majority of OECD countries (**Canada**, **Czech Republic**, **Japan**, **Korea**, **Mexico**, **Norway**, **Switzerland**, **United States** and all the countries of the **European Union**) also limit the percentage of assets that an insurance company may hold in financial instruments (shares, bonds, loans) issued by the same institution. There is a strong correlation between depreciation/credit risks of instruments from the same issuer and the investment risk is therefore heightened; in this case it is usual to speak of the concentration risk. The ceiling set ranges from 3 per cent to 10 per cent across the OECD area, but does not normally apply to government debt issued by the country concerned or by another OECD country. **Hungary**, **Poland** and the **Slovak Republic** set a limit above which the company is required to notify the supervisory authority accordingly. If the authority considers that the concentration risk incurred is too high, it may then require the company to diversify its assets by applying to another issuer. In the **Slovak Republic**, there is also a restriction on bank deposits: bank deposits in one bank cannot be higher than 40 per cent of the capital stock of this bank, and cannot be higher than 25 per cent of the technical provision of the insurance company. A notification threshold of 5 per cent applies in **Australia** for life insurance, but the supervisory authority is not empowered to demand that the company bring in another issuer. On the other hand, if the concentration risk exposure is high, the actuary must set up, alongside the provision for non-admissible assets, a provision specifically covering the risk (the level of this provision depends not only on the degree of concentration but also on the issuer's credit risk). Extension of this regulation to non-life insurance is envisaged.

To make these quantitative rules a little more flexible, ceiling overruns may be authorised within certain limits. In the **European Union**, for example, the statutory ratio of 5 per cent for securities, loans, etc. from the same issuer may be increased to 10 per cent, provided that the total value of the securities, loans, etc. from issuers whose issues are admitted beyond the ratio of 5 per cent does not exceed 40 per cent of the gross technical provisions. Temporary waivers may also be obtained with the agreement of the supervisory authority concerned.

In addition to the principles of diversification and dispersion, most countries also apply a principle of asset localisation. Thus in **Germany**, **Japan**, **Korea**, **Poland**, **Slovak Republic**, **Czech Republic, Spain** and **Switzerland** there is an upper limit on admissible technical provision investments that may be located in other OECD countries; it ranges from 5 per cent in Poland to 30 per cent in Switzerland and Korea. Much tighter restrictions are applied in the majority of OECD countries to investments in non-member countries. **Australia**, **Canada**, **Hungary**, **Mexico** and **Turkey** do not allow funds representing the technical provisions to be invested abroad.

NB: In most OECD countries investment regulation does not apply to the equity of insurance companies. Thus all Member States of the **European Union**, along with **Japan**, **Mexico**, **Slovak Republic** and **Switzerland**, differentiate between the treatment of assets representing technical provisions—which are intended to compensate policyholders—and treatment of the assets covering other liabilities—which serve to meet the claims of other creditors. The majority of OECD countries, with the exception of **Iceland**, **Japan**, **Norway** and **Turkey**, do not regulate free assets. The Member States of the **European Union**, moreover, have expressly undertaken not to do so.

Solvency requirements as related to investments

Investment regulation is not the only means used to deal with depreciation and liquidity risks. Many countries also apply solvency margin requirements designed specifically to cover these risks, or more generally the investment risk. This is the case in **Japan**[20], **Korea**, **Mexico** and the **United States** for both life and non-life insurance and in all OECD countries for life insurance. As a rule, the countries where investment regulations are very tight have commensurately lower solvency margin requirements in respect of investment risk. In non-life business, for example, nearly 25 per cent of the statutory minimum margin[21] is assigned to the investment risk in the **United States**, where the prudent person approach largely applies.

Because the risks attach to invested assets, it seems natural to use their amount as the basis for determining the capital necessary to cover the investment risk. **Canada**, **Japan**, **Korea**, **Mexico**, **Norway** and the **United States** have adopted ratios calculated on the basis of company assets. These ratios are cumulatively built into the calculation of the statutory minimum solvency margin. The different categories of assets are weighted according to their nature, degree of liquidity and class of credit risk. In most cases the weights range from 0 per cent for the safest assets, like bonds issued by the government of an OECD country or AAA-rated bonds, to 30 per cent or 50 per cent for high-risk assets, like shares not listed on a regulated market and therefore illiquid. A weight of 100 per cent is sometimes applied to the lowest-rated debt securities. In the **United States** the risk weights are increased when an insurer's assets are heavily concentrated on certain types of investment or on a small number of debt issuers. These asset-based ratios lie in the same range as that recommended by the Basle Committee for banking institutions. **Norway** makes explicit reference to the Committee's guidelines (BIS rules) for this segment of its solvency supervision system[22].

The **European Union**, on the other hand, has chosen a ratio based not on assets but on technical provisions (for life insurance only). The report of the European Conference of Insurance Supervisory Services explains this choice in the following manner. Given that the sole aim of solvency requirements is to guarantee that insurance commitments will be met, the calculation base should be only the amount representing the technical provisions. If total assets are used as the base, the "rich" companies are penalised. Additionally, any solvency regulation based, even partly, on assets will doubtless influence the investment strategy of insurance companies and encourage them to invest only in low-risk securities, chiefly government debt issues, in order to provide evidence of a smaller solvency margin, which is not desirable. For their part, weighting coefficients cannot be immutable, collateral for real estate assets having varied from one period to another—which justifies periodic adjustments (here there is criticism similar to that of investment dispersion thresholds). Against this reasoning it may be argued that a provision-based ratio is very sensitive to the risk of error in technical provision valuation (a higher risk than in asset valuation). Furthermore, companies with a very cautious policy as regards provisioning are required to have a larger solvency margin.

The directives of the **European Union** set different solvency requirements according to whether the insurer bears an investment risk or not. For contracts in which the company bears no investment risk the solvency requirement is 1 per cent of the mathematical reserves as against 4 per cent for the other contracts, on condition that the contract has a term of more than 5 years and that the amount covering the management costs specified in the contract is set for a period of more than 5 years. For contracts in which the insurance company bears only part of the investment risk, e.g. if it guarantees only a basic lump sum payment or a minimum indemnity in the event of death, the required solvency margin is 4 per cent of the mathematical reserves corresponding to the risk borne. In **Australia**, allowance for the investment risk (which takes the form of a provision for asset risk, see below) is also scaled according to the risk share borne by the insurer, but the latter must prove that the policyholder has been fully informed of the risk he bears. Furthermore, for all contracts in units of account, the insurer is required to have a solvency margin equal to 0.25 per cent of the mathematical reserves intended to cover the residual investment risks (policy surrender and asset realisation risks[23]).

Finally, it should be noted that the present **European Union** legislation does not include investment risk in the solvency requirements for non-life insurance. This risk is also absent from the non-life solvency tests in **Australia**, **Czech Republic**, **Hungary**, **Poland**, **Slovak Republic**, **Switzerland** and **Turkey**. On the other hand, it is always included in calculation of the statutory solvency margin for life insurance, and the countries that take it into account for both sectors generally set higher requirements for life business. This is justified by the fact that, unlike long-term life insurance contracts, the majority of non-life contracts are short-term and therefore less exposed to investment risks. Furthermore, the non-life insurer makes no commitment in terms of remuneration (guaranteed minimum rate, profit share). However, investment risks are not entirely absent from non-life insurance, especially for the long-term contracts, and the European Union is contemplating a reform on this point.

Provisions for asset risk

Allowance for investment risks may also be made in the valuation of provisions or invested assets. To remove the asset valuation risk, all OECD countries require insurance companies to apply a prudent and clearly defined method of valuation to all their investments. This method may be the historical cost valuation like in the Czech Republic, France, Germany (non-life), Hungary, Italy (fixed assets), Japan, Korea, Poland, and the Slovak Republic. It might also be the market valuation like in the Netherlands, or a hybrid solution between the two former methods (for example the lesser of market value and historical value). In the EU zone, according to the EU Insurance Accounting Directive, member countries have to choose either of the two. If market value is applied, the historical cost should be disclosed in the explanatory notes and vice versa.

Allowance for credit and depreciation risks by way of provisions likewise depends on the valuation method used. For example, countries that have chosen the historical cost method require companies to create a provision for depreciation in the event that the market value of their investments falls below the book value (the provision may be calculated asset by asset or for a whole category of assets, as the case may be). Latent asset appreciation, on the other hand, is recorded as an off-balance-sheet item and partly or wholly integrated into the solvency calculation. In principle, such adjustments are not necessary with the market value method, since the asset price is supposed to incorporate the credit risk and depreciation risk specific to each investment. In fact, this is more debatable in the case of illiquid assets like real estate. Consequently, special requirements are often attached to that class of assets: for example, the regulations may require valuation by independent assessors.

Finally, regulations may require the creation of a specific provision to cover the credit risk or depreciation risk. In **Australia**, for example, the solvency standard defined by the Life Insurance Actuarial Standards Board includes the creation of a resilience reserve to allow for adverse movements in investment markets to the extent that they will not be offset by improvements in the liabilities position (the adverse movements considered are a fall of 1.25 per cent in the return on shares and real estate, 0.6 per cent in indexed bonds and 1.75 per cent in all interest-bearing products). A similar resilience test is applied in the **United Kingdom** for life insurance. Three scenarios are tested. All three assume a fall in shares and real estate investments (of 10 per cent or 25 per cent), but one of them assumes an increase in the yield from fixed-interest securities (current yield per cent + 3 per cent) while the other two assume a decrease (respectively 0.8 and 0.9 * current yield).

Additionally, it is not uncommon for the supervisory authorities to require the creation of a reserve when they have serious doubts concerning the market value of an asset.

Other investment-related risks

In addition to the depreciation and liquidity risks common to all types of investment, there are other risks specific to one or another type. Depending on the country concerned, these risks are allowed for in the regulations and solvency requirements described above or are the subject of special measures.

Matching risk

The assets of an insurance company should at all times be sufficient to cover its insurance liabilities. But the value and yield of assets are continuously influenced by financial market fluctuations and cover of technical liabilities may therefore be endangered. This risk, known as the matching risk or asset-liability matching risk, essentially takes two forms: the currency matching risk, resulting from exchange rate movements, and the interest rate risk.

The currency matching risk arises when an insurance company invests its assets in a currency other than the one in which its liabilities are denominated. The most current regulatory measures to deal with this risk are the currency matching requirements imposed by the majority of OECD countries. These requirements may be total or only partial. The European Union directives, for example, state that insurance undertakings are authorised not to cover with matching assets an amount of up to 20 per cent of their liabilities in a given currency. Some countries, such as Canada, Korea, Japan, the Slovak Republic and the United States, actually impose no matching requirement. However, since the liabilities of insurance companies are mostly denominated in the national currency, the upper limits on investment abroad may in practice imply a degree of matching. Quantitative restrictions are not the only regulatory options for dealing with the risk. In Australia, for example, an unfavourable scenario including a fall of 10 per cent in unmatched assets is used for determining the amount of the provision for asset risks.

An interest rate change necessitates a new valuation of yields on the assets side and a new valuation of liabilities if the reserves are discounted at a technical rate reflecting the new market conditions. If the estimated inflows from investments do not coincide exactly with the estimated outflows associated with policy liabilities, the two adjustments do not correspond and the company is exposed to a risk of mismatch between assets and liabilities. This risk is seldom given specific treatment in the calculation of non-life solvency, since most of the policies are short-term and the technical provisions are generally not discounted. Only Japan takes it into account in both the life and non-life sectors with the RBC factor Expected Interest Rate Risk. In most countries the interest rate risk is explicitly taken into account in the life sector, notably in the case of the resilience reserve introduced in Australia and the United Kingdom. In the United States the interest rate risk is one of the four elements of the RBC ratio in life insurance. Products giving the policyholder certain guarantees in the event of surrender are regarded as particularly risky; thus the coefficient applied to the mathematical reserves to allow for the interest rate risk is scaled according to the policy guarantees offered (the maximum coefficient is applied in the case of policies that guarantee a cash surrender value). Furthermore, the weights are increased by a flat 50 per cent when the insurance company is unable to prove that its assets and liabilities are correctly matched. A similar ratio is applied in Canada. The coefficient is scaled according to the nature of benefits, the period of guarantee to run and the conditions of surrender.

Holdings of derivative instruments may also be set against the asset-liability matching risk. But derivatives are themselves risky and as such the subject of specific measures.

Risk attaching to derivatives

As with all financial instruments, the use of derivatives exposes the insurer to investment risks. But with derivatives the risks are greater. The valuation risk is increased by the absence of generally applicable regulations on this type of off-balance-sheet operations, the risk of error by the comparative newness and wide diversity of derivatives, and the liquidity risk by the fact that derivatives are traded in thin markets or over the counter and the leverage induces a large loss potential. Many OECD countries have therefore decided initially to prohibit or limit the use of derivative instruments by insurers. **France**, **Hungary**, **Luxembourg**, **Norway**, **Poland**, the **Slovak Republic** and **Turkey** have chosen to ban the use of derivatives entirely. **Belgium**, **Denmark**, **Germany**, **Iceland**, **Korea**, **Mexico**, the **Netherlands**, **Norway** and the **United Kingdom** authorise it for hedging purposes only.

Nevertheless, regulators recognise that derivatives are useful risk management tools for insurance companies. The present tendency is therefore to authorise their use within strict quantitative and especially qualitative limits, defined by legislation, by the supervisory authority and by the internal control procedures of companies. In the countries that allow the use of derivatives, prior authorisation normally has to be obtained from the supervisory authority or from company management for each type of derivative it is intended to use. The authorisation must specify the persons or services empowered to buy or sell the derivative and its intended use (hedge or speculative positions). Moreover, the company management must establish a system of estimation, quantitative limitation and monitoring of the corresponding risks. This type of approach is advocated by the International Association of Insurance Supervisors for countries that decide to authorise the use of derivatives.

Finally, the credit risk attaching to a derivative instrument may be directly included in the solvency margin requirement. In **Canada**, for example, the amount of capital to be held against this risk is determined according to the value of the instrument, the admissible guarantees, the nature of the instrument and its maturity, and the risk of default by the counterparty. In **Japan**, the derivatives risk and the other risks related to off-balance-sheet transactions form one of the five components of the investment risk.

Equity holdings and the contagion risk

An insurance company that has a stake in other companies may be obliged to provide additional equity funding. The economic or financial difficulties of the companies in which it has an interest may then be transmitted to it: this is known as the contagion risk.

Various regulatory measures aim to limit this risk. First, an insurance company's stake in another company may be limited by law: the **Czech Republic**, **Denmark**, **Finland**, **Hungary**, **Iceland**, **Japan**, **Norway**, **Poland**, **Switzerland** and the **United States** impose restrictions on insurance company shareholding in non-financial enterprises. Second, without being prohibited or quantitatively limited (by restrictions other than those applying to all investments), equity investment may be specifically monitored by the supervisory authorities.

A number of countries authorise equity investment in other insurance companies, but in some cases these holdings are not admissible to represent the technical provisions. Finally, specific restrictions apply in the case of insurance groups and financial conglomerates (see below).

D. Other risks

Management risk

This section deals with all the risks to which an insurance company is exposed through incompetent or improper management. Management risk is sometimes the primary cause of technical or investment risks, so its control is essential to a company's solvency. Moreover, management risk is the factor of insecurity most frequently cited by the Solvency Working Group of the European Conference of Insurance Supervisory Services.

To limit this risk, it is vital that insurance companies have officers and managers of high quality. The great majority of OECD countries require insurance companies, at the time of the licensing procedure, to provide information on the professional reputation and competence of their senior management personnel (fit and proper requirements). This information is submitted for approval by the licensing authorities, except in **Australia**, **Finland**, **France**, **Norway**, **Switzerland** and **Turkey**, where it simply has to be produced[24]. The "fit and proper" requirements correspond to clearly defined objective criteria (university degree, number of years spent in the insurance business, absence of conviction for breach of consumer protection rules in the financial sector) and more subjective criteria, such as professional standing or evidence of reliability and maturity in an individual's conduct and decision-making. To be able to have as accurate a picture as possible, the supervisory authorities of the different financial sectors and in the different countries arrange to exchange information on the competence of insurance managers, within the limits defined by the rules governing privacy. Ongoing evaluation is, of course, the practice in this area, notably at times of on-site inspection and management changes.

Japan is the only country in which the management risk as such is taken into account in solvency margin requirements, since it is included in the calculation of the aggregate RBC ratio by way of a specific factor termed the "business administration risk". In the **United States**, the risks associated with bad management are one of the elements built into the ratio corresponding to the business risk. In practice there are two obstacles to integration of the management risk in solvency margin requirements. First, the magnitude of the risk is particularly difficult to determine, which means that the level of guarantee set, say in the form of a percentage of premiums, is even more unreliable than for the other ratios. Second, a level of guarantee sufficient to cover the shortcomings of a few incompetently or dishonestly managed companies would heavily penalise the other companies that form the vast majority. This is why, including in **Japan** and the **United States**, the emphasis is more on "fit and proper" criteria, with the solvency margin requirement serving to cover the residual management risk.

Risk of failure of a privileged partner

Insurance brokers

Brokers, who obtain contracts for an insurer, may collect premiums, pay out claims and in some cases perform the management function by delegation; they are then continuous holders of funds on behalf of their partner. Failure of a brokerage business therefore entails a considerable loss for the insurer, since the premiums paid by policyholders commit the insurer once the broker has collected them. At least that is what the courts of law recognise in many countries.

To prevent insurance companies from being exposed to this risk, some countries, like **Japan** and **Turkey**, entirely prohibit brokers from collecting premiums for the insurer. In **Iceland** they may do so only with the insurer's written agreement. In **Belgium**, **Hungary** and **Sweden** prohibition applies only to certain types of policy.

The general rule, however, is to authorise insurers to delegate to brokers a portion of contract management (notably collection of premiums and settlement of small claims) provided that the brokers present guarantees. The most common requirements are:

- accreditation (**Australia, Belgium, Czech Republic, Finland, Hungary, Iceland, Italy, Korea, Luxembourg, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Turkey, United Kingdom, United States**);
- fitness and properness (**Belgium, Czech Republic, Finland, France, Hungary, Iceland, Italy, Japan, Korea, Luxembourg, Netherlands, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Turkey, United Kingdom, United States**);
- professional liability insurance (**Australia, Belgium, Czech Republic, Finland, France, Hungary, Iceland, Italy, Korea, Luxembourg, Mexico, Norway, Poland, Portugal, Spain, Sweden, Turkey, United Kingdom**);
- deposit of a financial guarantee (**Finland, France, Hungary, Iceland, Italy, Japan, Korea, Mexico, Norway, Spain**);
- ongoing supervision (**Belgium, Czech Republic, Hungary, Iceland, Italy, Korea, Mexico, Poland, Spain, Turkey**).

Most countries' regulations disallow claims on intermediaries as assets representing the technical provisions.

Shareholders

An insurance company set up as a joint stock corporation must be able to call on its shareholders to cover losses or to finance a new activity and will be in serious difficulty if they are unable to respond. The failure of an insurance company is sometimes caused by the failure of its chief shareholder.

To meet this risk, insurance regulations provide for shareholder supervision, although this is stricter in some countries than in others. All OECD countries have as a licensing requirement that information be supplied concerning majority shareholders or investors with a "qualifying holding" (generally 10 per cent or more of the capital), but this information is submitted for approval in only just over half of these countries (**Belgium**, **Czech Republic**, **Finland**, **Germany**, **Iceland**, **Italy**, **Japan**, **Korea**, **Luxembourg**, **Mexico**, **Netherlands**, **Poland**, **Portugal**, **Slovak Republic, Sweden**, **United Kingdom**, **United States**). Some countries require an insurance company to have as chief or controlling shareholder a corporation designated to negotiate with the supervisory authority if the company gets into difficulty. The criteria to be met by the corporation include, in addition to financial soundness, suitability as to the nature and extent of its activity, its top management and the corporate or group structure.

Shareholder supervision as part of the licensing procedure is necessarily accompanied by supervision of ulterior changes in share capital. Regulations require that the supervisory authority be informed beforehand of any significant change in a company's capital. A significant change is defined as a increase or decrease in capital so that the proportion of the capital held would reach a given threshold—generally 10 per cent, 20 per cent, 33 per cent or 50 per cent—or acquisition of 10 per cent or more of the company's shares.

Risk attaching to contingency liabilities

Suretyships given to third parties guaranteeing the performance of financial obligations undertaken by the latter may entail heavy losses. Many countries prohibit insurance companies from giving such guarantees, at least to companies engaging in activities other than insurance or not part of the insurance group concerned. Use of suretyships between insurance companies belonging to the same group is also often regulated so as to limit the contagion risk; for example, approval may have to be obtained from the supervisory authority before a suretyship can be contracted.

The contingency liabilities risk is taken into account in solvency margin requirements in **Canada**, **Japan** and the **United States**. In the **United States**, guarantees to subsidiaries and conditional liabilities are two of the four risk factors used in calculating the off-balance-sheet risk ratio. In **Canada**, contingency liabilities are first converted to credit equivalents (for example, a rate of 100 per cent is applied to financial guarantees or loan substitutes), then a weight ranging from 0 per cent to 8 per cent is applied to the amount obtained in order to determine the capital needed as cover. As in the case of investments, the weighting depends on the nature of the liability and the counterparty. In **Japan**, off-balance-sheet risks are one of the five components of the investment risk.

E. Measures specific to insurance groups and financial conglomerates

The increasing national and international convergence of the banking, insurance, brokerage and pension fund sectors—in the form of interlocking holdings or buyouts—presents a real challenge to supervisory authorities. The first problem is to formulate a solvency requirement applicable to groups and conglomerates. Here the main consideration is double or multiple use of equity capital. The regulatory framework must also encompass the additional risks to which an insurance company is exposed within a group or conglomerate, such as the opacity risk, the risk attaching to intra-group operations and the risk of conflict of inter-sector interests.

The increased contagion risk of groups and conglomerates

Any insurance company with a holding, especially a majority holding, in another company is exposed to the contagion risk, since it may have to make good the financial losses of the other company, thus reducing the capital available to cover its own liabilities. In the case of a group or conglomerate, however, the contagion risk is compounded by another factor, namely the risk associated with the company's public image. The setbacks of a financial entity reflect upon the companies bearing the same name, acronym or logo, or using the same counters. The insurance sector is admittedly less exposed to this risk than the banking sector—since non-life policies generally cannot be surrendered and the penalties for surrender of life policies serve as a deterrent—but it is exposed nonetheless (the impact on new policy writing is undeniable).

This is one of the reasons why many OECD countries regulate cross-ownership in the financial sector. Creation of a banking subsidiary by an insurance company is prohibited in **Finland**, **Iceland** and **Japan**. It is subject to restrictions in **Canada**, **Germany**, **Korea**, the **Netherlands**, **Norway**, **Sweden**, **Switzerland** and the **United States**. Equity investment by an insurance company in a bank is restricted in many OECD countries—**Australia**, **Canada**, **Germany**, **Greece**, **Hungary**, **Iceland**, **Ireland**, **Japan**, **Korea**, **Netherlands**, **Norway**, **Sweden** and **Switzerland**—and even prohibited in two—**Mexico** and **United States**. Equity investment by a bank in an insurance company is restricted in **Australia**, **Canada**, **Iceland**, **Japan**, the **Netherlands**, **Norway**, **Sweden** and the **United States**, and prohibited in Mexico. In many countries, insurance companies are not allowed to distribute banking products but banks are more often free to distribute insurance products.

However, these tight restrictions are tending increasingly to be eased. In the **Netherlands**, for example, the principle of segregation of the different financial sectors have been relaxed since 1990. The regulations on cross-ownership have not been entirely rescinded, but the policy in this regard has shifted from "no, unless…" to "yes, provided…". Furthermore, the different authorities concerned have agreed to jointly define the criteria for obtaining a certificate of non-objection.

Restrictions on shareholding are not the only ways in which regulation responds to the contagion risk inherent in cross-ownership. In **Japan** and the **United States**, this risk is also taken into account by a specific risk factor in the RBC model. In the American case, the weight of this factor is increased by the fact that the risk associated with related companies is systematically excluded from the adjustments designed to take account of covariance between the different risks.

Solvency of groups and conglomerates

With new insurance groups and financial conglomerates emerging constantly and the older-established conglomerates spreading their activities more evenly over different sectors, it is becoming increasingly necessary to establish a solvency norm specifically for them. The central consideration as regards group or conglomerate solvency is dual use of equity capital. This applies especially to financial conglomerates, since insurance companies, banks, pension funds and brokerage businesses are not subject to the same regulations and, being exposed to different risks, do not have to satisfy the same solvency requirements.

Most OECD countries now have solvency requirements specific to insurance groups and conglomerates. These regulations do not overrule the principle of solo supervision of the companies in a group but provide for an additional mechanism: solo-plus supervision. Only the **Czech Republic**, **Hungary**, **Korea**, **Mexico**, the **Slovak Republic** and **Turkey** do not appear to have any specific regulations in this area.

The solo-plus principle was adopted by the **European Union** in a 1998 directive on supplementary supervision of insurance undertakings in an insurance group (previously, several Member States had already established their own rules). This directive, which had to be written into domestic law by 5 June 2000, enters into effect for fiscal year 2001 at the latest. The Member State may choose one of three methods of calculating the adjusted solvency margin. The first of these is a deduction method whereby the aggregate capital requirement of the subsidiary is deducted from the capital of the parent company. This method has the disadvantage of not taking into account any capital "surplus" in the subsidiary or related undertaking. That drawback is overcome by the second technique, the deduction and aggregation method. The third method is to calculate adjusted solvency on the basis of the group's consolidated accounts. An insurance group must now submit, in addition to the mandatory statements of all its insurance subsidiaries, financial statements testifying to its adjusted solvency. Furthermore, a new draft directive provides for the application of similar principles in supervision of financial conglomerate solvency.

In the **United States**, financial conglomerates pose a particular problem in that insurers are supervised at State level and banks at federal level; hence there is clearly a conflict of jurisdictions. An approach is now under study that would leave individual States absolute jurisdiction in the insurance sector, whilst financial conglomerates would be supervised by the Federal Reserve. The aim is to define a single format for measuring and aggregating all the risks to which financial conglomerates are exposed. In theory, this approach is more satisfactory than calculating adjusted solvency on the basis of individual requirements after deduction of double counting, since it takes account of the increase or decrease in the conglomerate's total risk exposure due to interactions between the different constituent entities. In practice, however, it is very difficult to apply. A more realistic alternative would be that each conglomerate develops its own format and has it approved by the supervisory authorities (such a procedure is already being used in a number of OECD countries for credit institutions).

At the international level, the Basle Committee on Banking Supervision, the International Organisation of Securities Commissions and the International Association of Insurance Supervisors have together set up a body to formulate proposals for supervisory co-ordination in the different financial sectors: the Joint Forum. The forum has submitted to its parent organisations a number of proposals for the supervision of financial conglomerates, including different methods of defining the level of capital adequacy they should maintain[25].

Risks specific to insurance groups and financial conglomerates

Within a conglomerate, an insurance undertaking is exposed to additional risks that vary according to the conglomerate's size and the mix and location of its activities.

Risk of opacity

The information needed for supervision of an insurance undertaking may be difficult for supervisors to obtain when it is located in other companies, in another country or in an entity not subject to individual prudential supervision.

Accordingly, many OECD countries require insurance groups or financial conglomerates to comply with specific transparency measures. This is the case in **Australia** and the **United States** (for insurance groups only), **Mexico** (financial conglomerates only), **Norway** and all the countries of the **European Union**. In **Australia**, for example, the regulator requires that the structure of the group be sufficiently transparent to show which parts of the group conduct which activities, what is the risk profile of the group and its constituent entities, how risk management is organised and apportioned, and what are the organisational, financial and other links between the members of the group[26]. Under the **European Union** directives, the competent authorities must require any insurance undertaking subject to supplementary supervision to have internal control procedures adequate to produce the data and information necessary for the exercise of such supervision.

In cases where the necessary information is located in companies not subject to individual prudential supervision, regulations may guarantee supervisors access to these companies. For example, in the **European Union** supervisors of insurance undertakings may conduct on-site information checks in the parent companies, subsidiaries or related companies. However, requests for these information checks must always be sent beforehand to the undertaking supervised.

In **Australia**, as a measure to prevent the risks associated with non-supervised entities of a financial conglomerate from making the assessment of the supervised undertaking's risk exposure too difficult, the regulator may prohibit that undertaking from participating in a conglomerate or require that the group structure be reviewed. One of the main criteria in this decision is the ratio of non-supervised activities to the conglomerate's total activity. In principle it should not be more than 30 per cent. Other criteria include the agency rating of non-regulated entities, the nature of their activities, their financial soundness and the extent of intra-group financial relations.

Finally, in cases where the group or conglomerate includes entities subject to prudential supervision in another country or in another financial sector, the great majority of OECD countries have set up procedures for information exchange between the different authorities concerned. At the international level, the Joint Forum has established principles on information exchange between supervisory authorities[27]. Also, G7 finance ministers agreed on "10 Key Principles on information exchange" at their meeting in May 1998.

Risk associated with intra-group operations

Financial transactions between companies with ownership linkage, notably asset or risk transfer, may reduce the capital available for cover of insurance liabilities to the benefit of the group's other activities.

In response to this risk, the Member States of the **European Union** require insurance companies to notify the competent authorities of major intra-group operations at least once a year. If such information shows that an insurance company's solvency is endangered or likely to be, the authority orders that company to take remedial measures. Intra-group borrowing is subject to specific supervision in **Australia**, **Mexico** (financial conglomerates), **Norway** and the **United States** (insurance groups).

Risk of conflicting sector interests

One of the risks associated with a financial conglomerate is that there may be conflicts of interest between the different constituent entities. For example, the board of a conglomerate may have to decide between a capital increase for a banking subsidiary underwritten by an insurance company and other investments more consistent with the interests of policyholders.

Consequently, many countries require financial conglomerates to build "firewalls" between their different sectors. One fairly common measure of this sort is not to allow one person to hold management responsibilities in both a lending institution and an insurance company of a conglomerate. In **Finland**, for example, the CEO of an insurance company and his deputy may not have any activity in a bank, and the majority of the members and alternates of the insurance company's board must be different from those of the bank's board. But even with firewalls, there may still be a conflict of intra-group interests at the highest level of management. Only the "fit and proper" requirements applied to CEOs and board members can limit the residual risk.

IV Organisation of insurance solvency supervision

A. Regulatory and supervisory authorities

Practical organisation

Administrative status of regulators and supervisors and the means placed at their disposal.

With the exception of **Italy**[28], **Luxembourg** and **Portugal**, insurance regulation is the responsibility of a ministry. In most countries this is the ministry for economy and finance or the treasury, but other ministries may also have responsibility: trade and industry (**Iceland**, **Ireland**, **United Kingdom**, **United States**), social affairs and health (**Finland**), development (**Greece**). In some countries, regulatory functions are shared by the insurance supervision authority, notably for the enforcement of laws and regulations. This is the case in **Belgium**, **Finland**, **Iceland**, **Japan**, **Korea**, the **Netherlands**, the **Slovak Republic**, **Switzerland**, **Turkey** and the **United Kingdom**.

The supervision authority is an independent administrative body in most OECD countries. It is a ministry department in only four countries: **Austria**, the **Czech Republic**, **Greece** and **Turkey**.

Where it is not part of a ministry, the supervision authority is generally financed in full by contributions from the insurance companies. Supervision may also be partly financed by the State—in **Germany** (as to 10 per cent) and **Mexico**—or by another contributor—in **Korea** (5.4 per cent). The **Slovak Republic** Financial Market Authority is funded from state budget.

Depending on the size of the country and the number of insurance companies operating in it, the personnel strength of the regulatory and supervisory authorities varies widely: from 10 in the **Slovak Republic**, 15 or so in **Iceland** and **Luxembourg** to nearly 400 in **Australia**, **Germany** and **Mexico**. In some countries (e.g. **France**), this staff is seconded from the regulating ministry to the supervision authority.

Principal assignments

Licensing

The first stage in insurance solvency supervision is scrutiny of the file submitted by the company in order to obtain a licence or have it extended. In most countries the decision to license a company rests with the ministry responsible for regulation. In some countries, though, licensing responsibility is shared with the supervision authority—in **Australia**, **Germany**, **Korea**, **Luxembourg**, **Norway** and **Switzerland**—or wholly assigned to the latter—in **Denmark**, **Hungary**, **Italy**, the **Netherlands,** the **Slovak Republic** and **Sweden**. In cases of competence sharing, the ministry is usually responsible for licensing foreign insurers and the supervision authority for extending the licences of domestic insurers. The other tasks are shared differently according to country.

Off-site supervision

In all OECD countries the overriding assignment of the insurance supervision authorities is to protect the interests of policyholders, underwriters and beneficiaries. Promotion of a competitive, equitable and stable market for the different insurance companies is often an additional aim. Two complementary forms of supervision are applied to insurance companies: off-site and on-site.

Off-site supervision consists of the analysis of the financial reports each insurance company has to supply. These are:

- the annual accounts, comprising the balance sheet, profit and loss accounts and additional notes (all OECD countries);
- annual statements of the solvency margin requirement, margin actually constituted, investments, and constitution and liquidation of technical reserves (all OECD countries);
- semi-annual accounts or statements (**Czech Republic**)
- quarterly accounts or statements (all OECD countries except **Czech Republic**, **Denmark**, **Iceland**, **Ireland**, **Netherlands**, **Portugal** and **Switzerland**); these statements, which are more condensed, usually include a statement of investments and reserves);
- monthly statements (**Japan**, **Korea** and **Poland**).

By and large, the supervision authorities also have the right to require insurance companies, particularly if newly established or in financial difficulty, to submit more frequent reports or any other documentation necessary for supervisory or statistical purposes.

On-site supervision

On-site inspections are an essential adjunct to off-site supervision. They enable supervisors not only to check whether the reports submitted by a company accurately reflect its real economic and financial situation, but also to exercise a qualitative supervision of the company's operation, its standard of management and its internal control procedures. The **United Kingdom** is the only OECD country in which the insurance supervision authority does not practise on-site inspection. However, this absence is offset by close co-operation between supervisors and company auditors and actuaries (for life insurance) and by regular meetings between supervisors and company managers[29].

In the other OECD countries, supervisors perform on-site inspections. The frequency of these inspections may be prescribed by law—in **Canada**, for example, companies have to be inspected at least once a year or, if circumstances permit, less frequently but at least every two years—or left to the judgement of the supervision authority. In the latter case, however, the authority tries to have all companies inspected on a fairly regular basis, for example by limiting the maximum interval between inspections. The companies to be inspected and the key points to be examined are chosen in the light of supervisors' experience of those companies, information gathered from their submitted reports or the general concerns of the supervisory authorities in connection with market developments.

Finally, the supervisory authorities may remain in touch with insurance companies by arranging regular meetings between supervisors and company executives (the **Netherlands, Norway** and the **United Kingdom**) or by presence at annual board meetings (systematically in **Finland**).

Other assignments

While off-site supervision and on-site inspection are by far the most important activities of supervision authorities, the latter may also have other assignments, of which the most current are:

- collection and publication of statistical data;
- mediation between insurers and policyholders (**Australia, Belgium, Germany, Korea, Luxembourg, Mexico, Norway, Portugal, Spain, Switzerland, United States**);
- anti-money laundering efforts (all OECD countries except **Hungary**, **Korea**, **Mexico**, **Poland**, **Switzerland** and **Turkey**).

Consolidation of financial supervision authority[30]

The increasing convergence of the financial sector's different activities undoubtedly constitutes a major challenge for the practical organisation of supervision. The underlying question is what regulatory structure would permit the most suitable and efficient supervision of the financial sector generally and its conglomerates in particular.

The different degrees of integration of financial supervision authority

The diversity of the financial supervision systems set up in the OECD area shows that as yet there is no consensus on the best approach to adopt. The range of systems is very wide. At one extreme is the establishment of a sole supervision authority covering all sectors (banking, insurance, securities and pensions). This approach has already been adopted by **Denmark**, **Hungary**, **Iceland**, **Japan**, **Korea**, **Norway**, the **United Kingdom** and **Sweden,** and the creation of a sole supervision agency was recently announced in **Ireland**. A reform along these lines is also envisaged in **Germany**. Other countries have adopted a "semi-integrated" approach whereby only some of the sectors are subject to joint supervision by one authority: banking and securities in **Finland**, **Luxembourg**, **Mexico** and **Switzerland**; banking, insurance and pension funds in **Australia** and **Canada**; insurance and pension funds in **Belgium**, the **Czech Republic**, **Finland**, the **Netherlands**, **Portugal**, **Spain** and **Turkey**, capital market and insurance in the **Slovak Republic**. The remaining countries have preferred a separate supervision authority for each sector. Supervision co-ordination is then achieved by way of agreements between the different authorities, in some cases with the creation of a body comprising representatives of each sector.

Of the countries that have not adopted the fully integrated approach, **Austria**, **Greece**, **Ireland**, **Spain** and the **United States** have assigned the supervision of financial conglomerates to an umbrella authority, the one that supervises a parent company or a company performing the group's leading activity. The umbrella authority supervises the conglomerate's operations as a whole in co-ordination with the other authorities that supervise each of the constituent activities. In **Switzerland**, too, an umbrella authority is appointed, but on a case-by-case basis (i.e. not always the authority supervising the group's leading activity). **Belgium**, **Czech Republic**, **Finland**, **France**, **Germany**, **Italy**, **Luxembourg**, **Netherlands**[31], **Poland**, **Portugal** and **Turkey** do not designate an umbrella authority[32].

Operational structure of supervisory authorities: a tentative typology

Even among the countries with consolidated financial supervision the pattern of practical organisation varies widely. Consolidation of the individual supervisory authorities into a single authority has taken very different forms depending on the size of the country concerned, the regulatory structures already in place, the specifics of the national market and also the theoretical approach favoured[33]. There are four main types of consolidated organisation:

– The <u>institutional model</u> or sectoral model. Here the supervisory service is structured according to the different types of financial institution and not according to the activity performed (e.g. pension products are supervised by a different department of the service according to whether they are provided by a pension fund, a bank or a life insurance company);

- The functional model. Here the supervisory service is structured according to the activity performed (deposits, life insurance, pensions, securities management) and not according to the institutional form of the performer. In the case of a very segmented market, with strong regulatory barriers between the different sectors, this approach is equivalent to the institutional approach, but the progressive removal of these barriers in many countries is accentuating the difference between the two models;

- The operational model. Supervision is organised according to the different supervisory activities performed (off-site supervision, on-site supervision, research);

- The dual model. Supervision is based on the operational model, but within each supervisory department there is an institutional structure.

The structures actually adopted by consolidated supervision authorities vary considerably across countries. But in most cases they tend towards the institutional model (as in **Korea** and **Norway**) or the dual model (as in **Denmark**, **Sweden** and the **United States**). Also, most supervisory authorities do not have a special department to deal with financial conglomerates or diversified groups (though there are exceptions, as in **Australia**).

In practice it has proved extremely difficult to adopt just one type of approach. Where institutional specialisation is developed there is often an operational pattern not unlike the one found in countries using a non-integrated institutional approach. More broadly, it can be said that the organisation of supervision in countries not using an integrated approach reveals a typology similar to the one applying to single authorities. That is to say:

- a non-integrated institutional model for countries with a supervisory authority for each financial sector (the most current model);

- a non-integrated operational model where there is a different authority for each type of supervision assignment, e.g. **Australia**, where the Reserve Bank of Australia (RBA) is responsible for systemic stability, the Australian Prudential Regulatory Authority (APRA) for prudential supervision and the Australian Securities and Investments Commission (ASIC) for market trading and consumer protection;

- a non-integrated dual model where there is a different supervisory authority for each financial sector, but where each authority is organised according to the operational model, the different assignments (off-site supervision, on-site supervision, research) being carried out by different services.

B. Relations with other forms of supervision

Auditors

The essential function of an auditor is to verify that a company's books are kept in accordance with the regulations applying in the country concerned and to certify the correctness of the annual accounts. The profession is recognised by law and regulated in all OECD countries. In **Japan** and **Switzerland**, however, the appointment of an auditor is not mandatory.

In most OECD countries, insurance company auditors also act as intermediaries between the company and the supervisory authorities. They are required to report to the supervisory authorities in all OECD countries except **France**, **Hungary**, **Japan**, **Sweden** and **Switzerland**. And in all but the first four countries mentioned above, formal rules have been laid down for co-operation between the supervisory services and auditors. These relations are especially important to authorities performing no or few on-site inspections, as in the case of the **United Kingdom**.

In all OECD countries, insurance companies appoint their auditors. But to ensure that auditors are equipped to perform their role as watchdogs for the supervisory authorities, regulations impose requirements as to academic qualifications (all OECD countries except **Korea** and **Switzerland**), professional experience (all OECD countries except **Hungary**, **Iceland**, **Korea**, **Portugal**, **Sweden** and **Switzerland**) or "fitness and properness" (**Korea**, **Japan**, **Norway**, **Turkey**, **United States** and all Member States of the **European Union**). Furthermore, the supervisory authority generally has the right to refuse the appointment proposed by the company and, in the most serious cases, to appoint an auditor of its own choosing. Finally, in all OECD countries except **Switzerland** auditors have to be independent of insurance companies.

Actuaries

Actuaries, too, have a special relationship with the supervisory authorities. Although the profession is not recognised by law in **Belgium**, **Hungary**, **Luxembourg**, the **Netherlands**, **Portugal** and **Sweden,** the great majority of OECD countries require insurance companies to use actuaries. Only **France** and **Switzerland** have no such requirement. The requirement applies only to life insurance companies in **Australia**, **Denmark**, **Italy**, **Luxembourg**, the **Netherlands**, **Sweden** and **Turkey**.

Except in the case of **Australia** (and, of course, **France** and **Switzerland**), regulators impose requirements such as:

– qualifications, in the form of a diploma or membership of an institute of actuaries;

- professional experience (**Belgium, Czech Republic, Denmark, Finland, Germany, Hungary, Italy, Korea, Mexico, Norway, Poland, Slovak Republic, Sweden, Turkey, United Kingdom, United States**);
- fitness and properness (**Belgium, Czech Republic, Denmark, Germany, Hungary, Italy, Japan, Korea, Luxembourg, Norway, Poland, Slovak Republic, Turkey, United States**);
- independence from the insurer (**Australia, Iceland, Italy, Mexico, Norway, Turkey, United States**).

In countries where actuaries have to be appointed, they have statutory duties to perform. In the great majority of countries, the essential task of an actuary is to calculate the technical provisions and/or value policy liabilities. Other duties they may have to perform are:

- monitoring solvency (**Canada, Czech Republic, Denmark, Finland, Germany, Italy, Korea, Luxembourg, Mexico, Netherlands, Norway, Slovak Republic, Sweden, Turkey, United Kingdom, United States**);
- certifying the accuracy of the information submitted to the supervisory authority (**Belgium, Czech Republic, Denmark, Germany, Hungary, Iceland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, Norway, Portugal, Slovak Republic, Spain, Turkey, United Kingdom, United States**);
- certifying the correctness of premium rates and technical provisions (**Czech Republic, Hungary**, **Iceland, Italy, Korea, Poland, Slovak Republic**);
- advising the management (**Belgium, Czech Republic, Slovak Republic**);
- monitoring the distribution of surplus to policyholders (**Japan, Czech Republic, Slovak Republic**).

V Financial difficulties and insolvencies

A. Definition of insolvency: intervention thresholds

An insurance company is declared insolvent when it is not longer able to meet the solvency requirements with which it has to comply. However, the financial situation of an insurance company may be seriously threatened before there is any sign of a shortfall in terms of technical provisions or solvency margin, i.e. if the company's pricing policy is wrong, if its reinsurance programme is inadequate or if its investments are very risky. In several countries it has been seen that certain insurance companies still show a solvency margin above the critical threshold shortly before they have to go into liquidation.

Japan, **Korea** and the **United States** have accordingly provided for prompt corrective action by way of systems comprising several thresholds of supervisory intervention (three for **Japan** and **Korea**, four for the **United States**), each threshold corresponding to a percentage of the minimum solvency margin requirement.

On a more general basis, a number of countries have introduced early warning systems. These comprise a very wide range of schemes—prescribed by legislation or regulation, by directives from the supervisory authorities or even by internal rulings of the supervisory body—which identify companies likely to encounter difficulties, according to criteria that vary from country to country. The main advantage of an officially prescribed linkage between certain benchmarks and supervisory intervention is that it reduces the risk of discrimination between the different insurers and the risk that decisions to intervene will be disputed. On the other hand, this type of arrangement may be regarded in some countries as too limiting in that the supervisory authority cannot intervene outside it, even in cases where the authority has serious doubts about a company's solvency for reasons not covered by the early warning system. This is why the Solvency Working Group of the European Conference of Insurance Supervisory Services suggests, in connection with the revision of insurance directives, that no further attempts should be made to define the situations warranting intervention and the means to be made available for that purpose, in order to leave the supervisory authorities the necessary latitude to take measures of adjustment.

B. The rehabilitation procedure

The due process of law

Whatever measure is taken against it, an insurance company has the right to appeal. In most cases the rehabilitation procedure begins with a simple warning to the company, asking it to take the necessary steps as soon as possible. At a later juncture, the company is invited to put its case to the supervisory authority before any penalty is imposed. In the most serious cases, the supervisory authority may sometimes issue an immediate injunction or impose an immediate penalty. Finally, rulings by the supervisory authority may be appealed initially to the finance ministry (**Czech Republic**, **Hungary**, **Korea**, **Norway** and **Spain**) and subsequently, in all OECD countries, to the competent judicial authority, which in many cases is an administrative court.

Measures taken in the event of difficulties

It is not possible to compile an exhaustive list of all the rehabilitation measures and penalties at the disposal of the supervisory authorities. The range varies from country to country, and in most of them the list of statutory measures ends with a provision empowering the authorities to take any measure other than those explicitly mentioned, provided it is of a kind that will safeguard the interests of policyholders. The measures described below are only the most current ones.

The rehabilitation plan

As soon as the financial situation of an insurance company appears unsound or if the company is unable to meet its solvency requirements, the supervisory authority may require it to submit a rehabilitation plan for their approval. This applies in all OECD countries. Other than in **Poland**, **Portugal**, **Spain** and the **United Kingdom**, the rehabilitation plan may be drawn up by the supervisory services themselves if the company refuses to submit one or if the plan it submits is not approved.

The precise content of the plan is not defined by the regulations, since the measures to be taken vary according to the company's situation. Broadly speaking, though, a rehabilitation plan:

- lists the financial or administrative measures the company intends to take to improve its situation;
- specifies the qualitative and quantitative targets set;
- states the time frame for achieving the targets.

The short-term finance scheme

According to the directives of the **European Union**, if the solvency margin falls below the guarantee fund (i.e. one-third of the statutory margin or the absolute minimum), the supervisory authority of the competent Member State must require the insurance company to submit a short-term finance scheme for its approval. A similar arrangement is envisaged in the great majority of OECD countries: the company must inform the supervisory authority of the nature, amount and phasing of the new funds it intends to raise to restore its solvency.

Appointment of a special auditor

With the exception of **Austria**, the **Czech Republic**, **Greece**, **Iceland**, **Ireland**, **Poland**, the **Slovak Republic**, **Sweden**, **Switzerland** and the **United Kingdom**, all OECD countries empower their supervisory authorities to appoint a special auditor—a member of the supervisory service or a private expert—to conduct an in-depth examination of a financially troubled company. In most cases the auditor assists the company in drawing up the rehabilitation plan. This step is generally taken when on-site supervision has revealed serious problems in the company's bookkeeping or internal control procedures that do not show up in its submitted reports.

Prohibition of free disposal of all or part of company assets

This measure is taken in all OECD countries when a company has not set up adequate technical provisions or if these are not covered by a corresponding amount of admissible assets. The company may also be prohibited from investing in risk assets, required to liquidate certain assets, or required to repatriate the share of assets invested abroad needed to cover its domestic liabilities.

Restriction of all or part of company activity

When an insurance company's financial situation deteriorates to the point where the interests of policyholders and beneficiaries are compromised or likely to be, the supervisory authorities may decide to prohibit it from engaging in certain transactions or to limit its activities. Among other things, the authorities may limit the volume of premiums received (**Denmark**, **Ireland**, **Korea**, **Netherlands**, **Spain**, **Turkey**, **United Kingdom**), oblige the company to review its reinsurance programme (**Korea**, **Netherlands**, **Turkey**), or prohibit the payment of dividends to shareholders and distribution of surplus to policyholders over the legal or contractual level.

In the great majority of OECD countries the supervisory authorities are also empowered to suspend a CEO or board member and to temporarily appoint an administrator of their choice who would substitute for the firm's executive bodies (chairman, directors, officers, etc.) in exercising their powers and obligations.

Temporary suspension of activity

In a number of OECD countries (**Austria**, **Belgium**, **Denmark**, **Finland**, **Germany**, **Italy**, **Japan**, **Korea**, **Spain**, **Switzerland**, **United Kingdom**), the supervision authority may order a suspension of the company's activity or fix a period during which policyholders are not required to pay their premiums or the insurer to pay lump-sum benefits and indemnities (payment of annuities continuing in principle). Suspension does not necessarily lead to withdrawal of the licence. However, in many OECD countries, including all the Member States of the **European Union**, a regulation provides that any company having ceased its activity for a period of more than three or six months will have its licence withdrawn.

Compulsory transfer of all or part of the policy portfolio

When an insurer is in serious financial difficulty, portfolio transfer is sometimes seen as the best way to safeguard the interests of policyholders, especially in the case of long-term life insurance. In many OECD countries the supervision authority has the right to oblige a company to transfer all or part of its portfolio (**Australia**, **Belgium**, **Czech Republic**, **Denmark**, **Germany**, **Hungary**, **Iceland**, **Korea**, **Slovak Republic**, **Spain**, **Switzerland**, **United States**). In other countries (**Finland**, **Japan**, **Mexico**, **Norway**, **Turkey**) compulsory transfer exists, but the decision does not come from the supervision authority. In **France** and **Luxembourg** the transfer decision may be taken by the supervision authority or by another institution.

Unlike the case with a portfolio transfer organised voluntarily by a company, compulsory transfer does not generally necessitate the prior agreement of policyholders. They are nevertheless informed beforehand and any objections they may have are taken into account in the deliberations preceding the final decision. In many countries, policyholders are entitled to terminate their policies rather than have them transferred (**Australia**, **Belgium**, **Finland**, **Hungary**, **Iceland**, **Luxembourg**, **Mexico**, **Norway**, **Spain**, **Switzerland**, **Turkey, United States**).

In cases where other companies are unwilling or reluctant to accept the portfolio, the policyholder protection fund (see below) may step in and either take over all or part of the portfolio or offer the receiving company the additional assets needed for it to agree to the transaction.

Partial or total withdrawal of licence

In all OECD countries the heaviest penalty that can be imposed on an insurance company is the partial or total withdrawal of its licence. This step is taken only in the last resort when there seems to be no way to improve the company's situation. It triggers the winding-up procedure.

For policyholders, the consequences of a total withdrawal of licence differ depending on whether the portfolio is transferred to another insurance company, taken over by a guarantee scheme or included in the winding-up procedure. Policyholders may find that their premiums have been increased (**Czech Republic**, **Finland**, **Germany**, **Iceland**, **Japan**, **Korea**, **Norway**, **United States**) or their benefits reduced (in the same countries, except **Korea**, and in **Belgium**, **Denmark**, **France**, **Hungary**, **Mexico** and **Sweden**). As an alternative they may have the right to terminate their policies (**Czech Republic**, **Denmark**, **Finland**, **Germany**, **Hungary**, **Iceland**, **Italy**, **Japan**, **Mexico**, **Norway, Slovak Republic**, **Switzerland**, **Turkey**, **United States**).

Of the different measures discussed here, withdrawal of licence is the only one systematically published (in an official gazette, in one or more specialised journals or in one or more national daily newspapers, depending on the country).

C. Protection of policyholders in the event of insolvency of an insurance company

Notwithstanding all the supervision schemes that exist and all the rehabilitation measures that may be taken, insurance companies can become insolvent. Thus, in order to protect the interests of policyholders in the event of insolvency of an insurance company, certain special regulatory arrangements are normally established. These arrangements can be divided into two groups: those in the winding-up procedure and those outside it. The former type of arrangement is used in most jurisdictions. Such arrangements vary considerably across jurisdictions, however, largely depending on the peculiarity of the judicial insolvency procedures of respective jurisdictions. In addition, in many jurisdictions, policyholder protection funds (or guarantee schemes) have been established to provide certain protection for policyholders outside of the winding-up procedure.

Liquidation

The rules and regulations of OECD countries concerning liquidation differ on many points, particularly on the conditions for initiating a rehabilitation or winding-up procedure and the order of priority of creditors.

An insurance company remains under the supervision of the authority concerned (sole authority or insurance supervision authority) until the end of the winding-up procedure, i.e. until the company has discharged all its liabilities or, if the disposable assets are insufficient for this purpose, until it is declared bankrupt.

Liquidation of an insurance company may be requested by the company itself (all OECD countries except **Turkey**), by the supervision authority (all OECD countries except **Switzerland**) or by one of the creditors (**Australia**, **Belgium**, **Denmark**, **Finland**, **France**, **Hungary**, **Iceland**, **Italy**, **Netherlands**, **Portugal**, **Spain**, **Sweden**, **Switzerland**, **Turkey**, **United Kingdom**). In most OECD countries the decision to wind up a company is taken by the competent legal authority and a receiver is appointed, usually by the competent court but in some cases by the supervision authority or on its proposal.

In the winding-up procedure, policyholders receive preferential treatment in all OECD countries except the **United Kingdom**. The status of policyholders among the creditors accorded priority by the legislation on bankruptcy (employees, tax authorities, social security authorities, bankruptcy petitioner) differs across jurisdictions. In most jurisdictions the preferential payments made to policyholders are limited to the assets representing the technical provisions or mathematical reserves, but in some they are also made from the company's total assets (**Canada**, **France**, **Korea**, **Mexico**, **Norway**, **Spain**, **Turkey**, **United States**).

Policyholder protection funds or guarantee schemes[34]

When an insurance company becomes insolvent, policyholders will possibly suffer financial losses, as their claims may not be fully met. In order to protect policyholders in such a situation, many countries created a fund to compensate their losses.

Policyholder protection funds are fairly common among OECD countries. At least 21 countries have one or more such funds. These funds can be divided into two types. The first type comprises the funds that focus on the policyholders of one or a few branches of insurance. The funds of the second type cover most of the contracts subscribed to by the participating insurance companies. The former type is often referred to as a fund for a specific class of insurance, while the latter is known as a general fund.

Funds for specific classes of insurance

A fund for a specific class of insurance is normally established in association with compulsory insurance. The typical example is a fund for compulsory motor vehicle liability insurance. The purpose of this compulsory insurance would not be achieved if the insurer were insolvent and unable to pay a claim. A fund is therefore established to compensate the losses sustained by accident victims in such circumstances. It also steps in when the party responsible for the accident cannot be identified or is uninsured and thus no insurance protection is available for the victim.

The majority of OECD countries have funds that cover compulsory motor vehicle liability insurance exclusively (for the **European Union**, the establishment of such a fund is provided for by Article 1 of the second European directive on compulsory motor vehicle insurance[35]). Some countries also have funds that cover other branches of compulsory insurance: hunting accidents (**France**, **Italy**, **Spain**), certain categories of agricultural accident (**France**, **Italy**, **Japan**, **Poland**) and industrial accidents. These funds usually provide full compensation.

General funds

In contrast to a fund for a specific class of insurance, a general fund covers a wide range of insurance classes, both compulsory and non-compulsory, including most of the products of a not particularly specialised insurance company. Such a fund can ensure the payment of claims to policyholders when a company becomes insolvent and unable to meet its financial obligations. While the benefit of a fund for a specific class of insurance in ensuring the protection of the beneficiaries is widely recognised, the necessity of creating a general fund is not agreed upon internationally. To date only nine OECD countries—**Canada**, **France**, **Ireland**, **Japan**, **Korea**, **Poland**, **Spain**, the **United Kingdom** and the **United States**—have set up such funds. In recent years, however, there has been an increase in the number of funds created, and this trend will most likely continue.

Fund structure varies widely across countries as regards:

- the branches of insurance covered: life (**Canada**, **France**, **Japan**, **Poland**, **Spain**, **United States**), non-life (**Canada**, **Ireland**, **Spain**, **United States**), or both but in separate accounts (**Korea**, **United Kingdom**);
- eligibility of claimants : for example, **Ireland** and the **United Kingdom** limit fund coverage to natural persons;

- compensation limits: some countries have chosen to cap payments (**Canada**, **France**, **Korea**, **United States**), others limit compensation to a percentage of the claim (**Japan**, **United Kingdom**), and two countries (**Ireland**, **Poland**) apply both these techniques;

- funding: contributions from member companies are levied according to the pre-funding method (**Japan**, **Korea**), the post-funding method (**Ireland**, **Poland**, **United Kingdom**, **United States**) or both (**France**); the State may also provide funding **(Japan**, **Korea**);

- assessment of contributions: on the basis of premiums (**Canada**, **Ireland**, **Poland**, **Spain**, **United Kingdom**, **United States**), premiums and technical provisions (**Japan**), technical provisions only (**France**), premiums and the company's risk category (**Korea**).

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NOTES

1. Standard & Poor's and A.M. Best.

2. On this subject, see also the April 1997 report of the Conference of Insurance Supervisory Authorities of the Member States of the European Union.

3. Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

4. Canada is made up of ten provinces and three territories.

5 . Solvency supervision based on prudential return on a financial year or possibly smaller intervals.

6. Article 29 of the third non-life directive and Article 29 of the third life directive.

7. A fixed-ratio solvency test is also applied in Canada for non-life insurance, but a reform is expected to switch to a "risk-based" model by 2002.

8. See below, Other forms of supervision - Actuaries.

9 . The EU Third Life Directive (92/96/EC), new article 17 of the First Life Directive, paragraph 1, Section B (a), also allows for another method. When the assets are not valued at their purchase price, a Member state may stipulate that one or more maximum rates may be calculated taking into account the yield on the corresponding assets currently held, minus a prudential margin. The Netherlands (inter alia) applies this system.

10. See Practical organisation of supervision, Other forms of supervision.

11. Interest rate risk is classified as an investment risk.

12. The solvency rules in the first life directive called for a margin of 4per cent of mathematical provisions in addition to a ratio of 0.3per cent of capital at risk. The exception clause for contracts that are linked to investment funds allows one quarter of this (i.e., 1per cent of provisions) to be allocated to

covering the risk involving operating expenses (with the remaining 3per cent covering investment risk).

13. This category of risk is made up of two sub-categories: C4-a Business Risk, Guaranty Fund Assessment Risk (general business risk of life insurers) and C4-b Business Risk, Health Administration Expense Risk (due in particular to the administration of third-party programs and excessive growth).

14. It is in fact very commonplace, under proportional reinsurance treaties, for the reinsurer to assist the insurer with setting premiums or formulating underwriting policy, *inter alia* by sharing its knowledge of the market or by assisting it financially by discounting its reinsurance commissions.

15. The supervisory authority has stated a preference, however, that retention not exceed 3per cent of net assets based in Australia.

16. To avoid any discrimination, such a decision should be made subject to objectively verifiable criteria laid down in the directives.

17. Factor C1 – Asset Risk – Other, Plus Reinsurance.

18. For more information on this point, see the papers on recent investment developments by the Insurance Committee and the Working Party on Private Pensions.

19. This limit per issuer does not apply to financial instruments issued by the U.S. Government.

20. In Japan, the Asset Management Risk is the sum of 5 separate components: depreciation risk, credit risk, risk attaching to related undertakings, off-balance-sheet risk and credit risk linked with reinsurance transactions.

21. See study of Switzerland by Ré, 1997 figures.

22. The other segment is based on the European directives.

23. The surrender risk materialises when, for example, the charges specified in the contract are not sufficient to meet the costs of selling assets. The realisation risk appears when policy surrender necessitates the simultaneous sale of a large quantity of assets under unsatisfactory conditions of asset realisation.

24. In these six countries the required testimonials of competence and integrity are not submitted as such for approval, but they form part of the background information on the strength of which the authorities concerned might refuse to grant a licence.

25. *Capital Adequacy Principles Paper* and *Supplement to the Capital Adequacy Principles Paper*, Joint Forum on Financial Conglomerates, 1999.

26. *Prudential Supervision of Conglomerates, Policy Discussion Paper*, Nov. 1999, Australian Prudential Regulation Authority.

27. *Principles for Supervisory Information Sharing Paper*, documents on the supervision of financial conglomerates, Joint Forum on Financial Conglomerates, February 1999.

28 . According to criteria established by law

29. "These visits are not in the nature of detailed inspections. They are opportunities for supervisors to meet company executives in order to gain some idea of their quality and discuss their plans for the future. The visits enable supervisors to keep abreast of market developments. Also, by establishing personal contacts, they encourage managers to notify the supervisory authority of their projects or their concerns very early on".

30. See *Consolidated Supervision in Theory and Practice,* note by the Secretariat of the OECD Committee on Financial Markets, March 2001.

31 . In the Netherlands, there is a protocol agreement between the insurance and banking supervisory authorities on joint supervision of financial conglomerates. According to this agreement predominantly insurance or bank groups are being supervised by the insurance or banking supervisory authority. Mixed groups are being supervised jointly. Moreover, since 1 August 1999 a Council of Financial Supervisory Authorities has been established, which may set common rules for the insurance, banking and securities sector.

32. Source: Institute of National Bankers *Global Survey 2000,* plus national supervisory agencies.

33. See in particular *Financial Regulation: Why, How and Where Now?*, Goodhart et al (1998) and *"Twin Peaks": A regulatory structure for the new century*, Taylor (1995).

34. For more information on guaranty schemes, see *Policyholder Protection Funds*, paper for the Insurance Committee, OECD, November 2000, published in *Policy Issues in Insurance*, June 2001.

35. Second Council Directive of 30 December 1983 on the approximation of the laws of the Member States relating to civil liability in respect of the use of motor vehicles.

COUNTRY CONTRIBUTIONS

AUSTRALIA

The Australian Prudential Regulation Authority (APRA) was established in July 1998 and was formed from the merger of the supervision of banks (formerly with the central bank) and the Insurance and Superannuation Commission (ISC) which had supervised insurance and pension schemes previously. APRA is responsible for the prudential supervision of the financial sector in Australia and the Australian Securities and Investments Commission (ASIC) is responsible for market conduct and corporations law.

With effect from July 1999, the previously state based supervision of credit unions, building societies and friendly societies, was integrated into the APRA structure.

With respect to insurance supervision, there are approximately 150 authorised general insurers (non life) and 40 authorised life insurers with a further 50 friendly societies providing life insurance style benefits to members of these societies.

The major pieces of legislation for ensuring the financial soundness of companies carrying on life and general insurance business in Australia are the *Life Insurance Act 1995* (covering life insurers and those friendly societies that carry on life business) and the *Insurance Act 1973* covering non life insurers. In addition, the *Financial Sector (Shareholdings) Act 1998* controls changes of shareholding in financial sector companies and the *Insurance Acquisitions and Takeovers Act 1991* controls transfers of assets and liabilities, particularly where there is no change of shareholding in the companies involved in the transfer.

Regulation of the life and general insurance industries aims to protect the interests of policyholders and the viability of the financial sector, to promote confidence in the industry, and to encourage an innovative and competitive industry. Australia does not control the day to day market operations of companies, but provides and enforces prudential guidelines within which the industry can safely operate. The role of APRA is not, however, to guarantee the interests of policyholders and shareholders against loss in the event of company failure.

I Regulations concerning the supervision of solvency

A. Life Insurance

The Life Insurance Act sets out the following capital and solvency requirements for registered life insurance companies.

- Companies incorporated in Australia are required to hold, at all times, a minimum paid up share capital of at least $A10 million;
- Companies without share capital (mutual companies) are required at all times to maintain $A10 million in eligible assets (other than assets in a statutory fund);
- Foreign companies are required at all times to maintain in Australia $A10 million in eligible assets (other than assets in a statutory fund);
- All companies under the Life Insurance Act are required to maintain an excess of eligible non-statutory fund assets over non-statutory fund liabilities of not less than $A5 million.

"Eligible Assets" are defined to exclude certain assets invested in related companies and to avoid double counting of statutory capital where it is required to support a subsidiary of the life insurance company.

"Statutory funds" are established within a life insurance company to receive premiums, hold assets and pay policy obligations and other expenses in relation to life insurance business of the relevant fund. Other than prescribed by the Life insurance Act, assets of a fund must be used only with respect to policies written in that fund and not for any purpose associated with policies written in another fund. The assets of each statutory fund must be kept distinct from all other assets of the company and all income from these assets must be reinvested in the fund by which it was earned.

Policy liabilities and solvency and capital adequacy requirements are determined under standards issued by an independent board established for the purpose called the Life Insurance Actuarial Standards Board (LIASB). This structure of valuation of liabilities provides for a "best estimate" structure with a recognition of profits over the life of the contract in line with the provision of services implied under the contract – so called a "Margin on Services" method. This method is also translated to the methods of profit reporting used by companies in their public accounts. The Margin on services method provides for annual profit to be disclosed in terms of a release of the particular profit margins for the year, earnings on additional capital held in the statutory fund and an experience item that describes the profit arising from the variation in the profit arising from experience that varies from the best estimate basis. The best estimate basis is updated each year and profit margins are adjusted immediately. Where profit margins are negative, then the full extent of the loss is recognised in the year it is recognised.

Where profit margins are positive, changes in profit margin as a result of changes in the best estimate assumptions are recast over the future life of the contracts.

Solvency requirements are also prescribed such that the margin is introduced over the best estimate liability up to a level based on conservative assumptions. This margin is included in the statutory and public reports. The assumptions required to be utilised represent an adverse scenario for liability valuation with additional requirements for asset margins, particularly with respect to assets that have a limited likelihood of realisation in a wind up situation and for asset concentration risk. There is also a margin required which represents the expenses of distribution. In this way, the solvency requirement can be characterised as a wind up valuation with a one-year time horizon, having regard to the unique size and structure of the fund's future obligations.

A second level of requirement is the capital adequacy requirement. This requirement takes into account the future business plans of the company and aims to ensure continued compliance with the solvency requirements over a three-year time horizon. It is therefore able to be characterised as a "going concern" basis with capitalisation for growth expectations. As the requirement includes information that is based on the business plans of the company it is treated as confidential and is only disclosed to APRA.

There are obligations that automatically apply to a company when it meets the solvency requirement but does not meet the capital adequacy requirement. The most onerous obligation is a restriction on the distribution of capital and the payment of dividends. Failure to meet the solvency requirement provides APRA with the opportunity to intervene in the company operations in a very close manner and to appoint a judicial manager of the company.

In addition, each company must have an appointed actuary who is responsible for the valuation of liabilities and the ongoing assessment of solvency requirements. The actuary is required to submit reports to the board on the financial condition of the company as a whole and for these reports to be provided to APRA for information. The appointed actuary may be either an employee of the insurer or a consultant.

It should be noted that slightly different requirements currently apply to Friendly Societies but that these are currently the subject of a harmonisation process by the LIASB.

B. General Insurance

The Insurance Act ensures that authorised general insurers can cover their claims obligations if and when they occur and increases the confidence of insureds, and the public generally, that claims will be met.

A major review of the Insurance Act solvency requirements is in progress at the time of writing. This information is based on the current requirements.

Authorised insurers are currently required to hold paid-up share capital of not less than $A2 million.

The Act also requires that an insurer meets the following additional solvency requirement.

- For companies incorporated in Australia, assets must exceed liabilities by not less than $A2 million, 20 per cent of premium income, or 15 per cent of outstanding claims, whichever is the greater;
- For all companies, including overseas companies operating in Australia through branches, assets in Australia must exceed Australian liabilities by not less than $A2 million, 20 per cent of premium income, or 15 per cent of outstanding claims, whichever is the greater.

APRA expects that authorised insurers should maintain a suitable margin above the minimum requirement so that they can withstand fluctuations in experience and in the market value of assets and still be able to continue to meet the requirements of the Insurance Act. In this regard, there are requirements as to the maximum retention’s to any one risk and to any single event which are assessed in the context of the reinsurance arrangements of the company on an annual basis. Reinsurance arrangements are also approved on an annual basis given that the solvency requirements are determined on a net (of reinsurance) basis.

In addition, for the determination of assets which can count toward the solvency requirement there is an exclusion of some assets unlikely to be realised in the event of a distress situation and a requirement that certain other assets are subject to approval (representing assets with affiliates and assets where there is the potential for undue concentration of holdings).

Lloyd’s underwriters are also regulated under the Insurance Act but are subject to different rules than those that apply for authorised insurers. This line of business is not material in Australia so will not be covered further here.

II The practical organisation of this supervision

All entities supervised by APRA are assigned, regardless of their type of license, to a particular division within the organisation. In effect, this means that local conglomerates and those entities that part of an overseas operation are supervised by the "Diversified Institutions Division", and that all other entities (locally operating and owned entities except conglomerates) are supervised by the "Specialised Institutions Division".

In addition, there is a "Policy, Research and Consulting" Division that includes some particular specialist risk assessment teams.

Authorised insurers submit annual and quarterly statistical and financial data to APRA for assessment and monitoring. In addition, there is a standing process of annual consultation with APRA, which is conducted to monitor and update APRA on the strategic and risk management developments within the organisation. These visits also include a specific topic of interest, which could include a deeper analysis of operational risk, reinsurance or reserving arrangements, internal controls or some other topic. Entities are also expected to participate in the periodic program of visits from the specialist risk assessment teams where the focus of the visit is dedicated to a particular risk issue.

The various acts provide APRA with the power to request information, perform inspections, and conduct official investigations of companies as well as to issue formal directions to companies to act or refrain from acting in a particular manner.

APRA also has to be informed of developments at other times including when there is a change in the operations, key personnel, or direction for the company. In some cases, APRA has to approve changes (most particularly for auditors for general insurers) and in other cases APRA simply needs to express concurrence or "no objection". Secrecy provisions and a code of conduct with respect to "conflict of interests" apply to the regulatory staff and provide encouragement for an open dialogue with authorised institutions.

In the case of life companies, actuaries and auditors are subject to regulatory obligations to report critical concerns to APRA and are provided with qualified privilege to protect them from adverse coercion from a company in the event that they make such reports.

III Measures when difficulties arise

As indicated, APRA is able to enforce wide-ranging powers which include:

- Formal requests for information, including reports of financial condition from independent experts;
- Formal inspection;
- Directions, particularly with respect to the rectification of the solvency position of the company; and
- (In the case of life insurers) to appoint an internal administrator or a court appointed judicial administrator.

Directions can be all encompassing and are not limited.

AUSTRIA

I Introduction

The tasks of the Austrian Insurance Supervisory Authority are based on the Insurance Supervisory Act (VAG 1978), which has undergone a large number of amendments, in particular implementing three generations of EC directives (life and non-life).

II Regulations concerning the supervision of solvency

The basic objective of supervision of insurance companies in Austria is to ensure adequate protection for policyholders and beneficiaries. There are many rules aiming at supervising the companies' economic situation. One basic requirement is the company's obligation to establish capital funds of at least the same amount as the minimum solvency margin being one important measuring instrument of the insurance company's financial health.

The Austrian regulations on solvency supervision are in agreement with the respective EC Directives (Articles 16 and 17 of the Directive 73/239/EEC and Articles 18-20 of the Directive 79/276/EEC).

A. Solvency requirement

In principle, the solvency requirement depends on the company's business volume (i.e. variable solvency requirement). But in any case a minimum solvency margin – expressed in terms of absolute figures – is required in order to ensure that undertakings possess adequate resources when they are set up and that in the subsequent course of business the solvency margin shall not fall below a minimum amount.

Variable solvency requirement

Taking into account the mathematical reserves and the capital at risk (life assurance) and the yearly premium income and average amount of claims incurred (general insurance business) the solvency requirement varies with the course of business. A deduction of ceded reinsurance up to a certain level is allowed.

Non-life insurance

The Austrian calculation rules for *non-life insurers* which are based on Article 16 of the First non-Life Insurance Directive (73/239/EEC) can be summarised as follows:

The solvency requirement to be constituted is determined either by the premium index or the claims index.

– Premium index

The written premiums of the last financial year are divided into two portions (below and over 10 million EURO). 18 per cent of the first portion and 16 per cent of the second portion are calculated and then added. The result is multiplied by the ration existing in respect of the last financial year between the amount of claims for own account and the gross amount of claims. The percentage applied must not, however, be lower than 50 per cent.

– Claims index

For the calculation of the claims index the average of claims over the last three financial years (in some cases seven years) are divided into 2 portions (the triggering amount is seven million EURO). 26 per cent of the first portion and 23 per cent of the second portion are calculated and then added. The result is multiplied by the ration existing in respect of the last financial year between the amount of claims for own account and the gross amount of claims (a minimum of 50 per cent is required).

The amount of the solvency margin must be at least equal to the higher of these two indices, but in no event should be less than the minimum solvency requirement (as described under paragraph *Minimum solvency requirement* below).

In case where *health insurance* is managed according to the technical principles of life assurance the solvency requirement is reduced to a third.

Life assurance

The Austrian calculation rules for life insurers follows the Article 19 of the First Life Insurance Directive (79/267/EEC).

The solvency requirement is calculated as follows: 4 per cent of life assurance provision and the provision for unearned premiums (a deduction of ceded reinsurance up to 15 per cent is possible) and 0.3 per cent (for certain cases 0.1 per cent and 0.15 per cent) of the capital at risk (a deduction of ceded reinsurance up to 50 per cent is possible) are calculated and then added. The solvency margin must be at least equal to this sum, but in no case fall below the minimum solvency requirement.

In certain cases the percentage for calculating the capital at risk is lower: for *temporary assurance* on death of a maximum term of three years it is 0.1 percent. In case the term is between three and five years it is 0.15 per cent.

For *unit-linked* business the calculation is equal to that of life assurance. In case the insurance undertaking does not bear any investment risk, the term of the contract exceeds five years and the allocation to the cover management expenses set out in the contract fixed for a period exceeding five years 0.1 per cent of the mathematical provisions has to be calculated. If the company does not cover a death risk, the capital at risk is not included into calculation.

Minimum solvency requirement

The Austrian Insurance Supervisory Act requires a minimum solvency margin. As to undertakings transacting only life assurance (health insurance; other non-life insurance) it is 50 (30; 30) million ATS. In case the undertaking is active in more than one class it is for life assurance: 40 million ATS for health insurance: 20 million ATS and for other non-life insurance: 20 million ATS. For foreign insurers the amounts are halved.

B. Elements which constitute the solvency margin

The solvency margin corresponds to the company’s assets free of any foreseeable liabilities. The following elements are taken into account to constitute the solvency margin:

- paid-up share capital and half of the unpaid share capital (initial fund in case of mutuals),
- reserves,
- profits brought forward,
- subordinated capital subject to some limitations,
- profit reserves, if they may be used to cover losses and
- hidden reserves up to 20 of the sum of funds as described under 1 and 2 (subject to prior approval).

Upon calculation of the solvency margin the following elements have to be deducted:

- loss of the financial year,
- own shares,
- securities concerning own subordinated capital,
- intangible assets.

III Practical aspects of solvency control

A. General

The supervision of insurance companies is carried out by the Austrian insurance Supervisory which is part of the ministry of Finance. It is entitled to intervene in any matter of insurance undertakings' activities as far as the interest of the insured persons are concerned and to issue provisions which are necessary to protect these interests.

Information on the financial situation of insurance companies is mainly obtained from financial returns of the undertakings which are sent to the Insurance Supervisory Authority. Once a year (no later than 6 months after the end of the financial year concerned) the insurance companies have to forward to the Supervisory Authority their duly approved and audited financial annual accounts (together with the annual reports) including a confirmation of the insurance company's solvency status. In case of life insurance, health insurance and other non-life insurance (as far as the two latter are operated on a technical basis similar to life insurance) an actuary has to certify that the technical provisions are calculated on a actuarial basis and are in conformity with the relevant legal provisions.

The insurance companies have to complete forms, giving more detailed information about the structure of the items of the balance sheet and the profit and loss account. Quarterly the undertakings have to forward a list of assets, covering mathematical reserves. All this information is processed via EDP. It is the basis for further investigations by this authority, which is authorised to carry out on-the-spot investigations of insurance companies.

Generally speaking the Austrian Insurance Supervisory Authority monitors the financial health of the insurance undertakings, including the solvency status of the company, the establishment of sufficient technical provisions and the covering of those provisions by matching assets.

B. Solvency supervision

Solvency supervision of an insurance company starts with granting a licence, then is carried out regularly, at least on an annual base. Supervision of solvency ends with the winding-up of a company.

The Austrian Supervisory Authority, organised in three departments, checks if insurance undertakings, asking for a licence, possess adequate financial resources. At least once a year, it controls if the undertakings meet the solvency requirements, in order to be permanently capable to meet the obligations arising from the insurance contracts. The Supervisory Authority analyses the returns of the insurance companies, verifies the data directly with the undertakings, carries out regular on-the-spot investigations and looks at the current financial development of the companies.

IV Measures when difficulties arise (recovery measures)

In case the company's own funds fall below the solvency requirement the undertaking has to submit a plan for restoration of a sound financial position for approval to the Supervisory Authority (*solvency plan*).

The guarantee fund is usually one third of the solvency requirement, but must not be less than 50 (30; 30) million S as to undertakings transaction only life assurance (health insurance; accident insurance) and 40 (20; 20) million S as to undertakings transacting life insurance (health insurance; accident insurance) and being active in more than one branch. (The amounts are halved for foreign insurance companies). In case the company's own funds fall below the guarantee fund, the undertaking has to submit a short term financing scheme for approval to the Supervisory Authority (*financing plan*).

The Supervisory Authority is authorised to *prohibit free disposal* of all or part of the assets of the insurance company, if:

- the company's own funds fall below the solvency requirement and a deterioration of the financial situation is expected;
- the company's own funds fall below the guarantee fund;
- if the company hasn't established sufficient technical provisions or if the technical provisions aren't covered by matching assets.

The Supervisory Authority is authorised to withdraw the licence if the insurance company fails to take measures to fulfil the solvency (or the financing) plan within the prescribed time.

BELGIUM

I Regulations concerning the supervision of solvency

The solvency of insurance companies is supervised at a number of levels.

A. Solvency margins

The regulations on supervision follow EC Directives regarding the solvency margins that insurance companies should maintain, in both life and non-life business, in order to cover underwriting risks.

The *constituted solvency margin* corresponds to a company's assets, free of any foreseeable liabilities, less non-disposable intangible items.

The following elements are taken into account to constitute the solvency margin relating to non-life and life business:

- Paid-up authorised capital plus paid-in surplus or, for a mutual insurance association, initial paid-in funds plus members' accounts that satisfy certain criteria;
- Half of the company's unpaid authorised capital or initial funds, provided that at least 25 per cent of the total capital or initial funds is paid up;
- Uncommitted reserves, whether statutory or free;
- Profit or loss brought forward from previous years;
- Subordinated debt, subject to the following limitations:
  - Aggregate subordinated debt may constitute no more than 50 per cent of the margin, and fixed-term subordinated debt no more than 25 per cent.
  - For an issue to be taken into account, the indenture must stipulate that, in the event of the insurance company's bankruptcy or liquidation, the debt shall be subordinate to all other claims and shall be redeemable only after all other outstanding liabilities have been settled.

- Furthermore, subordinated debt is taken into account only in respect of the proceeds actually received, and provided that the issue complies with regulations.

- Perpetual securities and other instruments; (Only the proceeds actually received shall be taken into account, and the total of such securities plus the subordinated debt referred to above shall not together constitute more than 50 per cent of the margin. To be taken into account, perpetual securities and other instruments must also satisfy the following conditions:

  - It is not redeemable without the Office of Insurance Supervision's prior consent.

  - The indenture gives the insurance company the option to defer interest payments.

  - The lender's claims on the insurance company are entirely subordinate to those of all unsubordinated creditors.

  - The documents regulating the issue of the securities stipulate that losses may be offset by the debt and unpaid interest without preventing the insurance company from continuing its business).

The following elements are taken into account to constitute the solvency margin relating to non-life business only:

- The amount of supplementary contributions for which a mutual association may assess its members for the year, up to one-half the difference between the maximum supplementary contribution that may be assessed under the by-laws, and contributions already notified, with this amount not exceeding 50 per cent of the margin;

- On application by the company, with supporting documents, to the Office of Insurance Supervision, capital appreciation due to undervaluation of assets, provided that the capital appreciation is not exceptional.

The following elements are taken into account to constitute the solvency margin relating to life business only:

- Capital appreciation due to undervaluation of assets or overvaluation of liabilities other than life insurance provisions, provided that this capital appreciation is not exceptional;

- A percentage of the company's future life insurance profits, within regulatory limits;

- The undepreciated acquisition costs contained in the technical provisions, within regulatory limits.

The amount of the *solvency margin to be constituted* for non-life insurance is determined in relation to either annual premiums or the average claims ratio over the last three (and in some cases seven) financial years.

For life insurance, a different basis is used, based on the amount of mathematical provisions and the level of risk-reserve capital.

The regulations require a minimum solvency margin (or a minimum guarantee fund), the amount of which varies from one class of insurance to another and fluctuates in line with the European currency unit, subject to a threshold, however, for non-life insurance.

B. Technical provisions

Insurance companies are required to calculate and book as technical provisions the obligations that they assume under the insurance contracts they have issued, or that are imposed on them by the relevant laws and regulations. These technical provisions must be constituted on a gross basis (before reinsurance).

Insurance companies must set aside sufficient technical provisions, and book sufficient technical liabilities, to be able at all times to meet all their commitments under insurance contracts.

Technical provisions for non-life insurance must comprise:

- A provision for unearned premiums and outstanding risks.

The provision for unearned premiums corresponds to the portion of gross premiums (before reinsurance) that must be allocated to the following financial year, or to later years, to cover claims, administrative expenses and investment management charges.

The provision for outstanding risks is supplementary to the provision for unearned premiums. It is constituted if it is estimated that the total of claims and administrative expenses arising from outstanding policies and yet to be incurred by the company will exceed aggregate unearned premiums and premiums payable under the said policies.

- A provision for claims.

This provision corresponds to the estimated ultimate total cost to the company of all claims to date, whether reported or not, less any amounts already paid out in respect of those claims. It includes indemnities and internal and external claims management costs.

No deduction may be made to allow for investment income, except as permitted by the Office. Unrealised recoveries, including accidental damage excess to be recovered, may not be deducted from the provision for claims.

– A provision for equalisation and catastrophe risks.

This provision is constituted in order to compensate for a non-recurring technical loss, to smooth out fluctuations in the claims rate, or to cover special risks, in the years ahead.

It must be set up for the following risks: credit risk, risks due to natural elements, risks in the area of nuclear power, liability risks arising from pollution or defective products, aerospace risks and risks of terrorism and labour conflict.

– A provision for ageing.

Where claims rates increase with age, this provision corresponds to the estimated present value of the insurance company’s future commitments, less the estimated present value of future premiums.

– A provision for bonuses, including premium rebates allocated but not yet paid out.

– Any other provision the Office might require.

Technical provisions for life insurance must comprise:

– A provision for life insurance.

This provision is calculated in accordance with the regulations governing life insurance business.

– A provision for claims.

This provision corresponds to benefits incurred but not yet paid, and to the corresponding external and internal management costs.

– A provision for bonuses, including premium rebates allocated but not yet paid out.

C. Assets representing technical provisions

Technical provisions must at all times be backed up by equivalent assets that belong in full to the insurance company and are set aside to guarantee its commitments towards policyholders and beneficiaries, by class of business (there are a number of distinct classes, depending on whether the business is life or non-life, direct insurance or acceptance of reinsurance, etc.).

Assets representing technical provisions and liabilities must take into account the type of business carried out by the insurance company in order to ensure the safety, profitability and liquidity of its investments; the insurance company must ensure that its investments are sufficiently diversified and dispersed.

In addition, the assets representing provisions must be located:

- In the European Union, in the case of Belgian companies. Financial assets located outside the EU are also acceptable, provided that the National Bank or a foreign credit institution, brokerage firm or investment company licensed by the Banking and Finance Commission or by the competent authority of an EU Member State certify that it holds those assets, on the insurance company's behalf, through an establishment in the Union or in a credit institution or investment company established outside the Union that is licensed by a public body that performs a role similar to that of the Banking and Finance Commission.
- In Belgium, for Belgian establishments of third-country enterprises. Financial assets located outside Belgium are also acceptable, provided that the National Bank or a foreign credit institution, brokerage firm or investment company licensed by the Banking and Finance Commission or by the competent authority of an EU Member State certify that it holds those assets, on the insurance company's behalf, through an establishment in Belgium, in a credit institution or investment company established outside Belgium that is licensed by a public body that performs a role similar to that of the Banking and Finance Commission.

The location of an asset, real or financial, signifies the presence of that asset within the borders of a given country. Assets in the form of financial claims are considered to be located in the country in which they may be redeemed.

Assets representing provisions must satisfy regulatory matching requirements.

In addition, such assets must belong to one of the following categories of investments:

- Bonds;
- Equities and other variable-income securities;
- Shares in collective investment undertakings that invest in cash, other financial assets and real estate;
- Other money and capital market instruments;
- Call or put options on financial assets, futures contracts, and other derivative instruments that are traded on a regulated market that is liquid, recognised, open to the public and functioning in a normal manner, insofar as they help reduce investment risk or enhance portfolio management efficiency;

- Loans backed by sufficient guarantees;
- Real estate, claims on real estate, or real estate certificates;
- Claims on reinsurers (such claims need not be located in the EU, but they must be acknowledged in writing by the reinsurers and collateralised, under terms acceptable to the Office);
- Reinsurers' share in technical provisions, under terms acceptable to the Office;
- Claims on insurance buyers and intermediaries, arising from direct insurance transactions, except for claims in respect of premium payments that are more than one month overdue;
- Claims arising from recovery or subrogation and relating to Class 14 transactions (although such claims may be designated in respect of this one class only);
- Uncontested tax claims;
- Demand deposits or term deposits at the National Bank or a credit institution licensed by the Banking and Finance Commission or by the competent authority of an EU Member State in which that credit institution is headquartered;
- Policy loans, if authorised under the regulations governing the life insurance business (although such loans may be designated only in respect of the separate "life" class referred to in Section 9);
- Interest and rent accrued but not yet due on the designated assets (although such interest and rent may be designated only in respect of the same separate class as the corresponding assets; furthermore, interest accrued but not yet due may be designated only if it is not already included in the value of an asset belonging to another category);
- The Office may, under exceptional circumstances and for the duration thereof, accept other categories of investments that comply with the aforementioned principles of safety, profitability, liquidity, diversification and dispersal, and grant exemptions from asset location requirements.

The regulations set maximum percentages for certain assets or groups of assets.

Moreover, no more than 5 per cent of the assets representing an insurer's technical provisions and liabilities may consist of investments in equities or other money market or capital instruments from a single issuer, or of loans to a single borrower, taken in the aggregate. A number of exceptions are provided for, however.

The regulations also set the rules for estimating the value of assets.

D. Product profitability

Belgium believes that judicious pricing is the best guarantee of a company's financial soundness, and consequently of its solvency. In the long term, a company cannot set aside sufficient assets or increase its solvency margin unless it receives adequate premiums.

The regulations regarding the content and practical organisation of the supervision of profitability are explained in the Appendix.

E. Shareholders and insurance company officers

Recently, legislation has focused closely on shareholders and corporate management, and standards have been set for the professional ethics and qualifications of company officers.

F. Reinsurance

When they are licensed, companies must provide information concerning the method of reinsurance and the names of reinsurers. Any subsequent changes must be reported.

II Practical organisation of supervision

The supervisory authority is the Office of Insurance Supervision.

Financial supervision is conducted on the basis of the following documents:

- The annual accounts, including the balance sheet, the profit and loss account, notes on the accounts and an itemised breakdown of the profit and loss account;
- The annual statement of the constituted solvency margin, together with an estimate of the margin to be constituted;
- Statistics to be provided for each category of products, for purposes of supervising profitability and technical provisions (including the amount of annual benefits and provisions for claims);
- Information on pricing and the technical basis for calculating premiums and technical provisions for life insurance;
- Regarding representative assets: companies must keep an ongoing record of the assets for each separate class and file a statement of asset valuation for each type of investment with the Office of Insurance Supervision by 31 December of each year. Furthermore, at the end of each quarter, the company must report any changes regarding the assets allotted to each separate class, as well as an estimate of the amount of technical provisions.

In addition to a review of company-supplied data, on-site inspections are conducted. Office inspectors are empowered to demand all the information and documents they need to verify compliance with the laws and regulations applicable to licensed insurers.

In addition to supervision by these inspectors, who are part of the regular staff of the Office, audits are conducted by auditors appointed by the supervisory authorities, under the supervision of the Office. These auditors report on the financial situation and management of companies at the request of the Office, or at least once yearly.

Since 1991, the Insurance Supervision Act has required insurance companies to designate one or more actuaries who must be consulted with respect to pricing, reinsurance and the amount of technical provisions or reserves. Their opinions may be of assistance to the supervisory authority.

In addition, life insurance regulations require that an actuary prepare an annual report to the supervisory authority, indicating theoretical surrender values, the present value of insured benefits, zillmerisation values, valuation reserves and technical provisions broken down into mathematical balance sheet provisions, dividend funds and provisions for benefits to be paid out, as well as the information needed to justify any difference between mathematical balance sheet provisions and valuation reserves.

III Measures taken when difficulties arise (recovery measures)

If a company is not complying with the requirements for technical provisions and the corresponding assets, the Office of Supervision can restrict or prohibit the free disposal of assets. It can also require the company to increase its technical provisions and can take any additional steps required to protect the interests of insurance buyers, policyholders and beneficiaries.

To enable a company to recover when its solvency margin falls below the minimum amount, the Office requires that the company submit a recovery plan, and if it does not, the Office will impose its own plan. If the Office deems that the company's position is likely to deteriorate further, it can restrict or prohibit the free disposal of assets.

If a solvency margin falls below the level of the guarantee fund (one-third of the margin, at the very least), the Office requires the company to submit a short-term financing plan. The Office can restrict or prohibit the company's free disposal of its assets and take any additional steps required to protect the interests of policyholders and beneficiaries.

When the Office of Insurance Supervision finds that a company is not operating in accordance with the law or regulations, that poor management or a weak financial position is threatening the firm's ability to meet its commitments or that the company's management, accounting or internal control systems have serious defects, it sets time limits within which the situation must be corrected. If this is not done, the Office of Insurance Supervision may:

- Appoint a special auditor;
- Prohibit certain transactions or restrict business activities;
- Transfer some or all of its policies to another company;
- Require that managers, board members or general authorised agents be replaced within specified time limits, and if they are not, it may replace the firm's entire management staff with a provisional manager who will have complete authority to manage the company.

When an insurer's performance is such that the interests of policyholders and beneficiaries are at risk, the Office of Supervision may recommend that the firm take all necessary steps with a view to its merger with, or absorption by, another licensed company.

The Office of Supervision can also require that a company adjust a tariff appropriately if it observes that the pricing is causing the company to incur losses.

Lastly, its licence may be revoked by royal decree, on recommendation of the Office of Supervision, if a company:

- No longer meets the initial licensing requirements;
- Is seriously in breach of the regulations, especially with regard to the constitution of technical provisions or reserves and the corresponding assets;
- Was unable to meet the time limit for compliance with the provisions of a recovery or financing plan.

The revocation can apply either to all classes of insurance written by the company or to one or more particular classes.

The licence is revoked automatically if a company goes bankrupt or is dissolved. This revocation applies to all classes of insurance written.

**Annex to the Note by the Belgian Delegation
Concerning Insurance Supervision**

A. Introduction

Since 1975, the Office of Insurance Supervision (*Office de contrôle des assurances*, OCA) has overseen the solvency of insurance companies. In practice, the Office supervises an insurer's overall solvency, even though solvency margins are calculated separately for life and non-life insurance.

However, the solvency margin does not provide an absolute guarantee of solvency. It is calculated on the basis of premiums, which means that if the volume of premiums is low, the margin will be small. Furthermore, it is not possible to determine the causes of an insurance company's difficulties, nor to evaluate its medium or long-term prospects, on the basis of the solvency margin.

B. Rates

Prior to July 1991, rates were not subject to prior approval. They were approved on a rule-of-thumb basis, since the statistics needed to calculate the technically correct premium for each risk were not available.

Nevertheless, this procedure rarely gave rise to problems:

- There were almost no bankruptcies.
- There were imposed rates for certain mass risks (e.g. motor liability insurance).
- There were market agreements.
- In classes where there was systematic under-pricing, losses were offset by the profits from other life or non-life classes.

This situation is likely to change fundamentally over the next few years because of increased competition. As insurance companies are forced to become more competitive, there will be pressure on them to pare down rates to the minimum in a number of classes.

For this reason, there was a need to reinforce rate supervision; this could only be done retrospectively, after examining companies' results.

Consequently, the Insurance Supervision Act was amended on 19 July 1991. The new legislation confirmed the principle of retrospective supervision. Moreover, Article 21*bis* now empowers the Office to require an insurance company to raise its rates if they are shown to be unprofitable.

C. General principles

It is a basic principle of business that a company cannot sell its products at a loss. Furthermore, each product should be profitable in its own right. Although a company will not necessarily fail because it is undercharging for a given product, it is unacceptable - and unfair - that policyholders in one class of insurance should cover systematically the losses of another class.

Properly priced products are the best guarantee of a company’s financial soundness, and therefore of its solvency. In the long term, a company cannot build up substantial provisions or maintain its solvency margin unless it charges adequate premiums.

If supervision is limited only to a company’s overall financial position, then, as in the past, problems will not be detected until it is already too late, or until the only solution is to issue new equity.

Supervision of product profitability is an extremely effective way of getting companies to do something about excessively low rates before their overall position deteriorates. This does not necessarily mean that they have to raise rates; other measures can be considered (e.g., changes in the terms of insurance or acceptance policies, tighter control of certain costs, etc.).

Product profitability is generally calculated without taking into account income from free assets or deferred (unrealised) capital gains. However, elements such as capital gains realised on investments and depreciation or recoveries of depreciation on investment property should be included.

The analysis should be as factual as possible. Profitability should be examined over a number of years, taking account of the exceptional or recurrent nature of certain events. If necessary, the measures needed to redress the situation can be taken gradually so as not to create insurmountable difficulties in the short term.

D. Implementing supervision of profitability

The tremendous diversity of insurance products makes it impossible to supervise the profitability of each individual product. Even if this were feasible, the results would often have little significance because of the small number of contracts written for some risks.

Consequently, the Office decided to concentrate on the largest categories of contracts in each class of insurance (e.g., home fire insurance, personal life insurance in classes 21, 22 and 26, etc.).

Profitability is analysed using statistics for 33 categories of non-life products and 7 life products.

The attached table shows the different headings that make it possible to analyse the profitability of all of the categories mentioned above.

The key item is the *gross technical-financial balance*. The gross balance (before reinsurance) was selected because for many categories of products reinsurance data are either non-existent or unreliable.

This emphasis on the gross balance in no way signifies a lack of interest in reinsurance ceded. Reinsurance should play its "normal" role (for example, it would be absurd to require a balanced gross technical-financial balance in a year in which a major catastrophe occurred and was totally covered in a reinsurance treaty; that being said, it is absolutely necessary to re-establish profitability when a company resorts to reinsurance to offset a structural deficit on a category of products).

The following additional information is also relevant:

– *Operating expenses*

Companies are required to break down these expenses amongst the various categories of insurance products and to provide the Office with documentation supporting the breakdown. It has proven impossible to provide companies with clear-cut rules in this regard.

– *Technical provisions*

It is important to have an accurate idea of the "normal" amount of these provisions in order to calculate the profitability of product categories accurately. In addition to carrying out on-site inspections, the Office requires companies to complete detailed annual questionnaires regarding their methods of constituting provisions. Furthermore, new statistical documents include more information on loss provisions (especially per underwriting year and, in general, per ten-year period).

– *Financial returns*

The Office has developed a standard method for calculating the financial return on each category of insurance product. It is in fact an overall method. A rate of return is calculated by dividing a company's aggregate financial income by its aggregate assets (without distinguishing between representative assets and other assets, or between life and non-life business). The rate obtained is applied to the amount of technical provisions for each category of insurance product.

However, companies are free to choose another method as long as it complies with the principles explained above (see Section III). If necessary, the Office will analyse any significant difference between the results obtained using the Office's method and that of the company.

– *The accounting year and the underwriting year*

During an initial phase, only the results of the accounting year will be examined. However, the ultimate goal is to refine the analysis so that conclusions can be reached and measures taken on the basis of the underwriting year.

– *Direct business in Belgium*

Current statistics allow the supervisory authorities to analyse product category profitability in respect only of direct insurance operations in Belgium.

It is planned to expand the statistics so that the same kind of study can be carried out for accepted reinsurance and for insurance activities abroad (whether or not the company has an establishment abroad).

Items studied for the supervision of profitability

	Code (Breakdown of Annual Accounts, Chapter II, Section I)
I. Premiums and charges	
+ 1.1. Premiums written and to be written	002 + 004 – 0
a) Amount of premiums subject to contribution to the Belgian National Sickness and Invalidity Insurance Institute (INANI)	
+ 1.2. Policy and endorsement fees	006
II. Benefit payments, recoveries and handling of claims	
2.1. Direct payments to beneficiaries	032
- 2.2. External costs of settling claims	033
- 2.3. Internal costs of settling claims	(149) – (148)
+ 2.2. Recoveries of technical expenses	021
III. Technical provisions and estimated recoveries	
+ 3.1. Provision for unexpired risks, outstanding claims and probable losses, beginning of year	009
a) Provision for unexpired risks and outstanding claims	
b) Provision for probable losses	

	Code (Breakdown of Annual Accounts, Chapter II, Section I)
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a) Provision for unexpired risks and outstanding claims	
b) Provision for probable losses	
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a) Provisions for reported claims	
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a) Provisions for reported claims	
b) Provisions for claims IBNR	
c) Provisions for internal claims settlement costs	
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- 3.9. Provision for equalisation or balancing, end of year	(052)
3.10. Provision for equalisation, transferred	( )
+ *a*) Received	
- *b*) Ceded	
+ 3.11. Other technical provisions, beginning of year	(053)
a) Provision for ageing	
b) Other provisions	
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a) Provision for ageing	
b) Other provisions	
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+ *a*) Received	
- *b*) Ceded	
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	Code (Breakdown of Annual Accounts, Chapter II, Section I)
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CANADA

The following provides a general overview of the regulatory regime in Canada. A more detailed discussion of the subject as respects life insurance companies was presented to members of the OECD Insurance Solvency Committee at their inaugural meeting on 22 April 1993.

I Regulatory framework and supervisory approach

A. Canadian insurance industry

The Canadian insurance industry consists of both Canadian incorporated insurers (either federally or provincially) and insurers incorporated outside Canada. The Canadian market is dominated by federally incorporated insurers ("Canadian companies") and by foreign insurers operating a branch in Canada ("foreign companies"). Provincially incorporated insurers represent only 5 per cent of the market.

The federal and provincial governments share responsibility for insurance regulation in Canada. Federal authorities are responsible for ensuring the solvency of Canadian companies and the Canadian branch operations of foreign companies. Provincial authorities are responsible for reviewing and interpreting insurance contracts, licensing and supervising agents and ensuring the solvency of provincially incorporated insurers. In addition to becoming federally registered, a Canadian company or foreign company must also be licensed in every province and territory where it proposes to carry on business (there are 10 provinces and 3 territories, each with their own governing statute).

B. Regulatory authority

The Office of the Superintendent of Financial Institutions ("OSFI"), a federal agency, is the primary regulator of insurance companies in Canada. OSFI also regulates banks, federally incorporated trust and loan companies and pension plans of federally regulated industries. The Superintendent of Financial Institutions reports to the Minister of Finance.

OSFI is charged with the administration of the Insurance Companies Act ("ICA"), a federal statute applicable to life and non-life Canadian and foreign insurance companies. The rules are basically the same for all companies; the main difference is that foreign companies are required to vest in trust in Canada assets to cover their Canadian liabilities plus a margin. There are no significant differences in the rules applicable to direct writers and professional reinsurers.

The ICA contains provisions governing the incorporation and registration of Canadian and foreign companies, the capital structure and corporate governance of Canadian companies, the business and powers of Canadian companies, the investment rules, the capital adequacy rules and self-dealing rules applicable to Canadian and foreign companies, and the filing requirements applicable to Canadian and foreign companies. The ICA also gives the superintendent broad discretion to issue directions of compliance, to impose restrictions on a company's authority to insure risks, and to take control of a company or its assets when circumstances warrant.

C. Control of entry

The ability to maintain regulatory control over new entrant is a key element in ensuring the health of the Canadian insurance industry. The ICA sets out certain factors that the Minister must take into account before issuing letters patent incorporating a Canadian insurance company. These factors include the nature and sufficiency of the financial resources of the applicant as a source of continuing financial support for the new company, the soundness and feasibility of the company's business plans, the business record and experience of the applicants, the character and integrity of the applicants, or if the applicant or any of the applicants is a body corporate, its reputation for being operated in a manner that is consistent with the standards of good character and integrity, the competence and experience of company management, the impact of any integration of the operations and businesses of the applicant with those of the company on the conduct of those operations and businesses, and the best interests of the financial system in Canada. The ICA stipulates that a new Canadian company must have at least CS$5 million of capital or such higher amount as the Minister may require before commencing business.

In practice, OSFI requires that the amount of initial capital be adequate to meet the new company's needs for the first three to five years. In addition, a company specialising in reinsurance or some other speciality class like title insurance or mortgage insurance must have more capital than the statutory minimum. The OFSI routinely obtains police reports on directors and senior officials of a proposed new company.

A foreign company wishing to carry on insurance in Canada on a branch basis must first obtain the approval of the Minister. Before granting approval, the Minister must be satisfied that the foreign company is capable of making a contribution to the financial system in Canada.

There are several criteria that must be met before OSFI would be prepared to consider an application by a foreign insurer for registration in Canada. The applicant must have assets of at least C$ 200 million with capital and surplus of at least 20 per cent of assets for foreign non-life insurers and assets of at least C$ 500 million with a minimum capital and unappropriated surplus margin between 5 and 10 per cent of liabilities, the lower level becoming operative where assets exceed $500 million for foreign life insurers. The applicant must also have a successful record of operations in its home jurisdiction. In addition, OSFI must be satisfied that the company's business plans for Canada are acceptable and that the company will maintain adequate records in Canada.

D. Changes in ownership

Control on entry to the Canadian financial system is meaningless without similar controls on changes in ownership. The ICA stipulates that where more than 10 per cent of any class of shares of a company is purchased or otherwise acquired, the prior approval of the Minister is required. Any change in the control of a company is very significant to the regulator. Such situations are reviewed in much the same way as a new incorporation.

E. Fundamental changes

Demutualization, amalgamation, and business transfers are all fundamental changes, which can impact on the financial health of a company and consequently require the prior approval of the Minister. In most situations, the ICA requires that an independent actuary reports on the transaction and that the policyholders be informed.

It is standard practice for OSFI to request detailed proforma statements showing the effect of the proposed transaction on the parties involved. Considerable reliance is placed on the opinion of the independent actuary. OSFI would not likely support any transaction that would adversely affect policyholders of either company.

F. Capital adequacy – Life companies

The ICA requires Canadian life companies to maintain adequate capital, and adequate and appropriate forms of liquidity, and to comply with any regulations made in this regard. No regulations have been proclaimed to date, however, companies are expected to follow the Minimum Continuing Capital and Surplus Requirements ("MCCSR"). These requirements are set out in a guideline. A guideline is used because it is easier than legislation to change and update. The most recent version of the MCCSR guideline was issued in October 1997.

MCCSR measures the capital required by a company against the capital it has available at a certain date. The amount of capital required is based on a risk weight system similar to that in place for banks. The main difference is that, in the case of life companies, factors are applied to both assets and liabilities. The elements of capital acceptable to meet requirements are similar to those applicable to banks; two tiers of capital are acceptable, tier 1 consisting of capital with the most permanence and having no fixed interest or dividend charges. All capital must be subordinate to policyholder obligations.

The Superintendent may, by order, direct a company to maintain more capital than required under the MCCSR guideline. If a company's capital falls below the required level, the Superintendent, working with management, the appointed actuary, the board of directors and the external auditor, will require remedial action to be taken. The Minister is kept informed as to the financial strength of all companies.

Similar rules apply to foreign life companies in respect of their Canadian business. They are required to maintain an adequate margin of assets in Canada over liabilities in Canada, and adequate and appropriate forms of liquidity, and to comply with any regulations made in this regard. For foreign companies, the Test of Adequacy of Assets in Canada and Margin Requirements (TAAM) measures the assets required to be maintained in Canada against the assets available in Canada.

OSFI has established minimum capital levels for tier 1 capital at 60% of MCCSR and total capital at 120% MCCSR/TAAM. However, OSFI expects companies to establish target capital levels, and maintain ongoing capital, at no less than 105% MCCSR for tier 1 capital and at no less than 150% MCCSR/TAAM for total capital. The Superintendent may, on a case-by-case basis, establish in consultation with an institution an alternative supervisory target level based on an individual institution's risk profile. Companies falling below this level will be asked to submit business plans showing measures to be taken to restore capital to acceptable levels, will be subject to enhanced regulatory scrutiny including: more frequent reporting and examinations.

G. Capital adequacy – Non-life companies

The ICA requires non-life companies to maintain assets equal to their policy and other liabilities plus a margin equal to the greatest of the results of three calculations using: 1) unearned premiums and unpaid claims, 2) premiums written, 3) claims incurred over three years. These rules, which have been in place for several years, are spelled out in regulations. As in the case of life companies, the Superintendent may, by order, direct a company to increase its assets above the level required by the regulations. The sanctions against a company that fails to comply with the capital adequacy rules are the same as for a life company. The same rules apply to foreign non-life companies in respect of the assets they maintain in Canada to cover their Canadian liabilities.

OSFI, in conjunction with provincial insurance regulators in Canada has developed a risk-based Minimum Capital Test (MCT) for Canadian insurers and a similar test for foreign companies called the Branch Adequacy of Assets Test (BAAT). The primary difference between the BAAT and the MCT is that the BAAT is subject to the vested asset regime described above. These tests have been applied on a trial basis for several years, in parallel with the existing solvency tests and will continue to apply on a trial basis for 2002. Beginning in 2003 insurers will be required to file the new tests on a compliance basis.

Requirements of the new tests are specified by guidelines and are aligned with the basic approach in the life and deposit-taking institution sectors in Canada. The basis of the MCT/BAAT will change from an assets required approach under current P&C solvency tests to a capital adequacy approach that incorporates the major elements of risk. The tests measure the capital required by a company against the capital it has available as at a specific reporting date. The amount of capital is based on a risk weight system similar to that in place for life companies and banks. As with life companies, factors are applied to both assets and liabilities. The elements of capital acceptable to meet requirements are similar to those applicable to life companies and all capital must be subordinate to policyholder obligations. A key distinction of the MCT/BAAT is that it is not subject to a tiered capital approach that applies in the life and deposit-taking institution sectors. OSFI will apply an approach that is in principle similar to the approach for life companies, with an industry-wide target level and a minimum level.

H. Financial reporting

The ICA stipulates that a company shall provide the Superintendent with such information, at such times and in such forms as the Superintendent may require. This gives the Superintendent maximum flexibility. The ICA also sets out the type of information required as part of an annual return and the deadline for filing such return. Canadian companies and foreign companies alike must file audited returns. In addition, the return is not complete unless accompanied by the report of the appointed actuary.

In practice, all life and non-life companies are required to submit quarterly financial statements. Problem companies may be required to report more frequently. Special filings are required on an *ad hoc* basis; for example to determine exposures to specific risks or events such as the September 11 tragedy.

All companies file their annual and interim return data on diskettes, hard copies are also provided of the annual returns.

I. On-site examinations

The ICA requires the Superintendent to cause an examination or enquiry to be made into the business and affairs of each company at least once a year or, if circumstances warrant, less frequently, but not less frequently than once every three years. The stated purpose of the examination is to satisfy the Superintendent that the company is complying with the Act and is in a sound financial condition.

For the most part, companies are examined every two years by a team of OFSI examiners assisted by actuarial staff and on occasion, by outside credit consultants. The examination concentrates on those risk areas identified by OSFI staff in a pre-examination analysis of the company. The examiners also rely on the work of the external auditor. Where an insurance company is part of a conglomerate involving other federally regulated financial institutions, for example, banks or trust or loan companies, every effort is made to co-ordinate an examination of all federally regulated institutions at the same time. In addition, OSFI tries to ensure the sharing pertinent information among staff responsible for supervision companies in a conglomerate. Examination results are incorporated in a monthly report to the Minister on problem companies.

J. Remedial powers

One of the remedial powers available to the Superintendent is the issuance of a direction of compliance where a company or a person connected to a particular company, such as an officer or director, is committing or is about to commit an act that is unsafe or unsound or is pursuing or is about to pursue a course of conduct that is unsafe or unsound. The company or person to whom the direction of compliance is directed is normally given an opportunity to make representations before the direction is issued. However, the Superintendent may issue a temporary direction which has immediate effect if the Superintendent believes that the circumstances warrant. This power has seldom been used. The threat of issuing such an order is often sufficient to correct the unsafe or unsound practice.

II Supervising problem companies

A. Early warning systems

Over the years OSFI has developed a comprehensive procedure for identifying potential problem companies and action plans for dealing with such companies. OSFI reports to the Minister every month on problem companies outlining the problems and the proposed action. Some of the factors used in identifying problem companies are:

- incomplete filings;
- MCCSR less than 150 per cent or target capital level (life companies);
- asset margin 10 per cent (non-life companies);
- owners unable or unwilling to inject capital;
- weak management / inadequate internal controls;
- parent or affiliate in difficulty;
- inadequate or aggressive premium rates;
- succession of operating losses;
- lack of experience in new lines of business;
- material change in senior management;

- inadequate claims or policy reserves;
- high overhead expenses;
- questionable reinsurance arrangements;
- inadequate records;
- regulatory action taken in home jurisdiction.

B. Remedial actions

Once a company is identified as a problem company OSFI may take action as follows depending on the nature and severity of the problem:

- monitor company more closely;
- require company to file business plans and interim statements;
- conduct a special on-site examination;
- hire credit consultants to apprise asset portfolio;
- request additional capital or assets in Canada;
- issue a direction of compliance for unsafe or unsound business practice;
- restrict company's premium volume, investment activity or investing or lending operations.

The ICA provides that in certain specified circumstances the Superintendent may take control, for a period not exceeding sixteen days, of assets of the company. Such circumstances include where the company has failed or may be unable to pay its liabilities, a practice or state of affairs exists in respect of the company that may be materially prejudicial to the interests of its policyholders, the assets are not sufficient to give adequate protection to its policyholders, the assets are not satisfactorily accounted for, the regulatory capital has reached a level or is eroding in a manner that may detrimentally affect its policyholders, or the company has failed to comply with an order of the Superintendent. The Superintendent may take control for a period exceeding sixteen days, unless the Minister is of the opinion that it is not in the public interest to do so.

While the Superintendent has control, he can request the Attorney General to apply for a winding-up order against the company. The winding-up of a company is a last resort. OSFI will make every effort to assist the company in a reorganisation or restructuring to correct the problems. However, if it becomes obvious that the company cannot be saved then immediate action will be taken to minimise loss to policyholders and creditors.

Further information is available at OSFI's website at www.osfi-bsif.gc.ca

CZECH REPUBLIC

I Solvency margin

In accordance with the requirements of EC directives, the solvency of insurance companies is regulated. This includes a guarantee fund, which is a necessary criterion of the evaluation of the solvency of beginning insurance companies in particular. Similar conditions are stipulated for the activities of reinsurance companies.

Given the specific nature of the business of foreign insurance companies, the manner of reporting their solvency is also regulated. The basis for the evaluation of their financial stability with the aid of solvency indicators is the report that such insurance company submits to the supervisory authority of the country in which it has its registered office. If such a report has not been introduced in the country of its registered office or would not meet the stipulated conditions, such insurance company is to prepare a solvency report pursuant to the given legislation.

According to the Act on Insurance No.363/1999 Coll., an insurance and reinsurance company is obliged to report its solvency to the Ministry of Finance within 30 days from the date of the issue of the auditors statement in respect of the examination of the annual accounts or at any time upon the request of the Ministry. An insurance or reinsurance company is obliged for the entire duration of its activity to have available own resources at least in the amount of the minimum solvency margin, which means the amount of own resources calculated in a manner which the Ministry stipulated by the Decree No.75/2000 Coll.

A. Guarantee fund

One third of the minimum solvency margin shall constitute the guarantee fund. The guarantee fund may not, however, be less than

- CZK 40 000 000,- if an insurance activity is carried on according to one or more classes of life assurance,
- CZK 40 000 000,- if an insurance activity is carried on according to one or more classes No. 10, 11, 12, 13, 14, and 15 of non-life insurance,

- CZK 30 000 000,- if an insurance activity is carried on according to one or more classes No. 1, 2, 3, 4, 5, 6, 7, 8, 16 and 18 of non-life insurance,
- CZK 20 000 000,- if an insurance activity is carried on according to one or both classes No. 9 and 17 of non-life insurance.

If an insurance activity is carried on simultaneously for classes of life assurance and non-life insurance or for more classes of non-life insurance, the provisions concerning share capital shall adequately apply to the calculation of the amount of the guarantee fund.

The provisions mentioned above apply adequately to an activity of a reinsurance company, in which case the Ministry may require of the reinsurance company higher amounts depending on the risk level of reinsurance activity carried on, however not more than fivefold the amounts stipulated.

The Ministry stipulated the way of the determination of the value of own resources and the manner of reporting on solvency by the Decree. A foreign insurance company, with the exception of the insurance company having its seat in the territory of Member States of the European Union carrying on an insurance activity in the territory of the Czech Republic through its organisational unit is obliged to place a part of its own resources in the Czech Republic. The amount of this part of financial resources corresponds to that part of the minimum solvency margin which is linked to the volume of the insurance activity in the territory of the Czech Republic, not less, however then one half of the guarantee fund.

B. Classes and Groups of Insurance

Classes of Life Insurance

- Insurance on death, assurance on survival or assurance on death or on survival
- Marriage assurance or insurance of benefits for child’s maintenance
- Annuity assurance
- Assurance referred to in 1 through 3 linked to an investment fund
- Capitalisation
- Personal accident and sickness insurance if supplementary to classes 1 through 5

Classes of Non-Life Insurance

1. Accident insurance
    - with lump sum settlement
    - with benefits in the nature of indemnity
    - combination of the two
    - of passengers

2. Sickness insurance
    - With lump sum settlement
    - With benefits in the nature of indemnity,
    - combination of the two
    - contractual health insurance

3. Insurance against damage to or loss of land vehicles other than railway rolling stock
    - motor vehicles
    - other than motor vehicles

4. Insurance against damage to or loss of railway rolling stock

5. Insurance against damage to or loss of aircraft

6. Insurance against damage to or loss of
    - inland vessels
    - sea vessels

7. Insurance of goods in transit including luggage and other property irrespective of means of transport used

8. Insurance against damage to or loss of property other than included under 3 through 7 above caused by
    - fire,
    - explosion,
    - storm,
    - natural forces other than storm(e.g. lightning, flood, inundation),
    - nuclear energy,

- land slide or subsidence.

9. Insurance against damage to or loss of property other than included in 3 through 7 above due to hail or frost, or any other event (such as robbery, theft or damage caused by forest animals) if these are not included in class 8, inclusive of insurance against damage to or loss of farm animals caused by infection or by other causes.

10.
   - Liability insurance for damage arising out of ownership or use of land motor transport means vehicles, including carrier's liability.
   - Liability insurance for damages arising out of ownership or use of rail vehicle, including carrier's liability.

11. Liability insurance for damage arising out of ownership or use of aircraft, including carrier's liability.

12. Liability insurance for damage arising out of ownership or use of inland or sea vessel, including carrier's liability.

13. General liability insurance for damage other than mentioned in classes 10 through, including damage to environment.

14. Credit insurance
   - general insolvency,
   - export credit,
   - instalment credit,
   - mortgage credit,
   - agricultural credit.

15. Suretyship insurance
   - direct suretyship,
   - indirect suretyship.

16. Insurance of miscellaneous financial losses arising out of
   - employment risks,
   - insufficient income,
   - bad weather,
   - loss of profit,

- continuing expenses,
- unforeseen trading expenses,
- loss of market value,
- loss of regular source of income (loss of rent or revenue),
- other indirect trading financial loss,
- other financial losses.

17. Legal expenses insurance.

18. Assistance insurance to persons who get into difficulties while travelling or while away from their permanent residence.

Groups of Non-Life Insurance

- "Accident and Sickness Insurance" for classes No. 1 and 2,
- "Motor Vehicle Insurance" for classes No. 3, 7 and 10,
- "Insurance against Fire and other Damage to Property" for classes No. 8 and 9,
- "Aviation Insurance, Marine and Transport Insurance" for classes No. 4, 5, 6, 7, 11 and 12,
- "Liability insurance for Damage" ("Liability Insurance") for class No 13,
- "Credit and Suretyship Insurance" for classes No. 14 and 15,
- "Insurance against Other Losses" for classes No. 16, 17 and 18.

C. Determination of the Value of Own Resources

1) The value of own resources (hereinafter referred to as the " actual solvency margin") shall be determined as an aggregate of values of items according to (2) 1. to 10. from which the aggregate of values of items according to (2) 11., and (l) is subtracted. When determining the values of separate items according to paragraph (2), the insurance company uses the values stated in the chart of accounts according to a special legal provision.

2) The actual solvency margin is determined using following items:

   - the paid up share capital of the company, i.e. the value of the subscribed paid up share capital,

- value of one half of unpaid share capital of the company, i.e. one half of the value of subscribed unpaid share capital,
- the capital reserves, i.e. share premium, other capital reserves and revaluation differences of capital participation; in the case of a negative value of this figure the value is subtracted,
- the statutory reserve fund, i.e. a reserve fund according to a special legal provision,
- other reserves from profit, i.e. the amount of reserves established from the profit after taxation, except for the social funds,
- the profit brought forward from preceding years,
- profit or loss for the accounting period,
- reserves for other risks and losses, i.e. an aggregate of statutory reserves, reserves on exchange rate losses and other reserves,
- hidden reserves arising out of underestimation of assets, i.e. the amount of reserve resulting from the difference of the market value of the assets and the value of these assets recorded in the books,
- other items, i.e. the items approved by the Ministry,
- losses brought forward from preceding years,
- intangible assets in the amount of those assets recorded in the books if they form a part of share capital.

D. Calculation of the Minimum Solvency Margin and Solvency Reporting

The insurance company calculates the minimum solvency margin for non-life insurance and for life assurance separately. The reinsurance company calculates the minimum solvency margin in a similar manner as the insurance company does for non-life insurance; the provisions of this Decree shall apply for calculation of reinsurance company solvency adequately. The insurance company performing the reinsurance activity shall calculate the minimum solvency margin for the insurance activity and for the reinsurance activity separately.

In non-life insurance, the minimum solvency margin is the higher of two values calculated from the volume of gross premiums written and from the costs of claims.

In life assurance, the minimum solvency margin is calculated from the volume of technical provisions and from the risk capital. In the case of life assurance where an investment risk is borne by policyholder the minimum solvency margin is calculated separately from other types of life assurance. If an accident insurance or sickness insurance is carried on as supplementary to the life assurance, the minimum solvency margin is calculated from the volume of gross premiums written.

The insurance company reports the solvency to the Ministry in writing or on medium in the extent and layout corresponding to the Decree.

II Supervision of Solvency

State insurance supervision including solvency is exercised by the Ministry in particular in the interest of consumer protection with the help of the Office of the State Supervision in Insurance and Pension Funds, which is a part of the Ministry.

The Office is divided into sections, which deal with legal issues, licensing procedures, methodology, regulation and inspections, consumer's cases, and statistics.

The Office shall prepare an annual report on such activities, containing an evaluation of the situation on the insurance market and shall publish it in *Finan•ni zpravodaj (Financial Journal)* not later than on September 30 of each calendar year.

State insurance supervision applies to insurance companies and organisational units of foreign insurance companies that carry on insurance activity in the territory of the Czech Republic, domestic insurance companies and reinsurance companies carrying on reinsurance activity and legal and natural persons, which carry on insurance intermediary activity in this territory, as well as other natural and legal persons to the extent stipulated by this Act.

In the exercise of state insurance supervision, the Ministry co-operates with international organisations, state supervisory authorities of other countries, central administrative authorities and organisations active in the field of insurance.

DENMARK

I Supervisory rules - the Danish act on insurance business

The Act, which applies to all insurance business (both direct insurance and reinsurance), has been adapted to existing EU Directives and incorporates rules which to a great extent are common to non-life insurance business and life assurance business. Life assurance business shall not be combined with other insurance business within the same company. However, life assurance companies may carry on business within classes 1 and 2 (Accident and Sickness) in addition to life assurance business. Furthermore, reinsurance of life assurance and other insurance may be effected by the same company.

The insurance business may be carried on by public limited companies, by mutual companies where the policyholders are the owners and only members of the company, and by lateral pension funds (nation-wide occupational pension funds) comprised by the Act.

The right of foreign insurance companies to carry on business in Denmark is described below in Section II.A.

A large number of administrative rules have been laid down in relation to the Act.

II Supervision

The Danish Financial Supervisory Authority is responsible for the public supervision of insurance activities in Denmark.

A. Authorisation

Insurance companies with head office in Denmark

The company must have permission - authorisation - from the Danish Financial Supervisory Authority to carry on insurance business. A company is entitled to receive the authorisation without any limitation in time if it satisfies the conditions of the Danish Act on Insurance Business and an application for registration has been filed with the Danish Commerce and Companies Agency. The authorisation will be valid for - at least - the entire EEA and it will permit the company to carry on business there under either the right of establishment or the freedom to provide services.

Any application for authorisation must be accompanied by, among other things, a memorandum of association, a scheme of operations and information about anyone holding directly or indirectly at least 10 per cent of the capital or the voting rights or having a holding which makes it possible to exercise a significant influence over the operations of the insurance company as well as information about the size of the holding of these capital owners.

If an application is filed for authorisation to effect life and pension assurance, the general technical basis etc., is to be notified to the Danish Financial Supervisory Authority on or before the day on which the technical basis etc. begins to be used. The same applies to any subsequent change in the mentioned circumstances.

Foreign insurance companies with head office in another country within the EU or in another country within the EEA

A foreign insurance company having been granted authorisation in another country within the European Union or in another country within the EEA, may carry on business in Denmark through a branch and/or through the provision of cross-frontier services when the Danish Financial Supervisory Authority has received the documentation, including a solvency certificate, prescribed by the Third Non-life Insurance Directive and the Third Life Assurance Directive from the supervisory authorities of the home country.

Foreign insurance companies with head office in a country outside the EU or in a country outside the EEA

Such a foreign insurance company which lawfully carries on insurance business in its home country may be granted permission - authorisation - by the Danish Financial Supervisory Authority to carry on similar business in Denmark through a local branch subject to certain specified conditions. One is that Danish companies shall be granted a similar right in the country concerned.

B. Solvency control

According to the Insurance Business Act an insurance company must have a certain basic capital in order to carry on insurance business. The basic capital required is determined by calculating the company’s solvency margin. The basic capital must constitute at least the same amount as the solvency margin.

The Danish rules concerning calculation of the solvency margin comply strictly with the rules of the EU Directives on Non-life Insurance and the Directives on Life Assurance.

The basic capital is calculated on the basis of the company's capital and reserves with various additions and deductions.

The rules concerning the elements of the basic capital have been changed in various respects in connection with the implementation of the Third Non-life Insurance Directive and the Third Life Assurance Directive.

Of elements that can be added now can be mentioned:

– Subordinated capital contributions (subordinated loan capital) which meet certain specified conditions. The addition must not exceed an amount equal to 50 per cent of the solvency margin.

– Members' accounts in mutual companies and in lateral (nation-wide occupational pension funds) covered by the Insurance Business Act if the mentioned accounts satisfy certain specified conditions.

According to the Insurance Business Act, the companies must submit their annual accounts to the Danish Financial Supervisory Authority. In this connection, the companies must fill in a special form which shows how the solvency margin has been calculated, as well as submit a statement showing the amount and composition of the basic capital. This enables the Danish Financial Supervisory Authority to check the existence and adequacy of the basic capital.

If the basic capital is not sufficient, a number of measures are available to the Danish Financial Supervisory Authority.

Foreign insurance companies having their head office in another country within the EU or the EEA, (*cf.* II.A.1*b*) above), are not required to possess in Denmark any basic capital to cover the solvency margin. Instead, a solvency certificate issued by the supervisory authority in the country in which the company has its head office is required.

Neither is the company required in Denmark to be in possession of funds to cover its commitments under insurance contracts effected in Denmark.

Foreign insurance companies having their head office in a country outside the EU or the EEA, (cf. II.A.1c) above), must possess assets in Denmark for the coverage of the solvency margin required (not less than one half of the minimum amount fixed for domestic companies). Deposits are required and the deposits are normally amounting to ¼ of the minimum amount of the solvency margin calculated as for domestic companies.

In addition, the company must possess sufficient funds in Denmark to meet its commitments under direct insurance contracts effected in Denmark.

However, it should be noted that non-life insurance companies having their head office in Switzerland are subject to the rules laid down in the "Swiss Agreement" if such a company wants to carry on business in Denmark through a branch. This means that a solvency certificate from the Swiss supervisory authorities replaces the demand for funds in Denmark to cover the solvency margin.

C. Investment rules

In accordance with the Third Non-life and the Third Life Assurance Directives the Danish investment rules lay down:

– Investment principles to be incorporated by the companies into their investment policy within the applicable investment rules.

– An exhaustive list of admissible types of assets.

– Limits to the extent of investments in certain types of assets.

– Limits to the amount of any one investment.

Investment principles

The general investment principles stipulate that the type and composition of the assets applied in covering insurance provisions must be such that they can satisfy the insured in terms of **security, return** and **liquidity**. There must be no disproportionate dependence on a certain category of assets, a certain investment market or a certain investment.

List of assets

The list of admissible types of assets contains a more detailed description of categories of assets than the list of assets in the Directive. The reason for this is a desire to make the list suitable as a frame of reference for the fixing of investment limits.

Limits for types of assets

The rules lay down the following limits for investments in certain types of assets:

- Non-"gilt-edged" assets:	max. 70 per cent;
- Unlisted securities:	max. 10 per cent;
- Listed securities from countries outside zone A:	max. 10 per cent;
- Unsecured unlisted loans (not more than 1 per cent per debtor):	max. 2 per cent;

(Zone A is a category of countries laid down by a Directive, comprising the OECD countries and Saudi Arabia.)

"Gilt-edged" assets are government and mortgage credit bonds, properties, bank deposits, secured mortgages, etc. The most important asset of the non-"gilt-edged" assets is shares.

All the limits are applied in relation to the size of the insurance provisions for own account.

Limits for any one investment

Within non-life insurance there is a limit of 4 per cent of the insurance provisions for investments in any one enterprise.

Within life assurance there is a limit of 3 per cent of the insurance provisions for investments in any one enterprise. However, this limit is only applicable if the enterprise in which the investment is to be made has its head office and is quoted in the stock exchange in a country inside Zone A and has capital and reserves of not less than DKK 250 million. Otherwise the limit is 2 per cent.

In addition to the generally applicable limits for any one investment, a number of other limits have been fixed for special investments, namely:

- Any one property: max. 5 per cent;
- Minority holding in a property company: max. 5 per cent;
- A subsidiary under supervision (bank/insurance/mortgage credit): max. 5 per cent;
- Mortgage credit bonds per issuer: max. 40 per cent;
- Deposits with banks and bank insurance guaranteed claims per institute or insurance company: max. 10 per cent;
- Investment association units per association or division thereof: max. 10 per cent.

Consolidated approach (look - through principle) for certain subsidiaries

Certain subsidiaries are subject to special rules, according to which the underlying assets of the subsidiary may be treated directly as a part of the assets covering the parent company’s provisions. By way of example, the ownership of a property subsidiary is not treated as a share investment but as a property investment.

Such a consolidated approach can be applied in relation to the following types of subsidiaries:

- Investment subsidiaries, i.e. subsidiaries whose only activity is to invest in and manage such assets as are covered by the list of assets.
- Insurance subsidiaries. The assets of the subsidiary to which the rule can be applied are limited to assets which are not applied in covering the subsidiary's own insurance provisions. Moreover, the subsidiary's solvency margin must be deducted. If the subsidiary is a non-life insurance company, however, its assets can only be applied in this way within a limit of 5 per cent of the parent company's provision.

III Circumstances, forms and consequences of suspension and cessation of business

Suspension and cessation of the business of a company imply, in that order, suspension or cessation of the issue of new policies. Suspension and cessation may be voluntary or compulsory, partial or total.

A. Voluntary suspension - total or partial

The Insurance Business Act makes no direct provision for the situation in which a company wishes voluntarily to suspend issue of contracts in some or all of the classes in which it carries on business. There is nothing to prevent it from doing this. It is nevertheless a condition of suspension that the company inform the supervisory authority.

Such notice does not entail withdrawal of the company's authorisation, but the supervisory authority has the access to withdraw an authorisation if the company has not used it for 2 years or more.

Voluntary suspension of the issue of contracts has no effect on contracts in force.

B. Voluntary cessation - total of partial

If a company finally ceases issue of contracts in some or all of the classes in which it carries on business, the supervisory authority must be informed.

If the company ceases all issue of contracts and does not voluntarily transfer its portfolio within a reasonably short time, the supervisory authority normally asks that such transfer be made or that the company go into liquidation. In the case of a life assurance company it may be that the company's life assurance portfolio will be taken under administration. That decision is taken by the supervisory authority and at the same time the supervisory authority appoints an administrator to take charge of the administration of the portfolio of assurance contracts.

Such cessation has no immediate effect on policies already issued.

C. Compulsory suspension - total or partial

If the financial circumstances and situation of a company are such that the interests of the insured are in danger, the supervisory authority may require as a provisional measure that the company suspends issue of policies in some or all the classes in which it is doing business (see F. *Transfer of portfolio*).

It is not necessary that such a requirement be published.

Suspension does not entail immediate withdrawal of the company's authorisation.

If the situation of the company has changed so that the suspension is no longer necessary, the supervisory authority makes a statement to this effect.

If the opposite is the case, the suspension will be followed after a very short delay by the withdrawal of the company's authorisation and at the same time by a request from the supervisory authority that the company be wound up or, if it is a life assurance company, that its portfolio be taken under administration (cf. B). Compulsory suspension has no effect on insurance contracts in force.

D. Compulsory cessation - total or partial

If the financial situation and state of business of a company are such that the interests of the insured are endangered and the company does not take the measures which the supervisory authority has prescribed within the time that the supervisory authority allows for this, the latter may withdraw the company's authorisation and at the same time may require that the company goes into liquidation and, if it is a life assurance company, it may decide that the company's portfolio must be taken under administration.

In connection with any withdrawal of a company's authorisation the supervisory authority may prohibit the free disposal of the assets of the company or may restrict its free disposal of such assets.

As will be explained below in connection with administration of the portfolio of a life assurance company (cf. G *compulsory winding-up),* Danish law endeavours to ensure that the life assurance contracts in question will be kept in force, if they have to be administered, as far as possible.

E. Company's right of appeal

A decision by the supervisory authority that a company must suspend business, go into liquidation (apart from bankruptcy), or be placed under administration may be submitted to the Danish Commerce and Companies Appeal Board at the latest 4 weeks after notice has been received of such decision. The decision of the supervisory authority and that of the appeal board may be taken before the courts. In the latter case, the time limit is 6 months.

F. Transfer of contracts and transfer of the company

Transfer of portfolio

- without corresponding assets and liabilities;
- with corresponding assets and liabilities.

If a company wishes voluntarily to transfer its whole portfolio or a specified part of it to another company it must make a request to this effect to the supervisory authority, attaching the proposed agreement between the two companies, and subsequently forwarding information about the companies enabling the supervisory authority to judge whether the transfer is without risk for the policyholders. If the supervisory authority is of the opinion that the transfer should be authorised, it must publish a report relating to the transfer and an invitation to the policyholders to inform it in writing within three months if they do not wish the transfer to be made. At the same time, the company must inform the policyholders directly. After the expiration of the time limit mentioned above, the supervisory authority, taking due account of any objections advanced, shall decide whether the insurance portfolio may be transferred in accordance with the proposal submitted. The transfer may not be placed as grounds for cancelling an insurance policy.

By virtue of rules similar to those mentioned above, two or more life assurance companies (or non-life insurance companies) may, for example, merge and form a new company.

It is not necessary to get the permission of the supervisory authority for the transfer if the insurance company in connection with the transfer obtains the consent of every single policyholder.

The compulsory transfer of the portfolio of one insurance company to another will be dealt with in more detail below in the chapter on winding-up. The portfolio may be transferred to another insurance company.

As mentioned earlier the Danish legislation requires specialisation between life assurance and non-life insurance (*cf.* See Section I). This implies that a life assurance portfolio can only be transferred to another life insurance company and a non-life insurance portfolio to another non-life insurance company.

A possibility is given to an insurance company to transform itself to a non-insurance company after having transferred all its insurance activity to another insurance company.

It has been a normal rule that an insurance company, which no longer carries on insurance activity, should be dissolved either by amalgamation or by voluntary or compulsory winding-up.

According to a special provision an insurance company, which has transferred its entire insurance portfolio to another insurance company according to the legal procedure, can no longer exist as an insurance company. If it is not dissolved by winding-up or special cases of amalgamation, the Danish Financial Supervisory Authority shall approve the form and the content and the accomplishment of the liquidation as insurance company.

It means, for instance, that a limited insurance company having transferred its insurance activity can - if approved by the supervisory authority - remain as an ordinary limited company doing other business than insurance.

In so far the transfer has taken place to an insurance company being a subsidiary of the transferring company, the latter will then be a holding company for its insurance subsidiary.

Transfer of the company

Special rules are laid down in the case of mergers. These rules apply in the event of an insurance company wishing to transfer the whole of its assets and liabilities to another insurance company and if a decision is taken to merge two or more insurance companies into a new insurance company. Such transfers are only valid with the permission of the supervisory authority.

The same proceedings concerning publication of the proposed agreement and the time limit given the policyholders as mentioned above shall apply. Furthermore, the supervisory authority shall be ascertained that the continuing company still has sufficient assets to cover the solvency margin and the technical provisions, taking account of the portfolio transferred to it.

G. Winding-up

If an insurance company is doing business in several classes of insurance, the fact that it ceases to issue contracts in some of these classes does not normally result in its winding-up.

If, on the other hand, the company completely ceases to issue new contracts, the consequence may be as was stated above, that its portfolio has to be transferred to another company (or, if it is a life assurance company, that its portfolio is placed under administration), and at the same time, that the company is required to go into liquidation.

The following rules apply to voluntary liquidation

The general meeting of an insurance company may, according to what its Articles of Association lay down in the matter, decide that the company should go into liquidation. If it is a life assurance company, it may not do so without the consent of all the individual policyholders unless it has first transferred its entire life assurance portfolio to another life assurance company in accordance with the relevant rules laid down by law, or unless at least its life assurance portfolio has been taken under administration.

In case of liquidation, the general meeting elects one or more liquidators for this purpose. If it seems justified to safeguard the interests of the insured, of shareholders, of guarantors or of creditors, the Minister of Economic Affairs may, after obtaining the opinion of the supervisory authority, appoint a liquidator to take charge of liquidation jointly with the liquidators elected by the general meeting.

The liquidators ensure that accounts closed at the time of liquidation are drawn up and made available to the insured, to shareholders, to guarantors and to creditors at the offices of the company as quickly as possible, and that a copy is also sent to the supervisory authority.

The liquidators must also, be means of a published notice, invite the creditors of the company to present their claims. After the assets have been distributed, the liquidators submit their final liquidation accounts to a general meeting and also forward them to the supervisory authority.

If it becomes clear during the winding-up that the circumstances which led to it have changed, it may be terminated and the company may begin business again when its balance sheet shows, in the opinion of the supervisory authority, that its liabilities are entirely covered and that the capital is sufficiently intact.

If the company’s authorisation has been withdrawn, it cannot continue its activity, until a new authorisation has been granted.

The following rules apply to compulsory winding-up

a) Domestic non-life insurance companies

Under more detailed provisions set out in the legislation, the supervisory authority has the power to decide that an insurance company shall go into liquidation. This is to be done in particular if the financial interests of the insured are in danger and if this danger has not been removed by other measures. If the supervisory authority has decided that a company is to be liquidated, the Bankruptcy Court, after consultation with the supervisory authority, shall appoint one or more liquidators, one of whom shall have a law degree. The Act lays down more detailed rules for the liquidation procedure. The supervisory authority, in consultation with the liquidators, examines whether it is expedient to transfer the whole or part of the portfolio to one or more insurance companies carrying on business in Denmark. If transfer takes place in accordance with the decision of the supervisory authority, the winding-up and the transfer cannot be pleaded as grounds for terminating an insurance contract.

b) Domestic life assurance companies

In circumstances such as have been described above for non-life insurance companies the supervisory authority may decide to place the portfolio of a life assurance company under administration. In such cases, the right of the company to carry on life assurance business ceases, and the appointed administrator (cf. B.) takes possession of all the company's assets registered to cover the life assurance provisions. These assets will thus be used exclusively to meet the claims of the insured.

Individual policyholders may not bring claims against the company. On the other hand, the administrator acting on behalf of the estate under administration, may claim from the company any amount that may be shown by the valuation of the assets taken over to be needed to cover the technical provisions and insurance claims notified and due. Furthermore, the administrator acting on behalf of the estate under administration, may claim any amount corresponding to the basic capital that is equivalent to the solvency margin calculated for the company out of any money that may be in hand according to a balance sheet drawn up at the commencement of the administration procedure.

The administrator shall as soon as possible seek to have the whole of the assurance portfolio taken over by one or more life assurance companies carrying on business in Denmark. If a take-over offer is received, the administrator shall apply to the supervisory authority for authorisation of the transfer.

The application for such transfer shall be accompanied by the agreement made between the estate under administration and the accepting company.

An account of the planned transfer shall be published in the Danish Official Gazette and in daily newspapers, and shall contain an invitation to policyholders to inform the supervisory authority in writing within a time limit of at least one month if they have any objections to the transfer. At the same time, the company shall send a copy of the account and the proposal to policyholders whose addresses are known to it.

When the time limit has expired, the supervisory authority, having due regard to any objections advanced, shall decide whether the assurance portfolio may be transferred as proposed. The transfer may not be pleaded as grounds for cancelling an assurance contract.

If the assurance portfolio cannot be transferred the administrator shall carry out the final determination of the sums insured in accordance with the calculation made and shall convene a general meeting of the policyholders to form a mutual company. If a new company cannot be formed, the administration shall continue. The administrator decides if further attempts to transfer the assurance contracts to another company shall be made.

An insurance company may be declared bankrupt. A petition in bankruptcy can be filed with the Bankruptcy Court either by the company itself or by creditors. If an insurance company becomes insolvent, the supervisory authority shall file a petition in bankruptcy with the Bankruptcy Court.

FINLAND

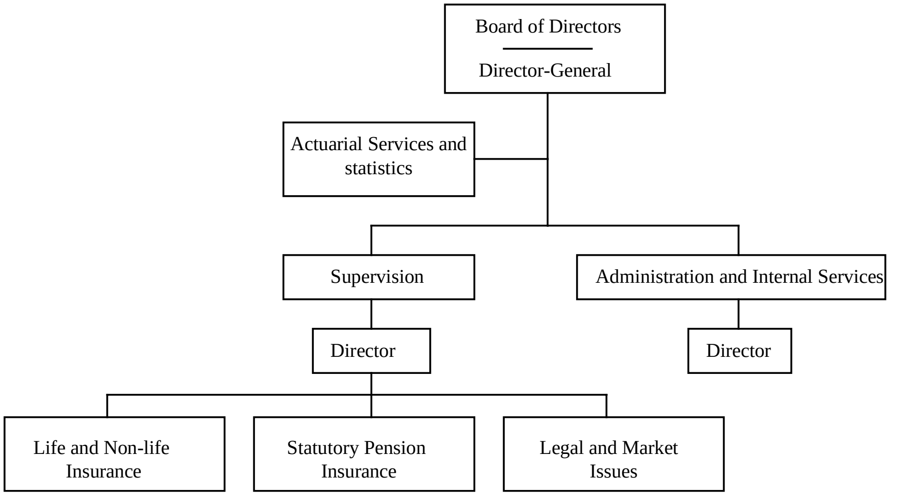
I The Insurance Supervision Authority

The new Insurance Supervision Authority was established at the beginning of April 1999. An Act concerning the Authority was ratified and a decree concerning it issued on 29 January 1999. The task of the Insurance Supervision Authority is to supervise and inspect the insurance and pension institutions and other agencies operating in the insurance business. This task was previously carried out by the Ministry of Social Affairs and Health. The objective of the activity of the Insurance Supervision Authority is to ensure that the Finnish insurance market is stable and produces secure, competitive insurance services. Each body supervised is analysed on the scale required. To achieve its objective the Insurance Supervision Authority:

- analyse and supervise the operations, risk position and liability capacity of individual bodies providing statutory insurance, and their impact on the provision and costs of statutory coverage as a whole;
- analyse and supervise the operations, risk position and liability capacity of each body providing optional policies, aiming to identify problems early enough not to endanger the insured people interests;
- provide expert advice in the drafting and processing of legislation and projects concerning supervision of the sector.

The highest organ of the Authority is a board of directors. It is composed of a chairperson and five other members, with personal deputies. The Ministry of Social Affairs and Health has the right to appoint three members of the board of directors and their deputies. Two of these members are appointed at the proposal of the Bank of Finland and the ministry responsible for credit institutions' business. Furthermore, the director general of the Insurance Supervision Authority, the director general of the Financial Supervision Authority and the director of the Insurance Department of the Ministry of Social Affairs and Health are the members of the board of directors. In addition, the staff of the Insurance Supervision Authority can choose among themselves a member to the board of directors.

The Insurance Supervision Authority is led by a director general assisted by directors of units. The present structure of the Insurance Supervision Authority is shown on the figure below.



II The role of the Ministry of Social Affairs and Health

Before April 1999 the supervision of insurance companies was operated by the Insurance Department of the Ministry of Social Affairs and Health. After the rearrangements of the insurance supervision the Insurance Department now develops social insurance and other insurance-related legislation. It is responsible for drafting insurance legislation and for a major part of the setting of norms concerning the agencies supervised, administrative management, and co-ordination of the activities related to the European Union and international co-operation. Decisions concerning the founding and authorisation of insurance companies and decisions concerning the bases of employment pensions have also remained the responsibility of the Insurance Department of the Ministry of Social Affairs and Health.

The Department comprises a social insurance branch, an insurance market branch, an unemployment security branch, and an international affairs and administrative support section.

III Solvency supervision

A. Requirements of the EU insurance directives and a solvency test

The principal role of the Insurance Supervision Authority is to safeguard the interests of insurance customers, and this is where the financial supervision takes the centre stage. The most vital parts of financial supervision are verification of the adequacy of insurance companies' solvency margins and supervision of investment in assets covering technical provisions. In these two fields, the supervisory body verifies that the companies meet the *minimum requirements imposed in EU insurance directives*. In addition to these minimum requirements Finnish non-life insurers' solvency is also supervised by means of *a solvency test*. The test is based on risk theoretical considerations and it incorporates an early warning system, which helps the supervisory authority identify risks early enough and tackle the problem if a company's solvency weakens. In its present form, the solvency test evaluates the nature of insurance business and the underlying risks as well as the risk content of the company's investments.

B. Equalisation provision

Non-life insurance business is particularly susceptible to stochastic fluctuations. To reduce the negative impact of stochastic fluctuations, insurers are required by the Finnish Insurance Company Act to include in their provision for claims outstanding a specific item, *equalisation provision*. This provision is used for adjusting the reported underwriting profits over a fixed period of time to a level required by the average loss ratio.

C. Guarantee scheme

Insurers writing statutory business are required to set aside funds for a *guarantee scheme* to make sure that the insured and claimants receive all compensation and benefits due to them under motor liability, patient, workers' compensation and employee pension insurance, even if the insurer becomes insolvent. When an insurer becomes insolvent, the other insurers are required to make contributions to the guarantee scheme to cover the amount needed for the payment of compensation and benefits due. The guarantee scheme has not been extended to voluntary lines.

D. Supervisory limits for life insurance companies

In addition to solvency requirements based on EU directives new *supervisory limits* for life insurance companies are applied on an unofficial basis since 1998. The limits of life insurance companies are determined primarily on the basis of the company's investment portfolio but they also depend on the type of insurance business carried out by the company. By means of the supervisory limits, the authorities can detect impairments in the state of a company early enough. The supervisory limits are accompanied by certain restrictions on operations and analyses, which are intended to achieve a turn in the company's current trend and to restore the state that does not call for any kind of special supervision.

The solvency supervision of foreign EEA insurance companies operating in Finland is the responsibility of the authority in charge of the supervision of insurance companies in their home countries.

E. *Provisions concerning accounting*

Those provisions of the Finnish Insurance Companies Act relating to the closing of the accounts were amended to become consistent with the EU directive on the annual accounts and consolidated accounts of insurance undertakings. As a consequence of this for example the profit and loss account was reformed and other provisions concerning the closing of the accounts were also amended. The new provisions concerning accounting were applied for the first time during the accounting period, which ended on 31 December 1995.

F. *Information needed for supervision*

One form of the Finnish insurance supervision is to examine the information that the insurance concerns without request are obliged to submit to the Insurance Supervisory Authority. The authority can nevertheless require other information necessary for the supervision from the insurance concern. The other form is to carry out inspections in the insurance concerns and to be present at the meetings of a domestic company.

FRANCE

The need for policyholder protection, acknowledged in France as it is elsewhere, has prompted legislators and administrators to establish technical and financial rules. Reading through those rules undoubtedly provides the best possible initiation to the field of insurance.

The intended purpose of such regulations is to secure the long-term solvency of insurers, in order that they may always be in a position to honour their commitments.

Yet if regulatory requirements are analysed against the principles of sound management, they will be seen to represent only minimal precautions.

It is from this standpoint that the following principles and rules should be examined.

I Prudential rules

A. Pricing

There are no particular provisions regarding non-life insurance.

For life insurance, the technical components of pricing are still subject to various restrictions *(e.g.* life tables, interest rates, underlying assets for unit-trust-linked contracts, etc.).

B. Technical reserves calculation

1. They must at all times be "sufficient to meet any liabilities to policyholders and beneficiaries".

2. They are calculated gross of claims and reinsurance ceded, and for each class of insurance.

3. In non-life insurance, the calculation of technical reserves now takes account of the Annual Accounts Directive of 19 December 1991 (91/675/EEC). Consequently, the new terminology applies the concept of a provision for unearned premiums (P.F.U.P.) calculated using a retrospective method (i.e. based on the premium

actually charged), to which a provision for unexpired risks (P.U.R.) may be added to cover the extra amount required when the total loss incurred is higher than that used to price contracts.

The P.F.U.P. is prorated for each category on a per contract basis or using statistical methods based on the business premium.

However, the portion of policy acquisition costs not chargeable to the fiscal year must be entered as assets on the balance sheet. They are calculated in the same way as the P.F.U.P.

The P.U.R. as defined above is calculated on a per contract basis or separately using statistical methods for each insurance category.

Provisions for claims outstanding are calculated on a case-by-case basis (basic rule) or using statistical methods (frequency of settlements, average costs, etc.). When several methods are used, the highest result is adopted. A management provision is added to this amount.

4. For life insurance, mathematical reserves are zillmerised. Theoretically, mathematical reserves are calculated on the same basis as premiums.

C. Assets representing technical reserves

- Liabilities, gross of reinsurance, must be represented by equivalent assets located in the E.U. (except in the case of EC co-insurance and policies written under the freedom of service provision) and be congruent, i.e. expressed or realisable in the same currency as the underwriting liabilities.

- Liabilities must be represented by assets that meet the criteria of security, liquidity and profitability as well as diversification, since a single investment can rarely satisfy all these criteria.

- The main investments authorised are as follows:
  - bonds issued or guaranteed by an OECD Member State;
  - bonds (and comparable securities) negotiated on a recognised market[1];
  - shares (and other securities) negotiated on a recognised market;

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1 The recognised markets are the regulated markets of the Member States of the E.E.A. or the markets of other Members of the OECD operating on a normal basis.

  - Real estate (and comparable assets) located in an OECD country;
  - Collateral loans granted to persons residing in an OECD country;
  - Deposits in a banking establishment located in the EU.

- Rules are imposed to limit and diversify assets. In particular, no more than 65 per cent of liabilities may be represented by shares, no more than 40 per cent by real estate assets and no more than 10 per cent by loans and deposits. The common diversification rule limits to 5 per cent the portion of liabilities that may be represented by securities issued by anyone body (except for countries or the equivalent), and to 10 per cent the portion that may be represented by an investment in any one building.

- For life insurance, policy loans may be used to represent reserves.

- Claims on reinsurers may be used only if they are collateralised *(i.e.* if securities have been pledged).

- Assets are carried at their purchase price or at cost (with real assets depreciated).

No provision is made for unrealised capital losses on shares or real property unless the aggregate disposal value of these investments is below cost.

D. Capital

Depending upon the class of insurance, the minimum share capital required for licensing is either FF 5 million (for life, capitalisation, liability) or FF 3 million. At least half this amount must be contributed in cash at the time of incorporation.

The licensing authority may, however, require a far greater amount of initial capital, depending upon an insurer's projected premium volume.

The other prudential aspects related to capital are discussed in connection with the solvency margin.

E. Solvency ratios

The French method for assessing solvency is based on the concept of the solvency margin, which is taken from EC Directives of 1973 and 1979.

Non-life insurance

At the very least, the solvency margin must equal the greater of two ratios -one involving premiums due, gross of reinsurance but net of tax and cancellations (18 per cent, then 16 per cent); the other involving the average loss burden over the past three years (26 per cent, then 23 per cent) -adjusted by a post-reinsurance retention rate *(i.e.* the ratio of net claims to gross claims).

To determine whether a company covers its solvency margin, the following component elements are aggregated:

- paid-up share capital;
- half of non-paid-up share capital;
- supplementary contributions required of policyholders (in mutual insurance companies);
- subordinated debt;
- free reserves and retained earnings;
- capital gains arising from undervaluation of assets.

This method is applied on an aggregate basis to all classes of casualty insurance, gross of reinsurance accepted.

Life insurance

The minimum margin formula varies according to class and is based on ratios involving mathematical reserves gross of reinsurance, capital at risk or premiums due. The list of elements covering the margin is similar to the one for non-life insurance.

F. Supervision of insurance products

Contracts and prices are no longer subject to prior approval, but the Minister for Economic Affairs, Finance and Industry can require insurers to submit contracts and prescribe changes or require that contracts be withdrawn. The opinion of an advisory board composed of professionals and representatives of policyholders is required, except in emergencies.

G. Company officials and shareholders

Before an insurer can be licensed, it must submit a list of its directors and executive officers. In making a decision, the Minister considers the qualifications and experience of these officials, which must also be outlined in the licence application.

When the applicant is a limited liability company ("société anonyme"), the application must also contain a list of its principal shareholders.

General agents of branches of foreign insurers must, if they are legal persons, be domiciled or headquartered in France. The relevant professional experience requirements are identical to those applicable to officers of French companies.

The annual reports submitted to supervisory authorities also include updated information on members of the Board of Directors and executive personnel.

II Supervision

A. Frequency of reporting and types of accounts furnished to supervisory authorities

Once a year, companies must provide the Insurance Supervisory Committee with two types of accounting and statistical documents:

- Public reports:
  - statement of earnings,
  - balance sheet,
  - annex, including a detailed list of investments.

- Reports prepared for the supervisory authority ("C" reports), the most significant of which are C1 (technical results per contract), C2 (liabilities and technical results by country), C3 (reinsurance accepted and ceded), C4 (premiums per contract and guarantees), C5 (assets covering priority commitments), C6 (solvency margin) and C10 (premiums and results by year when the loss occurred).

Companies must also provide the Insurance Supervisory Commission with quarterly reports summarising the investments representing their technical reserves and with a presentation of the effects that various predetermined assumptions regarding changes in the prices of different categories of assets will have on their performance.

B. On-site inspection

The Insurance Supervisory Commission delegates this task to insurance inspectors accredited to companies. The inspectors, who are technical officers with the Ministry of Finance, may extend their supervision to agencies and other intermediaries.

Inspectors exercise continuous supervision over insurers and make their own selections of the firms to be inspected on site, based on their experience with the companies and new information provided by annual reports.

C. Indicators

There are no standard indicators or set investigative procedures.

Such an approach is not only unnecessary, given the close, customised supervision, but inappropriate for the wide diversity of insurers (in terms of size, networks and legal status).

D. The importance of qualitative supervision

During their on-site examinations, inspectors may scrutinise various aspects of a company's operations and subsequently report any anomalies. The Insurance Supervisory Commission is empowered to suspend company officers temporarily if regulations have been violated.

The law clearly stipulates that the Supervisory Commission shall examine both the finances and the conditions of operation of insurance companies.

III Measures taken in the event of problems

A. First measures

If it is found that a company's financial position has deteriorated, or that there has been a serious infringement of the regulations, the Insurance Supervisory Commission may either issue *a warning* or *enjoin the firm to take remedial measures* within a specified period of time.

If a company starts to act in a way that is contrary to the best interests of its policyholders *(e.g.* by offering severely deficient financial guarantees), the Insurance Supervisory Commission may require it to submit a short-term financial plan. If the Commission approves the plan, it is carried out by an insurance inspector invested with special supervisory powers. The Commission may also decide to freeze the company's assets.

The Commission may also exercise a number of restraining powers. In particular, it has a list of sanctions it may use to bring a firm found wanting back to normal operation or to discontinue any activity that has gone counter to policyholders' best interests. These sanctions are: warnings, reprimands, the prohibition of certain transactions and any other limitation of operations, temporary suspension of one or more company officers, total or partial withdrawal of licensing, and compulsory transfer of portfolio.

B. Liquidation

A firm is liquidated after the Insurance Supervisory Commission withdraws its licence. The liquidator proceeds under judicial authority and is assisted by insurance inspectors.

Non-life policies cease being effective 40 days after a licence is withdrawn; for life insurance, contracts in force will be maintained as long as a decision to the contrary by the Insurance Supervisory Commission has not been published in the Official Gazette.

However, the liquidator may, with the approval of the bankruptcy judge, suspend payment of all amounts due under contracts. The premiums collected by the liquidator are paid into a special account that is liquidated separately.

The Insurance Supervisory Commission, at the liquidator's request and on the basis of the bankruptcy judge's report, may set the date at which policies are no longer effective, authorise their complete or partial transfer to one or more companies, defer premium payments, decide to reduce the amounts payable for life insurance and death benefits and other benefits, and surrender values so as to bring the value of the company's liabilities in line with the amount that can be obtained through liquidation.

The payment of periodical premiums is suspended ten days after the liquidator has been appointed until the publication of the Insurance Supervisory Commission's decision setting the date when contracts cease to have effect.

In the event of a transfer of portfolio, the suspended payments are made to the company to which the portfolio is being transferred at the reduced rate set by the Insurance Supervisory Commission.

Lastly, the Insurance Supervisory Commission must initiate the procedure for using the Guarantee Fund established by Act No. 99-532 of 25 June 1999 on savings and financial security (new Sections L 423-1 to L 423-8 and R 423-1 to 18 of the Insurance Code) when a company is no longer able to honour its commitments.

This Fund is designed to safeguard the interests of the holders and beneficiaries of personal insurance policies and capitalisation contracts issued by companies governed by the Insurance Code (except for provident institutions and independent mutual insurance associations). The companies concerned are required to contribute to this Fund.

Procedure for using the Guarantee Fund

The procedure for using the Guarantee Fund is initiated by the Insurance Supervisory Commission when an insurance company is no longer able to honour its commitments to policyholders and the Commission has exhausted the various means at its disposal.

When the Commission decides to initiate this procedure, it must first consult the Chairman of the Board of Directors of the Guarantee Fund in writing. If he contests this decision, he has 15 days to notify the Minister who may ask the Commission to reconsider the matter after receiving the written opinion of an arbitration panel consisting of the Director of the Treasury, the Chairman of the Insurance Supervisory

Commission and the Chairman of the Supervisory Board of the Guarantee Fund, or their representatives.

The insolvent company is immediately notified of the decision to initiate the procedure and must inform all policyholders and benefit recipients accordingly.

Mandatory transfer procedure

As soon as the insolvent company has been notified that the Guarantee Fund procedure has been adopted, the Insurance Supervisory Commission puts out a call for tenders with a view to the mandatory transfer of all or part of its contract portfolio as provided for under Article L 310-18. The Guarantee Fund is notified of this call for tenders.

The Commission selects the tenders that it considers will best protect the interests of policyholders and benefit recipients.

If it is decided to transfer the portfolio, the terms of the transaction are specified in the Official Gazette, and the company or companies to which the portfolio is transferred take over the commitments of the insolvent company.

When the portfolio transfer procedure is unsuccessful, the Insurance Supervisory Commission notifies the Guarantee Fund of this fact.

Intervention of the Guarantee Fund

The Guarantee Fund may intervene in two cases:

- if the portfolio of the failing company is transferred, the rights of any policyholders not covered by the company to which the portfolio is transferred are guaranteed by the Fund, which pays the necessary amount to the latter at its request. The transferee company calculates the amount to be requested on the basis of the commitments published in the Official Gazette. The transferee company then informs all policyholders and benefit recipients of the amounts paid by the Fund to reconstitute the reserves covering their policies.
- if the transfer procedure is unsuccessful, policyholders are compensated, at the liquidator’s request, by a payment made to them by the Fund. The amount of the payment request is calculated by the liquidator on the basis of the commitments established at the date when contracts ceased to have effect.

In both cases, the Fund has two months after the payment requests are received to verify that the policies are covered by the guarantee and to check the amount guaranteed for each policy; exceptionally, this period may be extended to three months.

The Ministry of Economic Affairs is notified of the Fund's decisions. If policyholders or the company to which the portfolio has been transferred contest these decisions, they must bring their case before the relevant court of their place of residence or their corporate headquarters.

Once all or part of the portfolio of the bankrupt company has been transferred or once the transfer procedure has failed, all of the insolvent company's licences are withdrawn.

Individual ceiling on compensation

The compensation paid when implementing the guarantee includes all reserves covering the rights of policyholders and benefit recipients under insurance policies and capitalisation contracts and bonds.

The Fund's right of subrogation

The Fund is subrogated, up to the amounts it has paid, in the rights of policyholders regarding the liquidation and in the rights of the insolvent company regarding the sums payable under the contracts in force. The Fund may also take any legal action for liability against the managers in fact or in law of the bankrupt company in order to recover the amounts paid.

Recovery of the remuneration and commissions of insurance intermediaries

The Insurance Code allows a portion of the commissions and remuneration of intermediaries (other than the general agents, authorised representatives and employees of insurance companies) to be recovered in the event of a mandatory transfer of the portfolio of a personal insurance company with which they placed contracts if their behaviour contributed to the difficulties of this company.

The amounts recovered are paid to the company to which the insolvent company's contract portfolio was transferred or, if the transfer procedure was unsuccessful, to the policyholders' guarantee fund.

The procedures for implementing this provision stipulate that the Insurance Supervisory Commission may decide to recover commissions after an investigation of insurance intermediaries has been conducted.

The liquidator disposes of assets and indemnifies creditors in the order of priority established by law:

- sums due to employees,
- the liquidator's expenses,

- sums due to the State and to labour organisations,
- sums due to policyholders and beneficiaries; first to settle claims, then to reimburse excess premium payments.

If assets are insufficient, the proceeds are distributed pro rata among creditors having equal priority of claims. The liquidator is empowered to come to terms with holders of doubtful claims.

C. International issues

Foreign companies doing business in France are liquidated according to the above procedure, on the basis of a special analysis of French operations.

No special treatment is reserved for foreign policyholders, whose position cannot be more favourable than that of domestic customers.

IV Special issues relating to groups of insurers

Directive 98/78/EC of 27 October 12998 on the supplementary supervision of insurance undertakings in an insurance group is currently being transposed into French legislation.

V Special issues relating to reinsurance

The technical provisions of ceding companies are calculated gross of reinsurance. The representative assets of these regulated liabilities may include claims on reinsurers, provided those claims are guaranteed by securities pledged to the cedent or by letters of credit. The insolvency of reinsurers (which, in France, are not subject to State supervision) is therefore not a problem, so long as the rule that technical provisions be covered gross is complied with.

VI Separation between life and non-life

In France, insurance companies cannot conduct both types of business at the same time.

However, this principle has been relaxed in compliance with the 3rd Life Directive. It is now possible to combine these areas in personal insurance provided that companies comply with the principle of separate management.

VII Special issues relating to specific types of insurance products

Examples:

- In the case of unit-trust-linked life insurance, mathematical reserves are represented by investments in the securities that make up the reference unit, in the same proportions.
- There are special provisions governing certain contracts for which a higher-than- normal rate is allowed in setting premiums and calculating mathematical reserves. In such cases *(e.g.* single-premium capitalisation contracts with a maximum maturity of 15 years), the corresponding asset must be kept separate and generate returns that are at least one percentage point greater than the rate used to calculate mathematical reserves.

VIII Adapting the current system to recent economic trends

The French regulatory framework is being adapted to European rules, in particular those being discussed in the fields of the liquidation of companies, pension funds and financial conglomerates.

GERMANY

I Financial supervision

A. Legal bases of financial supervision

Financial supervision of insurance companies is mainly based on the provisions of the Law on the Supervision of Insurance Companies (Insurance Supervision Law), the Commercial Code, the Stock Corporation Law, and the Regulations on External and Internal Accounting. While both the Civil Code and Stock Corporation Law contain provisions applicable also to non-insurance companies, the Insurance Supervision Law and the two Regulations apply only to insurance companies.

B. Actual organisation of financial supervision

Organisation of the insurance supervisory authority

The duties of financial supervision are mainly performed by four out of a total of six divisions of the Federal Insurance Supervisory Office. Legal- and, in personal insurance, actuarial – supervision and financial supervision used to be organised in separate divisions. Since April 1999, however, these supervisory areas have been combined in four operational divisions comprising 23 sections. Legal/actuarial supervision and financial supervision of an insurance company are now exercised by only one section staffed with an interdisciplinary team, which thus has an overview – required for supervision to be effective - of the insurer's overall situation. Most of the senior section staff responsible for financial supervision are holders of diplomas in business administration.

The sections in another division deal with special matters of financial supervision which concern all companies equally, e.g. accounting, solvency and investment.

Areas coming under financial supervision

Financial supervision begins with the procedure for the authorisation of an insurance company to carry on insurance business. During this procedure particular attention is given to adequate own funds and the establishment of an organisation fund. In addition, the insurance companies have to submit estimations of commission expenses, other current operating expenses, expected premiums, expected claims expenses and expected liquidity position in the first three years. The applicable provisions of the German insurance supervision legislation are mainly based on the harmonised conditions for the authorisation to take up insurance business including the provision of insurance companies with own funds of EC Directives 73/239/EC (First Non-Life Directive) and 79/267/EC (First Life Directive) which have been enacted into national law, as amended by the third Directive 92/49/EC or 92/96/EC.

After authorisation the business operations of insurance companies are subject to on-going supervision. Information about the financial situation of insurance companies is mainly obtained from the externally published annual accounts, the records to be submitted according to the Regulation on internal accounting, statistical surveys, and on-site inspections of insurance companies.

The essentials of on-going supervision are:

- *Solvency control*

According to Section 53*c* (1), first sentence of the Insurance Supervision Law, the insurance companies are required, for the purpose of securing their ability to meet their liabilities under insurance policies at any time, to establish free and uncommitted own funds an amount not less than the solvency margin which depends on the volume of business. The calculation method and the amount of the required own funds have been stipulated in the regulation on the funding of insurance companies. The rules concerning the submission of the external annual accounts and internal accounting documents to the insurance supervisory authority have been adapted to the third directives and Directive 91/674/EC (directive on the annual accounts of insurance companies). In particular as far as reporting to the supervisory authority is concerned, new statements covering the insurance business written in the EC member States were necessary to meet the reporting requirements of the third directives. The above provisions are mainly based on the harmonised solvency requirements according to EC Directives 73/239/EC et 79/267/EC which have been enacted into national law.

- *Control of insurance companies' investments*

The insurance companies may, within the framework of the provisions of the Insurance Supervision Law, take their own investment decisions. The investments of insurance companies are not subject to prior approval by the insurance supervisory authority; this does not apply to the exemptions which the insurance supervisory authority may grant, for instance, with regard to types of investment not mentioned in the Insurance Supervision Law or if certain limits are exceeded. The investment rules do not require the insurance companies to invest in certain types of investments. Therefore, the third directives only stipulate certain limits for the types of investments to ensure their safety. Even if the German legislator wished to favour investments in certain areas he would not be permitted to require the insurance companies to comply with this wish. As regards investments the insurance companies are required to submit to the insurance supervisory authority a number of (subsequent) notifications in particular concerning certain new investments.

– *General analysis of annual accounts*

This mainly concentrates on the technical reserves on the liabilities side of the balance sheet. In non-life insurance in particular the adequate allocation of funds to the provisions for outstanding claims is supervised; since estimations are used to establish these provisions a certain margin is left as regards fixing the required amount of these provisions. In life insurance the main emphasis is on the control of the mathematical reserves which are calculated on actuarial principles.

Financial supervision of day-to-day business is to ensure that the insurance companies are in a position to meet their liabilities under the insurance contracts at any time.

II Measures to be taken in case of financial difficulties of insurance companies

If the amount of an insurance company's own funds is less than the solvency margin the company shall, on request of the supervisory authority, submit for approval a plan to restore financial conditions (solvency plan) [Section 81*b* (1) of the Insurance Supervision Law]. If an insurance company's own funds is less than the guarantee fund the company shall, at the request of the supervisory authority, submit for approval a plan for the short-term procurement of the necessary own funds (financing plan) [Section 81*b* (2), first sentence of the Insurance Supervision Law]. Moreover, the insurance supervisory authority may limit or prohibit free disposition of the assets of the company [Section 81*b* (2), second sentence of the Insurance Supervision Law].

As regards investments the insurance supervisory authority may prohibit an insurance company from continuing to hold a participation in another company which is not supervised, if any such participation is, by its nature or scope, likely to endanger the insurance company [Section 82 (1), of the Insurance Supervision Law].

If the technical reserves of an insurance company are not adequately represented by qualifying investment the insurance supervisory authority may limit or prohibit free disposition of the assets of the company [Section 81*b* (4), of the Insurance Supervision Law]. The same applies if an insurance company does not establish adequate technical reserves.

The Insurance Supervision Law contains additional rules permitting the insurance supervisory authority to interfere in certain specific cases. Under certain conditions it is entitled to appoint a special commissioner [Section 81 (2*a*), of the Insurance Supervision Law] and to transfer to him all rights which the company bodies dispose of by law or under the articles of association, to withdraw the authorisation to do business either fully or partly in very severe cases [Section 87 of the Insurance Supervision Law] and to require changes to be made in existing contracts [Section 89, of the Insurance Supervision Law]. In case of withdrawal of the authorisation the insurance supervisory authority may take all suitable measures to safeguard the interests of the insured, in particular limit or prohibit free disposition of the assets of the company and entrust qualified persons with the management of the assets [Section 87 (4), of the Insurance Supervision Law].

Moreover, the insurance supervisory authority may give any orders which are appropriate and necessary to prevent or remedy any irregularities endangering the interests of the insured. An irregularity is in particular non-compliance with legal or supervisory provisions applicable to insurance [Section 81 (2), of the Insurance Supervision Law].

To avoid serious interference with a company's freedom to take decisions, as mentioned above, attempts are being made within the framework of on-going supervision to prevent any situations which would require such measures to be taken beforehand.

To prevent restoration measures from being endangered by third parties (such as creditors of the insurance company), only the insurance supervisory authority is entitled to file a petition for the institution of insolvency proceedings [Section 88 (1), of the Insurance Supervision Law]. In case of insolvency or over indebtedness, the board of directors of an insurance company must inform the insurance supervisory authority accordingly which will examine whether insolvency proceedings can be avoided in the interest of the insured and take the necessary action [Section 88 (2) and Section 89 of the Insurance Supervision Law]. All kinds of payments, especially of benefits, participations in profits and, in the case of life insurance, surrender values or policy loans and advances on policies may be temporarily prohibited [Section 89 (1), second sentence of the Insurance Supervision Law]. Under certain conditions the insurance supervisory authority may reduce the liabilities of a life insurance company under its insurance policies [Section 89 (2), first sentence of the Insurance Supervision Law].

GREECE

I Solvency of insurance undertakings

A. Regulations concerning the solvency

The insurance business derived through direct insurance in Greece and their financial supervision (solvency) are regulated by the Decree Law 400/1970 "About the Private Insurance Undertaking " as it is valid today, as well as by ministerial resolutions which have been issued in compliance with this Law.

B. Supervision - Focus

The supervision for the solvency of the insurance undertakings which have their head office in Greece as well as of the branches of insurance undertakings which have their head office outside Greece (seat of the head office in a Third country, outside of the countries of the European Union and the European Economic Area) is practiced by the Direction of Insurance Undertakings and Actuarial Studies of the Ministry of Development, and has the following objectives:

- the maintenance of the solvency and the safeguard of the assets of the insurance undertakings in order to counteract the insurance liabilities.
- the creation of conditions of sound competition.

These objectives are accomplished through control procedures, which start from the establishing of the insurance undertaking and are kept during the whole duration of its operation.

Main requirements are:

- a high level of honesty and professional capability from the part of the administrators.
- high share capitals.
- adequate technical reserves (technical provisions).

The provisions concerning the establishing of an insurance undertaking are fully harmonized with the provisions of the directives 73/239/EC, 79/267/EC, 92/49/EC, 92/96/EEC, and it is required that a share capital on establishing exists, which cannot be lower than the Minimum Guarantee Fund, which amounts to:

- EURO 1.200.000 if the undertaking exercises one or more of the classes 10 to 15.
- EURO 600.000 if the undertaking exercises one or more of the classes 1 to 8 and 16 and 18.
- EURO 400.000 if the undertaking exercises one or more of the classes 9 or or/and 17.
- EURO 1.600.000 if the undertaking exercises the life branch.
- EURO 1.400.000 if the undertaking exercises the credit class.

The branches of insurance undertakings which have their head office in countries outside the European Union and European Economic Area have to dispose of a Guarantee Fund, which amounts to ½ of the above mentioned amounts.

2/3 of the above mentioned capitals or of the initial contributions must be paid up in cash.

The technical reserves and the assets that the insurance undertakings dispose of to cover these technical provisions are defined by the Law, so that the safeguard, the rentability and the liquidity of the investments is secured.

Besides the technical reserves, the insurance undertakings are obliged to dispose of Solvency Margin, which corresponds to the free assets of the insurance undertaking.

The provisions about the technical reserves and the Solvency Margin are fully harmonized with the provisions of the directives 73/239 /EC, 79/267/EC, 92/49/EC, 92/96/EC AND 91/674/EC, with the reservation of the limits of the Minimum Guarantee Funds, which have been foreseen by the Greek legislation (double or triple of the Minimum Guarantee Funds, which are foreseen by the directives) as mentioned above.

II Practical organization of the supervision

In order to figure out the compliance by the insurance undertakings with the provisions of the Decree Law 400/1970, which refer to the Solvency Margin, the Guarantee Fund and the formation of the technical reserves as well as their investment, the Insurance Supervisory Authority (Direction of Insurance Undertakings and Actuarial Studies) continues to carry out obligatory control of their financial situation at least once a year.

In order to achieve this the Ministry of Development has defined samples of reports, on the basis which the insurance undertakings, which have their head office in Greece and the branches of insurance undertakings which have their head office outside the European Union and the European Economic Area send to the Ministry of Development (Greek Insurance Supervisory Authority), until the 30.6. of each year for the annual control, the reports on the formation of technical provisions and insurance disposal (Ministerial Resolution k4-2846/16.8.87 as it has been amended by the Ministerial Resolution k4-552/3/3/88) and on the Solvency Margin (Ministerial Resolution k3-8327/3.7.2000).

On the basis of the balance sheet for every financial year and the above mentioned reports it is controlled whether and how far the formation of the technical reserves, the investment of the assets representing these reserves as well as the Solvency Margin are exercised according to the provisions of the law.

More specifically there will be controlled: the height of the investments, the mode of their valuation and how far the assets which are disposed are kept according to the restrictions and the percentages which the valid provisions allow.

The procedure of this control can also be exercised during the financial year if it will be necessary because of serious problems, which occur in the undertaking.

Also, when necessary, the Supervisory Authority may demand any element or carry out on-the-spot investigations at the undertaking's premises.

During the first three financial years each insurance undertaking is obliged to submit to the Ministry of Development every six months brief financial statements for the control of the financial situation in relation to the submitted scheme of activities.

On completion of 12 months since the date of granting the license of operation the insurance undertaking is obliged to dispose of assets in insurance deposit as the Law determines, regardless of whether the official financial statement closes with a duration of more than 12 months.

III Measures which are foreseen when difficulties arise

If the own capitals of an insurance undertaking are less than the necessary Solvency Margin, the insurance undertaking is obliged to submit a plan for financial restoration.

If the own capitals of an insurance undertaking are less than either the Guarantee Fund, which the insurance undertaking must dispose or the Minimum Guarantee Fund, the insurance undertaking is obliged to submit to the Supervisory Authority for approval a short term financing scheme in order to complete such an efficiency immediately.

Until this completion the Minister of Development can prohibit the free disposal of the whole or a part of the assets belonging to the insurance undertaking according to the article 9 par. 2 and 3 of the Decree Law 400/1970 and take any appropriate measure to safeguard the interests of the insured persons.

Article 9 par. 2 and 3 of the Decree Law 400/1970 also applies in urgent cases if the Minister of Development is of the opinion that the financial situation of the undertaking will be worse.

In the case that the insurance undertaking violates the provisions about formation of technical reserves and investment of the corresponding assets, the Supervisory Authority, after it has exhausted all time limits allowed, imposes fines, starts the procedure of criminal prosecution against the responsible persons of the administration, and if the insurance undertaking still does not comply with the legislative provisions the Supervisory Authority withdraws the authorization for operation of insurance business.

The Minister of Development may withdraw the authorization for all classes operated by the insurance undertaking if it fails to comply with the measures contained in the restoration plan or short term finance scheme for the Solvency Margin.

After the withdrawal of the authorization of operation because of violations of the provisions of the law, the insurance undertaking is set under the stage of insurance liquidation and a Supervisor is appointed by the Ministry of Development, so that the insured persons and the beneficiaries can be satisfied in the best manner.

HUNGARY

I Regulation concerning the supervision of solvency:

According to the Insurance Act (Act XCVI of 1995 on Insurance Institutions and Insurance Activities) one can only form a life or a non-life company. For composite companies (founded before the Act came in force) the capital requirements of life and non-life branch should be added together. The calculation of the minimum level of solvency capital requirement complies with the EU model (as specified below).

A. Solvency margin

Solvency Capital of the Insurer

The solvency capital is the equity of the insurer to fulfil the obligations, if the premiums collected and the insurance reserves do not provide cover for that.

In order to be able to fulfil the obligations of the insurer arising from insurance contracts at any time, insurers shall possess a minimum solvency capital (solvency) corresponding to the size of business activities they pursue.

Elements of the Solvency Capital

The equity of the insurer shall be reduced by the following, when the solvency capital is established:

a) book-value of intangible assets,

b) book-value of a share in another insurer,

c) value of own shares repurchased in the case of a joint-stock company.

The calculation and the statement of cover of the minimum solvency capital shall be completed and sent to the Supervision by 31 March of the year following the subject year.

In case the solvency capital of the insurer does not reach the amount of minimum solvency capital, the termination of the shortage of solvency capital shall precede the satisfaction of the shareholders' and the members' demand.

Guarantee Fund

One-third of the minimum solvency capital shall constitute the guarantee fund of the insurer, in case it is higher than the value of the minimum guarantee fund specified below. The guarantee fund of the insurer shall be otherwise equal to the minimum guarantee fund.

The *minimum guarantee fund* of the company limited by shares shall be as follows:

a) two hundred and fifty million forints in the case of the life insurance branch (see below the classification of branches and sections)

b) non-life insurance branch:

    1. one hundred and fifty million forints for sections 9 to 17,
    2. two hundred and twenty million forints for sections 1 to 8 and 16 and 18,
    3. three hundred million forints for sections 10 to 13 and 15, as well as 14, in case the premium revenues of section 14 remain less than one thousand million forints or four per cent of the total premium revenues of the insurer,
    4. three hundred and fifty million forints for section 14, if the premium revenues of the section exceed one thousand million forints or four per cent of the total premium revenues of the insurer.

In the case of co-operatives, the minimum guarantee fund shall be seventy-five per cent of the specified values.

In the case of associations, the minimum guarantee fund shall be as follows, if in three consecutive years the annual premium revenues:

a) do not exceed fifty million forints, furthermore, in the case of associations commencing their activities: ten million forints,

b) exceed fifty million forints, but do not exceed seventy-five million forints: fifteen million forints,

c) exceed seventy-five million forints, but do not exceed one hundred million forints: twenty million forints,

d) exceed one hundred million forints: at least thirty million forints.

The minimum guarantee fund of specialised insurance associations shall reach the expected one-year amount of the obligation of providing services laid down in the statutes, but at least five hundred thousand forints.

If an insurer operates several non-life insurance sections, it shall possess the highest of the minimum guarantee fund values prescribed for the various insurance sections.

The requirements for minimum guarantee fund, determined by insurance sections, shall be added up, if an insurer operates life and non-life insurance branches jointly.

Classification of the Non-Life Insurance Branch per Sections

1. *Accident*
2. *Diseases*
3. *All damage to or loss of land vehicles*
4. *All damage to or loss of vehicles attached to rails*
5. *All damage to or loss of aircraft*
6. *All damage to or loss of marine, lake and river vehicles*
7. *Cargo*
8. *Fire damage and damage through disaster*
9. *Other damage to property*
10. *Liability connected with self-propelled land vehicles*
11. *Liability connected with aircraft*
12. *Liability connected with marine, lake and river vehicles*
13. *General liability*
14. *Credit*
15. *Suretyship and guaranty*
16. *Miscellaneous financial losses*
17. *Legal protection*
18. *Assistance*

Risk Classification per Sections of the Insurance Branch of Life Type

1. *Life insurance*
2. *Marriage insurance, birth insurance.*
3. *Life insurance attached to investment (unit linked policies.*
4. *Transactions related to capitalisation contracts.*

Calculation of the minimum solvency capital

Non-life insurance

The calculation rules are based on the Article 16 of the First Non-life Insurance Directive (73/239/EEC).

Life insurance

The calculation rules for life insurance follow Article 19 of the First Life Insurance Directive (79/267/EEC).

B. Technical provisions

In the interest of the safety of business, insurers shall form insurance reserves with regard to the fulfilment of the expected obligations existing on the balance-sheet date, the fluctuation of claims, the expected insurance losses, as well as premiums not earned by service.

The following shall qualify as insurance reserves:

a) unearned premium reserves;

b) mathematical reserves, including:

    1. life insurance reserves,
    2. reserves for health insurance,
    3. reserves for accident insurance annuities,
    4. reserves for third party liability insurance annuities,

c) reserves for outstanding claims, including:

    1. reserves for claims incurred and reported (itemised reserve for pending claims),
    2. reserves for claims incurred but not reported (IBNR),

d) reserves for premium refunds depending on profit,

e) reserves for premium refunds independent from profit,

f) loss fluctuation reserve,

g) reserves for major losses,

h) reserves for lapses,

i) other insurance reserves.

Insurers shall form insurance reserves to an extent that they provide a foreseeable cover, on the basis of reasonableness and the experience of insurance activities, to fulfil continuously and permanently the obligations of insurers arising from risks not transferred to reinsurance. In the case of life insurance, with the exception of the net risk life insurance and the risk part of insurance also containing death risk, insurance reserves shall also be formed with regard to risks transferred to reinsurance.

In the case of co-insurance, the parties taking part in co-insurance shall form the insurance reserves to an extent corresponding to their obligations arising from risk assumption.

Formation of technical provisions

Insurance reserves shall be formed by sections on the balance-sheet date.

The assets cover of mathematical reserves expected by the end of the year shall be established continuously, but at least quarterly, taking into account foreseeable obligations, and shall be maintained continuously, in order that an assets cover of the same size as the reserves required, complying with the regulations on investment, be available to the insurer by the end of the year.

Rules of Investment

The assets of the insurer shall be invested, taking into account the organisational form of the insurer and the insurance branch operated, in a manner that the investments meet the conditions of the highest possible security and profitability by simultaneously maintaining the liquidity of the insurer at any time.

In the interest of safe investment, the insurer shall simultaneously select several forms of investment, and shall also endeavour to reduce investment risk within the given form of investment, by dividing investment risks.

1) The insurer shall immediately report it to the Supervision, if it acquires an ownership share in another undertaking in excess of ten per cent of its own issued capital (proprietary share capital, initial capital).
2) The share of an insurer in another company limited by shares may not reach seventy-five per cent of the issued capital of the company limited by shares, except for the share in another insurer.
3) When the assets representing the insurance reserves and the minimum solvency capital are invested, the share of the insurer in another undertaking may not exceed twenty-five per cent of the issued capital of the given undertaking.
4) Insurers may not invest their assets serving as cover for mathematical reserves in an undertaking of the owner with influencing share, which does not carry out insurance activities, unless its activities are directly connected to the activities of the insurer at least at the rate of seventy-five per cent.
5) The investment restrictions prescribed in subsections (1) to (3) shall not apply to the undertakings serving the transfer of the own activities of the insurer, in case at least seventy-five per cent of the activities of the undertaking is carried out for the insurer.

6) The share of an insurer lower than the minimum level of the influencing share in another insurer shall be reported to the Supervision within thirty days reckoned from the transaction.

7) The assets covering the insurance reserves and the minimum solvency capital of an insurer may only be invested in Hungary, except for the acquisition of the ownership share, amounting to at least ten per cent, of an insurer based abroad or an economic association based abroad carrying out insurance broker's activities, if the equity of the insurer and the ownership shares of the owners of the insurer reach jointly at least the same level.

The insurance reserves and the guarantee fund of the insurer may be kept in the following assets:

a) state bonds, with terms up to one year and any securities, with terms up to one year, where the state undertakes joint and several suretyship for the fulfilment of the obligations contained therein, and which are qualified by the National Bank of Hungary (hereinafter: MNB) as domestic securities negotiable by the central bank,

b) state bonds, which expire after more than one year, and/or all securities, which expire after more than one year, where the state assumes joint and several suretyship for the fulfilment of the obligation contained therein, and which are qualified by MNB as securities, negotiable by the central bank,

c) domestic securities issued by Hungarian National Bank,

d) sum of money locked up in a deposit account with a financial institution, or securities issued by a financial institution and documents representing credit relationship,

e) shares listed on the Stock Exchange,

f) shares unlisted on the Stock Exchange,

g) securities issued by economic organisations,

h) securities issued by local governments,

i) securities issued by the pension plan and health insurance self-governments,

j) securities issued by public utilities,

k) investment units issued by securities funds,

l) real estates, investment units issued by or real estate funds,

m) life insurance policy loan extended to the insured,

n) mortgage bond specified in a separate legal rule,

o) cash, sum of money deposited in an account.

At least thirty per cent of the sum of the liquid assets serving as cover for the mathematical reserve and the guarantee fund shall be invested in the assets defined in paragraphs 1, 2 and 3.

Insurance companies may hold not more than twenty-five per cent of assets of their mathematical reserves and secondary reserves in investments specified under paragraphs 4 and 14, not more than twenty per cent thereof in investments specified under paragraph 12, not more than ten per cent thereof in each investment specified under paragraphs 5, 7, 9, and 10, and not more than five per cent thereof in each investment specified under paragraphs 6, 8 and 11.

Upon a licence from the Supervision, insurers may deviate, in justified cases, from the forms and proportions of investment.

In case the value of liabilities of an insurer arising from credit relationship is in excess of five per cent of its issued capital (proprietary share capital, initial capital), the insurer shall report its major characteristics to the Supervision without delay.

Insurers shall draw up reports during the year, quarterly, on the amount of their mathematical reserves and its investment, and send it to the Supervision by the last day of the month following the subject quarter, with the report on the fourth quarter, by 31 March of the year following the subject year.

II Practical organisation of supervision

There have been major changes in the system of insurance supervision recently. On the 1st of April 2000 an act came into force on the new supervisory authority - the State Supervision of Financial Institutions (hereinafter: Supervision).

This authority now integrates the:

- State Supervisory Authority of Insurance - responsible for insurance activities and insurance institutions,
- Banking and Capital Market Supervision - responsible for banking capital market activities and institutions,
- State Private Funds Supervision - responsible for private pension funds system.

The new Supervision is an independent central office, under the guidance of the Government, and under the supervision of the Minister of Finance.

The main structure of the Supervision is based on its types of duties. There are 4 directory dealing with:

- controlling, inspections,

- licensing procedures and other legal issues,
- economic, analytical and actuarial matters,
- consumers' cases, claims.

The rules regarding the system of Supervision's procedure, based on the Act XCVI of 1995 on insurance institutions and insurance activities have not changed yet. The draft bill modifying the Insurance Act is under discussion.

III Measures when difficulties arise

A. Withdrawal of the Activity Licence

The licence issued for the pursuance of insurance activities may only be withdrawn fully or partially, if an insurer:

a) fails to commence its insurance activities within twelve months reckoned from the date of issue of the licence, or suspends its insurance activities for a period in excess of six months,

b) repeatedly and seriously violates the legal rules applicable to insurance activities, and other measures were unsuccessful.

No new contract may be concluded following the withdrawal of the licence, the obligations undertaken by the insurer in existing contracts may not be increased and the contracts may not be extended.

Following the withdrawal of the licence, the Supervision shall take all measures, which serve to protect the interests of the insured. Thus, it may particularly restrict or prohibit the free disposal over the assets of the insurer, and may appoint a supervising agent to manage the assets of the insurer for a definite period of time. The rules applicable to the supervision commissioner shall govern the person, the competence and the remuneration of the supervising agent.

The interest representation organ concerned shall be consulted prior to the full or partial withdrawal of the activity licence of insurers, insurance brokers and insurance consultants.

Following the withdrawal of the licence, the Supervision shall inform thereof the supervisory authority of the country of the owner having influencing share, and the withdrawal shall be published in the official gazette.

B. Portfolio Transfer

The insurance portfolio may be partly or fully transferred on the basis of an agreement concluded by the transferor and the recipient, with the licence of the Supervision, leaving the terms and conditions of insurance contracts unchanged. The rules of the Civil Code applicable to debt assumption shall apply in the course of portfolio transfer, with the difference that the agreement of the insured, contracting parties is not required for portfolio transfer. As a result of portfolio transfer, the insurer which takes over the insurance portfolio will become the subject of the contract as of the date of the licence of the Supervision.

With the licence of the Supervision and by observing the provisions of legal rules on foreign exchange, insurers registered in Hungary may take over insurance contract portfolios from insurers registered abroad. This shall not affect the obligation of observing legal rules on foreign exchange.

The application for licensing portfolio transfer shall contain:

a) an exact description and the contractual conditions of the portfolio to be transferred,

b) legal declarations made by the transferor and the recipient in respect of the transfer and receipt of the portfolio,

c) an indication of the insurance reserves and their cover connected to the portfolio to be transferred,

d) date and consideration for the transfer of the portfolio,

e) certification that the minimum solvency capital required for the portfolio received is available to the receiving insurer in addition to the minimum solvency capital required for its own portfolio.

The insurer receiving the portfolio of contracts shall, within thirty days reckoned from the date of receipt of the licensing decision, inform in writing all concerned contracting parties and insured about the transfer. The contracting parties and the insured may terminate their contracts, with a period of notice of thirty days, on the basis of a written declaration submitted to the receiving insurer within thirty days reckoned from the date of receipt of the notice.

The rules applicable to portfolio transfer shall apply to the union, merger and splitting up of insurers, in respect of the obligation of notification and the right of termination by notice.

C. Supervision Fine

The Supervision may oblige the insurers, chief executive officers of insurers, insurance brokers and insurance consultants, and/or the heads of insurance brokers and insurance consulting activities to pay a supervision fine, if they

1. violate the provisions of this Act or other legal rules applicable to insurance activities,
2. fail to fulfil, or fail to fulfil in time the provisions prescribed in the decision of the Supervision, or
3. fail to fulfil their data supply or hearing obligation ordered by the Supervision.

The fine may also be imposed repeatedly, and may be applied together with the other measures defined in this Act.

No fine may be imposed after six months reckoned from the date when the negligence or breach of duty came to the knowledge of the Supervision, or after two years reckoned from the date it was committed, or if the failure or breach of duty qualifies as a crime.

Section 129

The amount of the fine shall be determined with consideration to the weight of deviation from the conditions prescribed in this Act, in other legal rules applicable to insurance activities and in the decisions made by the Supervision, furthermore, of the negligence or breach of duty.

The amount of the fine, which may be imposed to the debit of insurers, insurance brokers and insurance consultants may range from five hundred thousand to ten million forints.

The amount of the fine, which may be imposed to the debit of the chief executive officer of the insurer, and the head of insurance broker's and insurance consulting activities may range from one hundred thousand forints to one million forints.

For the purposes of subsection (1), the following shall particularly be considered as serious breach of obligations contained in this Act:

a) disclosure of any untrue piece of information or declaration in any application for a licence or notification,

b) distribution of a product violating legal rules,

c) performance without licence of an activity subject to licence, or in the case where an insurer or insurance broker carries out activities, which are not directly connected to the insurance or insurance broker's activities.

Section 130

The fine shall be paid to the account indicated in the decision within fifteen days following the becoming non-appealable of the decision made on its imposition. The amount received in the above manner shall be used to increase the standard of insurance culture, to train insurance professionals and to support the preparation and the publishing of notes and studies related to the insurance profession.

D. Reorganisation Plan

In case the solvency capital of an insurer is less than the minimum solvency capital specified in Schedule No. 5, and no resolution was adopted by the General Meeting on the scheduling of replenishment not exceeding two years, the Supervision may oblige the insurer to prepare a reorganisation plan in order to supplement the cover of minimum solvency capital required.

The reorganisation plan, which may not extend to more than two years, shall contain the manner and pace of terminating the shortage. The reorganisation plan shall be submitted to the Supervision for approval, within ninety days reckoned from the date of receipt of the decision of the Supervision. This deadline may be extended by thirty days in particularly justified cases.

The Supervision shall decide, within sixty days reckoned from the submission of the reorganisation plan, whether the reorganisation plan is suitable for terminating the solvency capital shortage of the insurer.

In the case of rejecting the reorganisation plan, or if its implementation fails, the Supervision is entitled to take the measures contained in Section 143, subsection (2).

E. Financial Plan

Section 83

The Supervision shall oblige the insurer to prepare a financial plan, if

a) the solvency capital of the insurer does not reach the prescribed amount of the security capital, or

b) the insurance reserves of the insurer do not reach the necessary level, or if the cover for the insurance reserves is not satisfactory.

The financial plan shall contain measures for not more than a half-year period for terminating the reserve and/or security capital shortage of the insurer. The insurer shall submit the financial plan to the Supervision for approval, within thirty days reckoned from the date of receipt of the decision of the Supervision.

The Supervision shall decide, within thirty days reckoned from the submission of the financial plan, whether the financial plan is suitable for terminating the security capital and/or reserve shortage of the insurer.

In the case of rejecting the financial plan, or if its implementation fails, the Supervision is entitled to take the measures contained in Section 126, subsection (1), paragraph e) and in Section 143, subsection (2).

F. *Supervising commissioner*

Section 116

A supervision commissioner shall be appointed in case of emergency, as specified in Section 143, subsection (1).

The supervision commissioner shall be appointed and recalled by the president of the Supervision. A supervision commissioner may be appointed for not more than ninety days, but this period of time may be extended until a liquidator is appointed [Section 146, subsection (3)].

In the case of liquidation proceedings, the mandate of the supervision commissioner shall extend until the liquidator is appointed.

The responsibilities of the supervision commissioner shall be defined in his letter of commission.

The legal status of the supervision commissioner and the chief executive officer of the insurer shall be provided for simultaneously with the appointment of the supervision commissioner, and the owners (members) having influencing share shall also be informed about the appointment.

The president of the Supervision may suspend the mandate of the chief executive officer of the insurer for the period of the mandate of the supervision commissioner. In case the mandate of the chief executive officer is suspended, the supervision commissioner shall act within the competence of the chief executive officer of the insurer.

In case the mandate of the chief executive officer is not suspended, his decisions shall only be valid if they are countersigned by the supervision commissioner.

The supervision commissioner shall declare in writing upon his appointment the type and the magnitude of the face or market value represented by the ownership share owned by him or his close relative in any insurer, insurance broker or any company pursuing insurance consulting activities.

ICELAND

Iceland is part of the European single market for insurance and has in its legislation adopted the EU solvency system for insurers. The relevant legal acts are mainly the EEA (European Economic Area) agreement that binds Iceland to adopt the EU insurance directives and, in national legislation, the Law on Insurance Activity No. 60/1994 with later amendments and regulations based on that law. This law transposes the EU provisions into national legislation as well as laying down provisions on aspects that are not harmonized at the EEA level.

The EU solvency rules are implemented directly as far as domestic insurers are concerned. The rules apply to reinsurers as well as to direct insurance companies, thus extending their scope from the directives. Insurers from other EEA countries can operate in Iceland as the single market provides for. No third country (i.e. outside the EEA) direct insurers operate in Iceland, but their activity would be governed by an EEA adaptation of the corresponding EU rules.

Among the regulations based on the law on insurance activity mentioned above is Regulation No. 494/1997 concerning assets which may be included in the solvency margin of insurance companies and the calculation of minimum solvency margin. It explicitly states that in addition to deductions from own capital provided for in the EU solvency rules, likely reductions of the solvency in the next three years shall be deducted right away.

While the annual accounts are a statement of the board of the insurance company concerned, the solvency calculation is made by the supervisory authority. It uses the annual accounts as a starting point together with detailed reports from the insurer and any additional data from the company that the supervisor deems of relevance. The supervisory authority may then make its own assessments of individual items, thus leading to an eventual decrease (or increase) of the initial solvency estimation provided by the insurance company itself.

Normal recovery measures in the past have been to transfer the portfolio of the company in question to another domestic insurer, leading to either the merger of the two or the winding-up of the troubled company. The role of the supervisor in such cases has mostly been to underline that problems are at hand and action must be taken. The company itself then negotiates a solution with another insurer. In the past decade, the supervisor has never been obliged to remove power from the board of an insurance company. No direct insurer has gone bankrupt since official supervision of insurance companies started in 1974.

IRELAND

I Regulations governing the supervision of solvency

The basic objective of financial supervision of insurance companies in Ireland is that of ensuring that insurers firstly maintain sufficient assets to cover their liabilities to policyholders and secondly, meet the minimum solvency margin requirements specified in the EC directives. In order to achieve this, insurers are required effectively to maintain solvency at three levels in the following descending order.

A. Underwriting liabilities and equivalent assets

The most basic layer of solvency of an insurer is the ability to cover its policyholder liabilities with equivalent and matching assets. Matching in this sense means that the assets backing the underwriting liabilities should be denominated in the currency of the underwriting liabilities. The amount of the reserves required to meet these policyholder liabilities is determined, in general, by the State where the undertaking carries on business. Another important feature is the necessity for an insurer to hold assets backing policyholder liabilities in categories, which are approved categories. There are also rules, which determine the maximum levels of policyholder liabilities, which certain assets represent. In this context, insurers must exercise care that they achieve the necessary spread of assets.

In the context of EC insurance undertakings, the third generation of directives, which were transposed into Irish law in December 1994, while they do not harmonise Member States' regulations in relation to the nature, spread and valuation of assets representing the insurance liabilities do lay down rules which:

- confine the list of acceptable assets to certain categories ;
- specify the maximum amount of insurance liabilities certain assets may represent; and
- set out the guiding principles to be followed in the valuation of assets.

The mutual recognition is very important in the context of the third generation EC Directives where the establishment of reserves will be solely under the control of the home Member State. (The "home Member State" is the Community State in which the insurance undertaking’s head office is located).

The assets acceptable as cover for the liabilities include shares, debt securities, bonds, bank deposits and property.

B. Minimum guarantee fund

The intermediate layer of solvency required of insurers is the minimum guarantee fund, which, subject to certain minimum limits, is equivalent to one third of the solvency margin. The minimum guarantee fund for non-life insurance business ranges from Euro 200,000 to 1,400,000 depending on the risks covered, whereas, for life insurance it is Euro 800,000.

C. Solvency margin

The final and ultimate measurement of an insurance company’s financial health is the requirement that it maintain a solvency margin, which, in effect is an excess of free assets over liabilities. The minimum margins of solvency are calculated differently for life and non-life business. For non-life insurers, the method of calculation of the solvency margin is set down in Article 16 of the First Non-Life Directive (73/239/EC).

There are two methods of calculation – the Premiums and Claims Basis. The Premiums Basis is calculated by reference to the volume of gross premiums written in a financial year while the Claims Basis is calculated by reference to the average burden of claims occurred over a three-year period. The solvency margin to be maintained is the higher of the two calculations. The minimum margin on the premium basis is 16 per cent of gross annual premium income or, if greater, 23 per cent of the annual claims.

For life business, the method of calculation is set down in the First Life Directive No 79/267/EC. The minimum solvency margin requirement for life business is equivalent to between 0.1 per cent and 0.3 per cent of capital at risk.

II The practical organisation of supervision

The Supervisory Authority requires each authorised insurance company to file audited returns on an annual basis. For newly authorised companies inaudited accounts are required at more frequent intervals (*i.e*. quarterly or biannually) for at least the first three years of operation. The type of accounts which are required include a Revenue account which provides information on the levels of premium written; cost of claims; commission levels and, in the case of non-life the underwriting result for each class of business. Balance Sheet, Profit and Loss account, asset valuation form and statement of solvency margin are also required.

Upon receipt of the accounts, the Supervisory Authority examines in detail the set of accounts presented with particular regard to the level of reserves set up, the cost of claims and the level of management expenses. These analyses provide the basic indicators from which decisions can be taken on the need for follow-up for instance on inadequate reserves or reserving methodology with the company concerned. Having examined the adequacy of the reserves required by a company, the nature and acceptability of the assets put forward to meet these liabilities are then examined. The basis of this examination is to see that the range of assets included are soundly based and that their spread is sufficiently prudent in the light of the claims likely to be made on the insurer.

The second level in the supervisory mechanism relates to the solvency margin requirement. The solvency margin is calculated by reference to the company's total business wherever this is conducted. Under EC Directives, responsibility for the verification of the solvency margin rests with the supervisory authority in whose territory the Head Office is located. Having identified the level of solvency margin to be established, the Supervisory Authority then examines the adequacy and acceptability of the assets available to the company to meet this requirement. This can be monitored both by analysing the movement of assets and liabilities within the Balance Sheet and Profit and Loss Account and also through the use of asset analysis returns whereby it is possible to establish the appropriate value of total assets held and then to match these assets to the technical reserve requirement, the current liabilities and the solvency margin requirement itself.

III Recovery measures

Failure to maintain the required solvency margin results in an undertaking being required to submit a plan for the restoration of a sound financial position to the supervisory authority of the Head Office for approval. If the solvency margin falls below the level of the minimum Guarantee Fund (defined as being equal to one-third of the solvency margin) an undertaking is required to submit a short-term finance scheme for approval. Failure to restore the solvency margin within the time allowed may result in an undertaking's authorisation being withdrawn.

The Supervisory Authority also has powers under the 1989 Insurance Act to intervene in cases of doubtful solvency. The powers vested in the Supervisory Authority include a right to give direction to an insurer to refrain from taking on new business; to limit premium income to a set amount; to refrain from making investments in specified timeframe; to maintain in the sate assets of a value equal to the whole or a specified amount of its liabilities in the State.

ITALY

The solvency of the Italian insurance industry is supervised by ISVAP, the supervisory authority instituted by Act No. 576 of 1982, as amended in 1998 by Legislative Decree No. 373, which extended the authority’s scope of action by transferring a number of powers previously vested in the Ministry of Industry.

The measures taken to ensure the solvency of insurance undertakings are summarised below.

I Regulations concerning the supervision of solvency

A. Authorisation to engage in the insurance business, or to branch out into other classes of insurance

In order to engage in the insurance business, a company headquartered in Italy must be licensed by ISVAP, which assesses the firm’s position, looking at its administrative and accounting operations as well as technical aspects.

First, the supervisory authority checks that a company meets capital adequacy requirements and that the amount of its organisation fund is not below the regulatory minimum for the industry.

The following are also examined: the company’s instrument of incorporation and statutes, the list of directors, legal representatives, general managers and natural or legal persons directly or indirectly holding a controlling interest in the firm, or interests exceeding specified thresholds. Such persons must prove that they meet the requisite "fit and proper" conditions.

Special scrutiny is given to the business plan, which must indicate the risks that the company intends to cover, reinsurance criteria, the assets constituting the authorised capital, projected start-up costs, overheads and premium revenues, along with the financing needed to meet commitments and cover the solvency margin. The business plan must be accompanied by a technical annex setting forth the criteria used to formulate it.

In order to get the scope of its licence extended, a firm must prove that its capital is fully paid-up and that it is in compliance with requirements regarding its solvency margin and technical provisions.

Requests for licence extensions must be accompanied by the most recent approved balance sheet and a business plan in respect of the classes for which the licensing extension is being sought.

B. Solvency margin

Insurers must have solvency margins that cover all of their operations both in Italy and abroad. Industry regulations impose highly detailed criteria for setting and calculating a company's minimum required solvency margin. In any event, one-third of the minimum solvency margin, i.e. the guarantee fund, must not be less than EUR 800 000.

If the minimum solvency margin is not met, the company is asked to submit a recovery plan; if the margin falls below the guarantee fund, the firm is required to submit a short-term financing plan. Such plans must outline all of the steps the company intends to take to restore its assets and its financial position.

In either of these cases of insolvency, ISVAP may deny the firm free access to its assets within Italy. Any such prohibition must be notified to the competent authorities of any other Member States of the European Union in which the company does business or possesses assets.

C. Technical provisions

In line with the rules established under Community directives, ISVAP has enacted measures governing the valuation of assets backing technical provisions, ceilings and investment criteria.

Every three months, companies must file a prospectus, prepared in accordance with ISVAP directives, reporting on the assets that cover their technical provisions.

If a firm does not comply with the requirements for technical provisions, it is invited to do so and may also be denied free access to its assets within Italy. Any such prohibition must be notified to the competent authorities of any other Member States of the European Union in which the company does business. ISVAP can also request that foreign authorities take similar measures in respect of company assets located within their jurisdictions.

Lastly, if a company fails to comply with ISVAP's recommendations, it may be barred from writing new business.

II Practical organisation of supervision

A. Analysis of annual balance sheets and interim reporting data

Another fundamental aspect of the supervisory authority's supervision of insurer solvency is its analysis of company balance sheets, including reports by a firm's auditing firms and actuaries, and of interim reporting data.

ISVAP conducts an initial review of the balance sheets of non-life companies using 18 indicators, for each of which an acceptable interval has been set, making it possible to assess the circumstances of each firm quickly and objectively. This assessment lays the groundwork for subsequent further exploration, though special requests and, if needed, on-site inspections.

These indicators include: the ratio of annual earnings to premiums, the solvency index, ordinary and extraordinary profitability, the ratio of liquidity to direct insurance technical provisions and, more particularly in respect of the balance sheets of companies that write motor liability insurance, the ratio of such premiums to aggregate premiums, the rapidity of current-year claims settlement (number of claims) and the rapidity of prior-year claims settlement (number of claims).

B. Inspections

If necessary, on-site inspections can be used to supplement the analysis of balance sheet materials and interim reporting data. Such audits are carried out at the headquarters or outlying facilities of life or non-life insurers, or at the offices of insurance intermediaries or other targets, some of which may not be authorised. Such inspections generally focus on:

- Specific aspects of underwriting (premiums, claims, reinsurance, main classes written);
- Corporate assets and financing aspects;
- Administrative and accounting procedures;
- Internal control procedures.

Inspections also seek to check compliance with regulations concerning money laundering.

III Measures to be taken when difficulties arise

A. Supervision of shareholders, shareholdings and intra-group transactions

Regulatory controls are imposed on shareholders, acquisitions of shareholdings in insurance undertakings and other companies, and on transactions involving transfers of assets between companies belonging to the same group, in order to preclude any erosion in the asset values of insurance undertakings by the controlling group to benefit its other businesses. Groups are also required to draw up consolidated balance sheets.

B. Recovery measures

ISVAP can adopt specific recovery measures for troubled insurers.

If, for example, a company's solvency margin or guarantee fund is insufficient, ISVAP requires that the firm submit a recovery plan or short-term financing plan, respectively, in order to restore it to financial health. If the firm fails to complete the recovery or financing plan within the time allotted in the approval order, its licence may be revoked, triggering a compulsory administrative liquidation procedure.

For the least serious irregularities, i.e. those that can be resolved without having to replace any corporate bodies, recovery measures can include the convening of a meeting of shareholders, the board of directors or any other administrative body.

However, "replacement" measures can include the appointment of an officer empowered to take any steps necessary, or the issuance of an extraordinary administration order. Extraordinary administration is imposed in the event of serious administrative irregularities or serious breaches of legal, regulatory or statutory provisions.

JAPAN

I Regulations concerning the supervision of solvency

A. Conservative reserving policy

To ensure sound operation of insurance business, the supervisory authority requires insurance companies to observe conservative reserving policy. Insurance companies are required to establish underwriting reserves to meet liabilities arising in the future. Under the standard underwriting reserves system, the reserve may not be less than the minimum amount of reserves calculated with the net level premium method (Article 116 of the Insurance Business Law, Article 68, 69, and 70 of the Ministerial Ordinance).

Additionally, life insurance companies are required to set aside contingency reserve against any risk likely to occur in the future, and non-life insurance companies are required to set aside catastrophe loss reserve in preparation for losses arising from a catastrophe (Article 69 and 70 of the Ministerial Ordinance).

Besides, it is regulated that insurance companies set aside price fluctuation reserve in preparation for losses in the event of future devaluation of assets (Article 115 of the Insurance Business Law), and that mutual companies set aside the reserve for loss compensation (Article 54 of the Insurance Business Law).

B. Solvency Margin Standard

In light of increase of risks with progress of deregulation and the intensification of competition in the insurance sector, the solvency margin standard was introduced as an index which indicates the capital adequacy of insurance companies to cover the risk beyond the normal estimates (Article 130 of the Insurance Business Law, Article 86, 87, 161, 162 and 190 of the Ministerial Ordinance).

The standard, or the solvency margin ratio, is calculated with the risk beyond the normal estimates quantified under given assumptions as the denominator, and the solvency margin composed of capital, funds, reserves, etc. which provide for the risk above as the numerator. It is considered appropriate when the ratio is above 200 per cent. The supervisory authority may take some measures if the ratio goes under 200 per cent (cf. III-A "Prompt Corrective Action").

C. Regulations on assets management

In order for insurance companies to diversify investment risks and secure liquidity of assets, regulations on the method of assets management, and restrictions on assets management are stated in Clause 2 of Article 97 of Insurance Business Law, and Article 47 and 48 of the Ministerial Ordinance. Under these regulations, insurance companies are required to submit a "Report on Assets Management" to the authority semi-annually (Article 128 of the Insurance Business Law).

D. Other Regulations

Licensing

Clause 1 of Article 3 of Insurance Business Law states that insurance business in Japan cannot be conducted without a license in order to protect policyholders. Moreover, Article 6 of the Law and Article 2 of the Ministerial Ordinance set the minimum amount of capital or aggregate foundation fund at 1 billion yen.

Restriction of carrying on other business and prohibition of carrying on both life and non-life insurance business

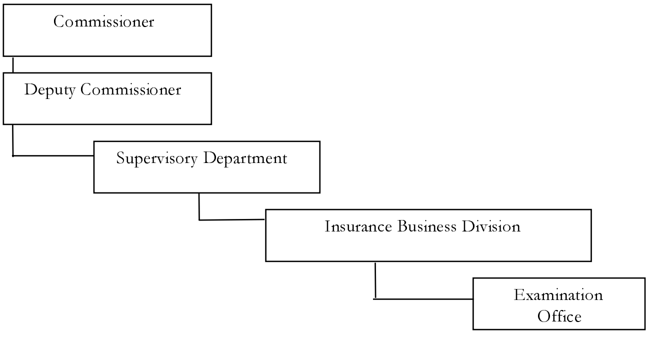
Article 100 of Insurance Business Law states restriction of pursuits of other business in order to protect policyholders in case of failing operation of other business. Clause 3 of Article 3 of the Law prohibits carrying on both life and non-life insurance business. For instance, a loss incurred by carrying on non-life insurance business should not be covered by a profit accrued by carrying on life insurance business.

Regulations on the scope of subsidiary of insurance company

An insurance company is prohibited to establish subsidiaries other than a life insurance company, a non-life insurance company, a bank, a securities company, a long-term credit bank, foreign insurance company, a foreign bank, a foreign securities company, a company engaging in subordinate business or financial services, a holding company, and a company investing a new business field (Article 106 of Insurance Business Law). With respect to the shares of general firm, an insurance company and/or its subsidiaries may not acquire or hold shares of more than 10 per cent in aggregate (Article 107 of Insurance Business Law).

II Practical organisation of the supervision

FINANCIAL SERVICES AGENCY (FSA)



III Measures taken when an insurance company is in a financially difficult condition

The Solvency Margin Ratio	**Measures**
200%~	-
100%~200%	The insurance company is to be ordered to submit and implement a management improvement plan.
0%~100%	The insurance company is to be ordered to carry out the following measures : 1. formation of a solvency increase plan and its execution, 2. restraint or prohibition on paying dividend, or on paying bonuses to members of a board of directors, 3. restraint or prohibition on paying dividend to policyholders, 4. changing of the assumed interest rate for new contract, 5. restraint on high-risk investment, 6. curtailment of the operational expense, 7. curtailment of business operation, 8. disposal of shares and subsidiaries, 9. others
~0%	The insurance company is to be ordered to suspend whole or a part of its business for a designated period of time.

A. Prompt Corrective Action

In order to secure sound and appropriate business operation of insurance companies and to protect policyholders, a measure called "Prompt Corrective Action" was introduced with the revision of Insurance Business Law in 1998.

Prompt Corrective Action shall be decided by following orders classified in accordance with the level of the solvency margin ratio of insurance companies (Article 132 of Insurance Business Law, Article 2 and 3 of the Ministerial Ordinance).

B. Measures taken for policyholders protection

If the supervisory authority considers that the continuation of insurance business by an insurance company is difficult in light of the condition of its business or its assets, or that the operation of its business is extremely inappropriate so that the continuation of the insurance business may lead to a situation where the protection of policyholders is lacking, the authority may: (1) order the insurance company to suspend its business in whole or in part, or to hold consultations concerning a merger, transfer of insurance contracts, or an acquisition of stocks of the failed insurance company by other insurers or an insurance holding company, (2) entrust an insurance administrator with the administration of the insurance company's business and assets (Article 241 of Insurance Business Law).

a) The supervisory authority must appoint one or a few insurance administrators and can order him to take necessary measures (Article 242 of Insurance Business Law).

b) The supervisory authority can order the insurance administrator to prepare a plan concerning the operation and the management of property of the failed insurance company, including a policy on consolidating and rationalising the operations of the failed insurance company. The plan needs to be approved by the authority. After the approval, the insurance administrator is required to carry out the plan without delay (Article 247 of Insurance Business Law).

c) The insurance administrator can require directors of the failed insurance company to report on its operation and property, and can conduct investigations of the failed insurance companies. Moreover, the insurance administrator is required to take necessary civil and criminal legal measures in order to clarify the responsibility of managers and former managers of the failed insurance company for its failure (Clause 2 and 4 of the Article 247 of the Insurance Business Law).

d) In the event of transfer of an insurance portfolio of all its insurance contracts, merger, or an acquisition of stocks of the failed insurance company by an insurance holding company etc. after consultations provided for in Article 241, the insurance company may make alterations in contractual terms including a reduction in the sum insured (Article 250, 254, and Clause 2 of Article 255 of Insurance Business Law). In practice, the insurance company is required to hold a general meeting of shareholders and to adopt a resolution for the approval of a transfer of contracts, a merger, or an acquisition of stocks by other insurance companies. The insurance company is required to give public notice concerning changes in the rights and obligations of policyholders arising from the changes in the contractual terms within two weeks from the resolution at the general meeting. This public notice should contain a statement that any policyholder should express his opposition, if any, within a given period. The transfer of contracts, the merger, or the acquisition of stocks by other insurance companies is to be carried out when the adverse decision does not have the approval.

Given that insurance companies (especially life insurance) are coming up against the problem of negative spread between investment returns and guaranteed yield, the Insurance Business Law and the Special Law Concerning Reorganisation Proceedings of Financial Institutions were amended and enforced in June 2000. The new legislation develops bankruptcy legislation to enable the application of reorganisation proceedings to mutual insurance companies[1] so that (1) proceedings can be initiated promptly before an insurer falls into excessive debt by requiring an insurance company to report to the supervisory authority in the event that an insurance company finds it difficult to continue its insurance business in view of its operations and assets, (2) rights of policyholders can be adjusted through judicial procedures, and (3) insurance coverage can be provided successively.

C. Policyholders Protection Corporations

The Policyholders Protection Corporations, for both life and non-life insurance respectively, were established under the Financial System Reform Law enforced in December 1999, working as a safety net in the event that an insurance company has difficulty in continuing its business. In order to protect policyholders, the Corporations provide the successor with the financial aid and take other necessary measures. In the case that no successor appears, the Corporations underwrite existing insurance contracts. As an extensive protection, all claims arising before the end of March 2001 are fully protected and will be paid in full amount.

At the end of 1999, the amount of financial aid for a failed life insurance company (Toho Life Insurance Mutual Company), which became insolvent in June 1999, was finally settled (380 billion yen). As a result, a considerable portion of the fund of the PPC was disbursed. Therefore, the Insurance Business Law was amended and enforced in June 2000. The new legislation incorporates additional funding to the Life PPC to maintain the function of the PPC and to strengthen policyholders' protection.

The level of the safety net will be expanded by 500 billion yen, from 460 billion yen to 960 billion yen. In other words, the Life PPC can increase its borrowing up to 960 billion yen to deal with life insurance company failures. In doing this, the life insurance industry will make an additional contribution of 100 billion yen. And the government subsidies up to 400 billion yen will be available for failures occurring before the end of March 2003, in order to respond to cases that, if all costs required for financial assistance and other operational costs incurred by a failure occurring before the end of March 2003, are funded entirely by contributions from life insurance companies, it is difficult to maintain confidence in insurance business, by worsening the financial situation of insurers, and thereby may cause unexpected confusion in the financial markets or in the people's lives.

In addition, government guarantees that the borrowing, which are effective till the end of March 2001 under the current legislation, will be perpetuated.

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1 To date, "the Special Law Concerning Reorganization Proceedings of Financial Institutions" has been applied only to stock companies.

KOREA

I Overview

The insurance business is generally defined as the management of an insurer's property for the fulfilment of claims or benefits payment obligations on insurance contracts for incidental losses which are paid for using premiums collected from the insured, the latter comprising an unspecified number of the general public. Due to the unique traits of the insurance business, its management entails both public and social responsibilities. The insurance industry is therefore subject to strict legal regulation and supervision in order to establish a fair order in insurance transactions and to protect the general public. This is in recognition of the fact that the insured are often subject to unilateral pressure to purchase insurance policies in the form of recommendations from insurance salespersons rather than purchasing policies based on an independent evaluation of the managerial or financial status of the insurance companies.

The type of regulatory supervision depends on a country's particular circumstances and policy, but most regulators place various regulations on insurance businesses with a view to protecting policyholders and the national economy. Considering the public responsibility of insurance, Korea has also adopted a practical supervisory system that exercises stringent surveillance and regulation on the insurance industry ranging from entry into business to exit from the market.

Companies that wish to enter into the insurance business should obtain a license from the FSC (Financial Supervisory Commission). The FSC guides insurance companies by establishing the standards of financial soundness, such as the solvency margin regulation, in order to monitor claims payment capability even after a company has entered the insurance business, and strictly supervises the overall management of insurance companies to foster a fundamentally sound and healthy insurance industry.

The FSC's major supervisory and regulatory responsibilities relating to the insurance business are as follows:

- authorisation and registration of business
    - permission to engage in insurance business;
    - permission for concurrent operation of other business;
    - registration of insurance agents and brokers.

- authorisation and approval
  - approval of amendments to basic documents such as the Articles of Incorporation;
  - approval of conclusion, change and abolition of mutual agreement;
  - approval of capital reduction;
  - approval of transfer of insurance contracts and business;
  - authorisation of dissolution and mergers, etc.;
  - approval of exceptions on operation of insurer's assets;
  - approval of insurer's share participation in subsidiary.

- matters to report
  - change of trade name or denomination;
  - appointment and dismissal of executive officers;
  - change of major shareholders;
  - suspension or resumption of business of the insurer's head office;
  - increase in the insurer's capital or foundation fund;
  - foreign direct investment or the establishment of an office or branch in foreign countries;
  - resolution to change the structure of the insurer's organisation.

- miscellaneous matters
  - public notice of the insurer's managerial performance, which may include financial situation and profits/losses, etc.;
  - public notice of the insurance products to be offered;
  - submission of financial statements and operation results.

II Entrance Regulation

A legal person or entity that intends to engage in the insurance business should obtain a license from the FSC. Legal entities eligible to obtain such a license are limited to stock corporations, mutual companies, and foreign insurers. No insurance business is allowed to commence operations unless it has at least 30 billion won or more in paid-in capital or foundation funds. If it intends to conduct insurance business as a single line insurer, 10 or 20 billion won is to be paid-in depending on the kind of the insurance line. An insurer should deposit funds for the protection of policyholders (hereinafter referred to as "protection deposits") to the FSS (Financial Supervisory Service), which should amount to 30 per cent of the paid-in capital or the foundation fund prior to commencing its business.

In case a foreign insurer intends to engage in the insurance business in Korea through use of a branch office, such insurer should also be conducting insurance business in its home country. It should retain at least 3 billion won in paid-in capital and should provide adequate protection deposit in accordance with the requirements mentioned above.

III Prudential Regulation

An insurer should maintain a solvency margin ratio of 100 per cent or more in order to secure capital, asset, and managerial soundness. An insurer also should classify assets such as loans and invested securities in terms of soundness and reserve bad debt allowance at a certain ratio or greater.

A. Solvency margin

The FSC has adopted the EU-based solvency margin method as a standard guideline for the financial soundness of insurance companies. The FSC uses the solvency margin ratio as the criterion to evaluate the financial soundness of insurance companies, and requires insurers to maintain a solvency margin ratio of 100 per cent or more, which is calculated by dividing the solvency margin by the solvency margin standard.

$$\textbf{Solvency Margin Ratio} = \frac{\text{solvency margin (actual)}}{\text{solvency margin standard (required)}} \cdot 100\%$$

- *Solvency margin (actual):* Solvency margin refers to the amount that an insurer retains in excess of its liabilities such as underwriting reserves, that is, an insurer's surplus payment capacity. The solvency margin amount is calculated by subtracting the sum of non-amortised initial expenses and intangible assets such as goodwill and prepaid expenses from the sum of the capital account such as paid-in capital, capital surplus, retained earnings and capital adjustment plus the amount of allowance for bad debts out of assets classified as "normal" and "precautionary," plus subordinated debt, policyholders' profit dividend reserve and catastrophe reserve.

- *Solvency margin standard (required): S*olvency margin standard means the minimum amount (required solvency by regulatory body) that an insurer should retain to meet its liabilities. This standard is set by the FSC. The standard applies differently to non-life insurers and life insurers depending on the characteristics of an insurer as follows.
  - *Life insurer:* The solvency margin standard for life insurers is the sum of the amount calculated by multiplying the loss reserve risk quotient (4 per cent) by an amount calculated by subtracting non-amortised initial expenses from the policy reserve amount based on pure premium, plus the amount calculated by multiplying the insurance risk quotient by the risk claim amount. The FSC has arranged for application of the above solvency margin standard to be phased in by increasing the standard at an interval of every 6 months from September 1999. It will be in line with EU standards by March 2004.
  - *Non-life insurer:* In the case of non-life insurance, the solvency margin standard should be the sum of the amounts calculated separately by traditional non-life insurance and long-term insurance. For general insurance, a premium-based amount or a claim-based amount, whichever is greater, each calculated by insurance class, should be the solvency margin standard. For long-term insurance, the solvency margin standard shall be the sum of 4 per cent of the policy reserve at the end of each year plus a premium-based amount, or a claim-based amount, whichever is greater.

B. Classification Standard of Asset Soundness

Insurers should regularly classify the soundness of their assets into five different categories: "normal", "precautionary", "substandard", "doubtful", and "estimated loss", and accumulate adequate allowance for bad debts. The amount of allowance for bad debts that insurers shall accumulate, pursuant to the results of classification of their asset soundness, is as follows:

Table 21:Standards for Classification and Provisioning

Classification of Soundness	Provisioning Standards
Normal	More than 0.5%
Precautionary	More than 2%
Substandard	More than 20%
Doubtful	More than 50%
Estimated Loss	100%

IV System for Evaluating Management Status

The system for evaluating management status, the so-called CAMEL system, for insurance companies is divided into 5 parts: Capital adequacy (solvency margin), Asset soundness, Management, Earnings (profitability) and Liquidity. The evaluation is made in terms of quantitative and non-quantitative standards. Evaluation of insurance companies is made differently from that of the banking and securities sectors, with weight given according to evaluation criteria and parts. Each management status part is rated on a scale of one through five, with "1" representing the highest and "5" the lowest levels of operating performance.

The FSC/FSS will enhance the reliability of the system for evaluating management status by making all insurance companies that have operated continuously for two (2) or more years subject to on-site evaluation. Contrary to practice under the previous system for evaluating management status, evaluation results are not publicly disclosed. Instead, the results are used as internal data by the FSC/FSS for supervision and inspection and applied to prompt corrective actions such as management improvement recommendations, requirements, and orders, depending on the results of the evaluation.

Table 22:Evaluation Procedure

1st stage	*Evaluation of quantitative items: estimation of provisional evaluation grade by part * Evaluation of non-quantitative items
2nd stage	*Determination of evaluation grade by part (1~5 grades): by comprehensively considering the analysis result of non-quantitative items and provisional evaluation grade by part
3rd stage	*Estimation of provisional composite evaluation grade
4th stage	*Determination of composite evaluation grade (1~5 grades): by comprehensively considering provisional composite evaluation grade and the overall management status, business capability and financial and economic conditions, etc.

Table 23: Evaluation Factors

Classification	Quantitative	Non- Quantitative
Capital adequacy (Solvency)	-Solvency margin ratio I -Solvency margin ratio II	- Appropriateness of changing factors of solvency margin -Possibility of improvement of solvency margin in the future -Reasonableness of an insurer’s policy to maintain its solvency margin -Other matters acknowledged as important
Asset soundness	- Ratio of weighted non-performing assets to assets classified under FLC - Ratio of risk-weighted assets to total assets	-Appropriateness of classification of asset soundness -Appropriateness of an insurer’s retention level of risky assets -Management capability of non-performing assets -Appropriateness of loan control - Other matters acknowledged as important
Management		-Overall management status and business capability -Appropriateness of an insurer’s establishment of managerial policy and implementation function -Appropriateness of risk management -Reasonableness of internal management -Compliance with rules (laws, regulations, etc.) -Other matters acknowledged as important
Earnings	<Life insurance> - Ratio of earning rate on total assets to average expected interest rate - Ratio of death benefits to risk premiums - Ratio of operating expenses to expenses loading <Non-life insurance> - Earned-incurred loss ratio - Ratio of net operating expenses to earned premiums - Ratio of operating income on investment to invested assets	-Appropriateness of changing factors of earning structure -Appropriateness of profit management by source of profit (underwriting profit, expense profit and interest profit): (life insurance) -Appropriateness of loss ratio management (non-life insurance) -Efforts for management rationalisation such as efficient execution of expenses, etc. - Other matters acknowledged as important
Liquidity	<Life insurance> - Ratio of liquid assets to total assets - Ratio of cash flow to claims <Non-life insurance> - Ratio of liquid assets to total assets - Ratio of cash flow to net premium written	-Appropriateness of liquidity changing factors -Reasonableness of fund raising and its operation -Liquidity management capability - Other matters acknowledged as important

Table 24: Measures for PCA

Classification	Requirements	Detailed Action
Management Improvement Recommendation	- Solvency margin ratio: 50%~ below 100% - As a consequence of evaluation of management status, when an insurer is evaluated as level 4 (weak) or below in respect of solvency margin or asset soundness whereas its general evaluation level is level 3 (normal) or better - When an insurer is clearly expected to fall under the above requirement due to occurrence of a huge amount of financial accident or non-performing loans	-Caution or warning against an insurer or directors; -Increase in, or reduction of, paid-in capital; -Curtailment of net operating expenses; -Management improvement of business offices; -Restrictions on investment of fixed assets; -Disposal of non-performing assets; -Improvement of manpower and institutional management; and -Prohibition of acquisition of treasury bonds; -Restrictions on dividend and policyholders' dividend; or -Restrictions on new businesses or new capital investments; -Rate adjustment advice.
Management Improvement Requirement	- Solvency margin ratio: 0%~ below 50% - As a consequence of the evaluation of management status, when an insurer is evaluated as level 4 (weak) or below in its general evaluation grade. - When an insurer is clearly expected to fall under the above requirement due to an extremely large financial accident or extremely large amount of non-performing loans	-Closure, consolidation, or restriction on opening places of business; -Demand for change of officers; -Suspension of part of business; -Reduction of manpower and institution; -Planning of a merger, including into a financial holding company, acquisition by a third party, or assignment of all or part of a business; -Restriction on holding risk assets and disposition of assets; -Resettlement of subsidiaries; -Reinsurance placement; and -All or a part of actions mentioned in the above measures for recommendation on Management improvement.
Management Improvement Order	- Solvency margin ratio: below 0% - When an insurer falls under the category of the ailing financial institutions under the Act on Structural Improvement of the Financial Industry.	-Retirement of part or all of the issued stocks; -Suspension of business execution of officers and appointment of insurance administrator; -Suspension of all insurance businesses within six (6) months; -Transfer of all or part of contracts; -Merger, including into a financial holding company; -Assumption of insurance business by a third party; -Assignment of all or part of business; and - All or a part of actions mentioned in the above measures for demand on Management improvement

V Prompt Corrective Action (PCA)

In order to prevent insurance companies from falling into insolvency and to encourage sound management, the FSC/FSS can order insurance companies to submit a management improvement plan under the system of prompt corrective action (PCA). Under the PCA, the FSC/FSS can require implementation of management improvements by issuing management improvement recommendations, requirements, or orders. Requirements by type and contents of measures under the PCA are as follows:

VI On-site Examination and Off-site Surveillance

A. On-site Examination

Like other financial institutions such as banks, insurance companies are subject to the FSS's comprehensive examination. On-site examinations are divided into two categories: regular examinations (full-scope examinations) and target examinations (partial examinations). Examination is usually focused on checking the following items:

- soundness of assets;
- compliance with relevant statutes, decrees, regulations and instructions;
- adequacy of internal control systems;
- evidence of fraud, embezzlement, and other financial irregularities;
- accuracy of statistical returns and reports submitted; and
- information collection.

During the examination, the FSS evaluates management status and checks risk management (with risk management checklists) according to examination policies focused on management status evaluation and risk-focused supervision, and then recommends appropriate measures including prompt corrective actions, etc.

In order to enhance the effectiveness of on-site examinations, the FSS receives business reports regularly from each insurance company, analyses the current status of its management, and gathers what preparatory information is available. After the examination, the FSS evaluates the management status of an insurance company, such as the quality of its assets and reserve holdings and the adequacy of its internal controls. It then recommends appropriate measures to cope with problems that have come to light during the examination.

B. Off-site Surveillance

The FSS undertakes off-site surveillance of insurance companies as well as on-site examinations. Off-site surveillance is mainly accomplished through the ordinary surveillance system that operates to monitor the soundness of an insurance company's management. In addition, off-site surveillance is also partially accomplished through the analysis of other reports and documents.

The FSC/FSS can use the results of off-site surveillance when they enforce supervisory actions, such as recommending (or requiring, ordering) management improvements, adjusting the management status evaluation rating, or reflecting examination planning and major examination items, for a problematic insurance company and its areas of weakness.

VII Restrictions on Asset Management

An insurer's assets are formulated by the premiums paid by insured parties and are mainly composed of assets representing technical reserves to fulfil its insurance liabilities. Therefore, an insurer must consider the protection of insured people's interests during the operation of asset management in order to manage assets in the most prudential manner.

Consequently, the FSC strictly restricts the methods of asset operation and the asset operation ratio in order to ensure that the insurer's assets are managed in such a manner as to assure safety, profitability, and liquidity, while also protecting the insured people's interests at the same time. The regulation methods of asset management of insurance companies are composed of positive methods prohibiting a certain type of asset operation according to insurance-related laws and regulations.

The scope of asset operations is as follows:

- acquisition and operation of securities;
- acquisition and operation of real estate;
- loans and discounts of promissory notes;
- deposits into financial institutions;
- entrusting money, securities or real estate to investment and trust companies;
- futures trading and overseas futures trading;
- call loans;
- share participation in investment association for establishing small-to-medium-size enterprises;

- share participation in investment association for venture capital business using new technology;

- share participation in corporate restructuring co-operatives;

- acquisition and operation of foreign currency; and

- investment in public interest businesses (businesses contributing to improvement of public health and welfare, or to the promotion of culture and the arts).

In order to prevent the extension of disproportionate support by an insurer to affiliates within its own business group and to induce the spread of investment risks, the FSC regulates an insurer’s investment limits and its investment categories. An insurer’s limits on asset operation by subjects eligible for investment are as follows:

VIII Approval system for insurance products

The FSC/FSS had strictly regulated all insurance products that can be sold after obtaining prior approval from the FSC/FSS, but repealed the approval system on insurance products as part of deregulatory measures that were introduced in July 1993 to promote autonomy of the insurance business. The regulation on insurance products has been converted to the "File and Use" or "Use and File" system by classifying insurance products into three categories including "File and Use", "Use and File", and "No File".

"File and Use" products are to be filed with the FSC/FSS in the case of insurance products having a substantial influence on the national economy such as auto insurance, etc. Such products are automatically deemed approved 20 days after the date of filing.

"Use and File" products are to be automatically approved through their filing with the FSS within 3 months after the sale of products (in the case of non-life insurance, within 15 days).

Products whose contents are the same as products already being sold by other insurance companies after obtaining approval from the FSC/FSS have been stipulated to be sold freely.

Table 25: Limits on Asset Operation of Insurance Companies

Items	Limit (based on total assets)	Remarks
Stocks	40%	
Unlisted stocks	Equity capital	
Real estate	15%	
Total amount limit on loans to the non-insured	40%	
Holdings of stocks and bonds of the same company, and mortgage loans thereon	5%	
Loan to a single person	3%	30 billion won plus 1.5% of the asset in excess of 1 trillion won for an insurer of which total assets exceed 1 trillion won
Holdings of the same property and mortgage loan on the same collateral	5%	
Loans to its affiliates	2%	
Holdings of stocks and bonds of its affiliates, and mortgage loans thereon	2%	
Loans to any of the same designated affiliation groups	5%	Affiliation groups: 60 major business groups whose subsidiaries are linked through a system of cross-guarantees on each other's liabilities
Holdings of stocks and bonds of any of the same designated affiliation groups, and mortgage loans thereon	10%	
Holdings of foreign currency, foreign real estate and foreign currency-denominated securities	10%	
Holdings of stocks issued by small and medium size enterprises (excluding venture capitalists)	1%	
Futures trading	3%	Based on customer margins
Total limit on large loans	20%	Large loans: loans exceeding 1% of an insurer's total assets out of the loans to the same person or affiliation groups respectively

Note: Based on general account

GRAND DUCHY OF LUXEMBOURG

I Supervision of the solvency margin of insurance undertakings

Financial supervision consists in verifying that insurance companies are solvent in all their activities, and that they maintain technical provisions, including mathematical provisions, and corresponding assets in compliance with the regulations and practices of the Grand Duchy of Luxembourg and EU provisions.

A. Solvency margin legislation

Luxembourg's solvency margin legislation is in line with Economic Union directives. Each insurance company in Luxembourg engaged in direct risk insurance in either life or non-life classes must maintain an adequate solvency margin for all of its activities.

Components of the solvency margin

The solvency margin corresponds to the company's assets, free of any foreseeable liabilities, less any intangible items. In particular, it includes:

- The company's paid-up share capital or, for mutual associations, the actual initial fund;
- Half of the company's unpaid authorised capital or initial fund, provided that at least 25 per cent of the total capital or initial funds is paid up;
- Statutory and free reserves;
- Profit or loss brought forward from previous years;
- Capital gains resulting from an under-valuation of assets or an overvaluation of liabilities, upon request and with justification (under the conditions laid down by law);
- Cumulative preference shares and subordinated debentures (under the conditions laid down by law);
- Perpetual securities and other instruments (under the conditions laid down by law).

Special provisions for non-life business

Special provisions for non-life business stipulate that the solvency margin may also include:

- Supplementary contributions for mutual insurers and similar companies (under the conditions laid down by law).

Special provisions for life business

Special provisions for life business stipulate that the solvency margin may also include:

- An amount representing 50 per cent of future earnings;
- In the case of non-zillmerisation, or of zillmerisation that does not cover the loading for acquisition costs contained in the premium, the difference between the non-zillmerised or partially zillmerised mathematical provision and a mathematical provision zillmerised at a rate equal to the loading for acquisition costs contained in the premium.

The amount of the solvency margin

For non-life insurance, the amount of the solvency margin is determined by reference to the annual amount of premiums or contributions, or to the average loss burden for the last three or seven financial years, depending on the risks covered.

For life insurance, the minimum solvency margin must be equal to a given fraction of the mathematical provisions and a fraction of the capital at risk.

The guarantee fund

One-third of the minimum solvency margin constitutes the guarantee fund, which may not be lower than certain amounts set by law.

One-half of the guarantee fund must consist of:

1. *the company's assets*, free of any foreseeable liabilities, less any intangible items. In particular, this includes:
   - The company's paid-up share capital or, for mutual associations, the actual initial fund;
   - Half of the company's unpaid authorised capital or initial fund, provided that at least 25 per cent of the total capital or initial fund is paid up;
   - Statutory and free reserves;
   - Profit or loss brought forward from previous years.

2. *Profit reserves*, to the extent that they can be used to cover future losses and have not been earmarked for distribution to policyholders.

B. Technical provisions

All insurance companies must constitute adequate technical provisions, including mathematical provisions, for all of their business.

Technical provisions include:

For non-life insurance:

- loss reserve;
- provisions for unearned premiums and outstanding risks.

The loss reserve corresponds to the total estimated cost that the company would have to bear to settle all claims incurred, whether reported or not, by the end of the financial year, less the sums already paid for those claims.

The provision for unearned premiums corresponds to the portion of gross premiums that must be allocated to the following financial year, or to later years.

The provision for outstanding risks corresponds to the amount set aside in addition to unearned premiums to cover risks that the insurance company will have to assume after the end of the financial year, in order to meet all claims and all expenses arising from policies in effect in excess of the amount of unearned premiums and premiums payable in respect of those policies.

For life insurance:

In addition to the above provisions, the life insurance provision and the provision for bonuses and rebates.

The life insurance provision corresponds to the estimated actuarial value of the insurer's commitments, including bonuses already allotted, less the actuarial value of future premiums.

The provision for bonuses and rebates corresponds to amounts earmarked for policyholders and beneficiaries in the form of bonuses and rebates.

For credit insurance:

The equalisation provision includes all sums set aside under legal or administrative requirements to smooth out loss ratio fluctuations in the years ahead, or to cover special risks.

Technical provisions are to be calculated individually for each contract or, failing that, by using flat-rate methods.

Technical provisions must at all times be covered by equivalent and matching assets. However, insurance companies may hold non-matching assets to cover an amount not exceeding 20 per cent of their liabilities in a given currency. The nature of the assets and rules for determining their amounts are laid down in a Grand-Ducal regulation.

All insurance companies must keep a permanent record for each class of business. This consists of a register in which all assets intended to cover technical provisions are recorded. At the end of each quarter, the total assets entered into this register must be equal to no less than the value of technical provisions.

Assets covering technical provisions constitute, for each class of business, a separate category of assets earmarked specifically to guarantee the payment of liabilities arising from direct insurance contracts.

If these separate assets are inadequate, liabilities can be met only by reducing the share of separate assets attributable to policyholders, the insured or beneficiaries, who retain a secured claim on the insurance company's surplus.

C. Shareholdings in excess of specific thresholds, and the identity of shareholders

Companies operating in Luxembourg are required to notify the Insurance Commission of acquisitions or disposals of equity that increase or decrease their capital beyond thresholds of 20, 33 or 50 per cent. They must also inform the Commission at least once a year of the identity of shareholders or partners holding shares in excess of the specific thresholds, and of the amounts involved.

II Practical organisation of financial supervision

The following forms are used in conducting financial supervision:

- An annual profit and loss account form;
- An annual solvency margin form;
- Periodic continuous inventory statements:

- *An annual statement* providing a summary of the assets covering provisions and a detailed list of assets by category of investment;
- *A quarterly statement* listing the assets covering the technical provisions recorded in the register. This quarterly statement must show, for all categories of assets, the value of the assets allocated at the end and at the beginning of the quarter.

Each insurance company is required to submit to an external audit carried out annually at the company's expense by an independent auditor chosen from a list authorised by the Insurance Commission. The auditors' report is sent to the Commission.

The Insurance Commission may ask companies to provide any information and documents it requires to evaluate insurance operations in general, and it may also carry out on-site inspections.

III Measures to be taken when difficulties arise (recovery measures)

The Commission requires a recovery plan to be drawn up if the solvency margin falls below the prescribed minimum and a short-term financing plan if the solvency margin no longer covers the guarantee fund. The recovery plan and the short-term financing plan must be submitted to the Commission for approval.

If a company does not maintain adequate technical provisions or if those provisions are not covered at all times by equivalent and matching assets, the Commission can prohibit or restrict the company from disposing of its assets freely.

The Commission can impose fines on licensed insurance companies.

Furthermore, the Commission can take disciplinary action. It can:

- Issue a warning or reprimand;
- Prohibit a company from carrying out certain operations or impose other restrictions on its activities;
- Temporarily suspend one or more of the company's officers.

MEXICO

The Mexican Constitution establishes that the Federal Government, through Congress, has the authority to regulate all issues concerning financial services, and the "Secretaría de Hacienda y Crédito Público" (SHCP: Ministry of the Treasury) is responsible for regulating the financial sector.

The supervisory authority is a decentralised federal agency of the SHCP, created in 1990: the "Comisión Nacional de Seguros y Fianzas" (CNSF).

I Solvency regulation

A. Minimum paid capital

The minimum paid capital is constituted in order to guarantee the solvency of a company. It is determined in the first quarter of each year by the SHCP and is calculated for each business line operated by the insurance company.

The minimum paid capital is required in investment units denominated UDIS. These units include the inflationary effect.

B. Rates

Insurance companies are free to set the rates and conditions for their services. However, they must register each product at the CNSF with a technical note. This registration is automatic, i.e. the companies can sell the product immediately. The CNSF has 30 days to provide any comment on its feasibility, and can always stop the sale of a product if it is jeopardising the solvency of the carrier.

C. Reserves

For life insurance, the mathematical reserve for traditional products must be constituted according to mortality tables issued by the SHCP and an interest rate less than or equal to 8 per cent for plans in national currency and 4 per cent for plans in foreign currency.

The unearned premium reserve for health, accident and general insurance, except earthquake, is constituted by subtracting the acquisition expenses for the premiums, according to the exact days or 1/24 methodology.

The reserve for pending claims is constituted for losses and matured policies, policies benefits, premiums in deposit and for incurred but not reported claims.

An equalisation reserve, called "reserva de previsión" (prevision reserve), must be constituted. It is accumulative up to 50 per cent of the Gross Solvency Requirement. The prevision reserve can only be used by an insurance company for extraordinary losses, with the previous authorisation of the CNSF.

For earthquake, a tax deductible catastrophic risk reserve must be accumulated up to 90 per cent of the five-year average possible maximum losses.

For some lines of business, in which periodic deviations in the loss ratio are likely to occur such as agriculture, cattle, and traveller's insurance, a special contingency reserve must be constituted.

D. Solvency margin

The Solvency Margin is determined by the Assets Counted Towards Minimum Guarantee Capital (ACTMGC), minus the Minimum Guarantee Capital (MGC) required.

The ACTMGC corresponds to the assets capable of covering the MGC required.

The MGC is equal to the Gross Solvency Requirement (GSR) minus Deductions.

The Deductions are mainly determined by the balances of the prevision reserve and the catastrophic risk reserve.

The GSR is determined in a similar way as in the European Union.

The GSR is equal to the capital required for probable deviations in the retained losses and/or adverse fluctuations in the price of those assets in which the technical reserves are invested.

The GSR is calculated separately for life, pension insurance derived from social security law, accident, health, agriculture, motor vehicle, credit, earthquake and jointly for all the other general lines.

Considering that the reinsurers quality is part of the insurer's solvency, in order to impact the solvency margin of ceding companies in case of dealing with a low quality reinsurer (low rated by an international rating agency), the regulation establishes a "reinsurer quality weight" that applies to the GSR of every line.

Also, there is a GSR for the operation of resurety (reinsurance of sureties) and another for investments.

For life insurance, the GSR is equal to 0.03 per cent of the averaged sum insured over the last 12 months.

For pension insurance derived from social security law, the GSR is equal to 4 per cent of the sum of the mathematical reserve plus the unearned premium reserve of additional benefits. To this result is added a capital requirement if there is a mismatch between assets and liabilities.

For accident, health, agriculture, motor vehicle, credit and general insurance, the GSR is calculated using two different methodologies: one according to the premiums written in the last 12 months, and another according to the annual average losses suffered during the last three years.

For accident insurance the GSR is equal to the largest of 13.87 per cent of the premiums for the last 12 months and 20.92 per cent of the annual average losses suffered during the last three years, each multiplied by the maximum between the company and market retention ratio.

For health insurance the GSR is equal to the largest of 13.87 per cent of the premiums for the last 12 months and 20.92 per cent of the annual average losses suffered during the last three years, each multiplied by the maximum between the company and market retention ratio.

For agriculture insurance the GSR is equal to the largest of 49.19 per cent of the premiums for the last 12 months and 74.43 per cent of the annual average losses suffered during the last three years, each multiplied by the maximum between the company and market retention ratio.

For motor vehicle insurance, the GSR is equal to the largest of 20.54 per cent of the premiums for the last 12 months and 30.14 per cent of the annual average losses suffered during the last three years, each multiplied by the maximum between the company and market retention ratio.

For credit insurance, the GSR is equal to the largest of 113.62 per cent of the premiums for the last 12 months and 179.82 per cent of the annual average losses suffered during the last three years, each multiplied by the maximum between the company and market retention ratio.

For earthquake, the GSR is equal to the largest of the maximum probable loss for the company, considering the retention of the company and considering the market retention average.

For general insurance, the GSR is equal to the largest of 23.67 per cent of the premiums for the last 12 months and 41.94 per cent of the annual average losses suffered during the last three years, each multiplied by the maximum between the company and market retention ratio.

For surety reinsurance, the GSR is equal to the amount of liabilities for sureties retained by the company, multiplied by a claims expected coefficient. The result is multiplied by the maximum between the company and market retention ratio.

For investments, the GSR is equal to the sum of the requirement for lack in the coverage of technical reserves of the company plus the requirement for financial credit risk for the company investments, determined by the nature of the securities operated by the company.

E. Investments

There is a list of authorised securities, as well as investment limits according to the type of assets and to the issuer of the financial instrument. The regulation applies only to those investments that support the Technical Reserves and the Minimum Guarantee Capital. A minimum percentage has to be invested in short-term financial instruments, defined as those with a maturity period less than or equal to one year. Since 1993 investments are valued and disclosed to the public at market prices.

II Supervision

A. Supervision by the CNSF

The CNSF has financial, actuarial, reinsurance and pension areas responsible for supervising the insurance companies, based on information they provide during the year.

The CNSF publishes several periodicals including the following information: financial statements and ratios, premiums and claims per company and line of business, and statistical information per insurance line.

B. Supervision by external auditors

Insurance companies are required to be examined each year by independent financial examiners and actuaries.

The independent financial examiner verifies the accuracy of the financial statements and is responsible for notifying to the CNSF any anomaly or problem in the carrier.

The independent actuary reports to the CNSF the adequacy of the mathematical reserve for life insurance, and since December of 1994, companies also report the sufficiency of all technical reserves.

III Actions to be taken with problem companies

Whenever the guarantee capital of an insurance company falls bellow the minimum amount required, the company must submit, within 15 days, a plan for restoring its financial position. This plan, if authorised by the CNSF, must be accomplished within 6 months at the most.

If the company does not comply within that time, the CNSF's Boards of Governors may take any of the following actions:

- Grant it a fixed period of time, which cannot be extended, to be adequately capitalised;

- Dissolve it and transfer its business to another firm, or

- Take over its administration.

NETHERLANDS

I Introduction

Generally speaking supervision of insurance companies aims at the protection of the interests of - present and future - policyholders and insurance claimants. The general goal is to minimise the risk that the insurance company cannot meet its commitments to its insured.

This note provides in a nutshell an overview of the way in which insurance supervision is exercised in the Netherlands. Section II gives an overview of the Dutch system of insurance supervision. Section III deals more in detail with the organisation of solvency supervision in the Netherlands. In Section IV one finds information on which measures apply when difficulties arise.

As explained more in detail in this note, from the very outset the *Verzekeringskamer* (Insurance Supervisory Authority of the Netherlands) is in charge of supervision of insurance companies. From the 1950's the Verzekeringskamer was also put in charge of supervision of supplementary pension funds. Because of the growing importance of the supervision of pension funds it was decided to rename the Verzekeringskamer into *Pensioen- & Verzekeringskamer* (Pensions & Insurance Supervisory Authority of the Netherlands). The relevant bill has been enacted in January 2001. On every instance where in this note reference is made to the Verzekeringskamer (Insurance Supervisory Authority of the Netherlands) from January 2001 onwards one should substitute it for Pensioen- & Verzekeringskamer (Pensions and Insurance Supervisory Authority of the Netherlands).

II The Dutch system of insurance supervision

A. Legal base

The legal supervision of insurance companies in the Netherlands originates from 1922, when the *Wet op het Levensverzekeringsbedrijf* (Life Assurance Companies Act) passed Parliament. In pursuance of this act the Verzekeringskamer started its work in 1923. Some 40 years later, in 1966, by virtue of the *Wet op het Schadeverzekeringsbedrijf* (Non-life Insurance Companies Act) the non-life insurers were also placed under supervision of the Verzekeringskamer.

Through implementation of the EEC First Life Assurance Directive (Directive 79/267/EEC) and the EEC First Non-life Insurance Directive (73/239/EEC) in 1987 one integrated Act on the Supervision of life and non-life insurance came into force: the *Wet toezicht verzekeringsbedrijf* (*WTV*) (the Insurance Business Supervision Act). In 1990 respectively 1992 the *WTV* was amended to implement the EEC Second Non-life Insurance Directive (88/357/EEC) respectively the EEC Second Life Assurance Directive (90/619/EEC).

In order to implement the EEC Third Non-life Insurance Directive (92/49/EEC) and the EEC Third Life Assurance Directive (92/96/EEC) in 1994 a new, completely redrafted IBSA was enacted: the *Wet toezicht verzekeringsbedrijf 1993* (*WTV 1993*) (Insurance Business Supervision Act 1993). In 1994 the *WTV 1993* was amended to reinforce the legal base for co-operation with supervisors of other sectors of the financial industry (see also section II.3 Financial Conglomerates). In 1996 the *WTV 1993* was amended to implement the so-called BCCI Directive (95/26/EC). Through an amendment of the *WTV 1993* the Verzekeringskamer was empowered, as from 1 January 2000, to impose penalties and fines on non compliance with legal regulations and requirements. In 2000 the *WTV 1993* was amended to implement the Directive 98/78/EC on the supplementary supervision of insurance undertakings in an insurance group into Dutch law. In January 2001 a bill wasenacted that introduces the so-called *Opvangregeling Levensverzekering* (Early Intervention Arrangement for Life Assurers (EIALA)) in the *WTV 1993*. More details of this EIALA are explained in section IV.B.

From the very start of the life assurance supervision in the 1920's the so-called funeral in kind assurers were exempted from supervision. Funeral in kind assurers generally supply a small cost of funeral indexed 'capital assurance' covering the funeral expenses, i.e. the assurance company takes care of the funeral. There has been an ongoing discussion on the subject of supervision of this category of assurers. Eventually, in 1995 the *Wet toezicht natura-uitvaartverzekeringsbedrijf* (*WTN*) (Funeral in kind Assurance Business Supervision Act) was enacted, which entered into force on 1 January 1996.

B. Insurance Supervision: an overview

Dutch insurance supervision is based on the third generation EC Insurance Directives. Generally this implies a system of *single licence* within the EU/EEA and *home country control* by the home supervisor. Moreover the third generation directives introduce a system of *a posteriori* controls – a system on which Dutch supervision has been based from the very start: i.e. there are no restrictions as to the business policy of an insurance company (policy conditions, tariffs, investments, etc), provided that the company meets the respective legal requirements and standards according to the *WTV 1993*.

This overview includes the following items:

- admission
- prohibition of ancillary business

- fitness and propriety
- technical provisions
- investments
- solvency
- annual reporting
- information to policy holders

Admission

Insurance companies are not allowed to operate in the Netherlands or to provide services to the Netherlands without a licence granted by the Verzekeringskamer or unless the company has completed a notification procedure to the Verzekeringskamer.

Licence

A licence procedure applies to an insurance company with a head office in the Netherlands and to a branch office in the Netherlands of a non-EU/EEA based insurance company.

An application for a licence - for each class of business - has to be submitted by means of a specific form. This form must be accompanied by the following addenda:

- an authentic copy of the Articles of Association;
- a business plan consisting of:
  - a statement of the nature of risks to be covered,
  - an explanation of the guiding principles to be followed on reinsurance,
  - evidence of the required minimum guarantee fund,
  - an estimate of the costs for setting up the administration and distribution network,
  - evidence of funds necessary to pursue business as planned,
  - estimates of financial results and solvency for the next three years,
- a list of names and addresses of directors and supervisory directors,
- the identity of persons with a qualified participating interest in the company,
- data regarding the expertise of directors, their curricula vitae, and past records of directors and supervisory directors.

Notification

A notification procedure applies to an EU/EEA based insurer that intends to sell insurance policies by way of provision of services or through a branch office. An insurer has to apply for a notification procedure to the supervisory authority of the state of the head office. The latter will notify the Verzekeringskamer. The insurer has to specify the kind of insurance contracts that will be entered into or the kind of risks that will be covered. After completing the notification procedure the insurer is allowed to pursue its business.

Prohibition of ancillary business

An insurance company is not allowed to carry out any other business than either life or non-life insurance business (the so-called prohibition of ancillary business rule). Composite insurance companies – combining life and non-life insurance business within a single legal entity - are not allowed and are therefore non-existent in the Netherlands.

Fitness and propriety

According to the *WTV 1993* the board of managing directors of an insurance company shall consist of at least two persons. Public limited companies must have a board of supervisory directors consisting of at least three persons. Members of the board of managing directors should have adequate expertise. Their fitness and propriety are assessed by the Verzekeringskamer. For this purpose – as stipulated in section II.2. *Admission* - insurance companies are required to supply relevant information about their directors and supervisory directors.

Technical provisions

An insurance company must hold adequate technical provisions. In order to clarify the regulations on the establishment and the assessment of technical provisions for life assurance, following the implementation of the Third EC Life Directive, the Verzekeringskamer has released a *Guidance Note on Actuarial Principles for Life Assurance* in 1994. The EU regulations stipulate that: 'the provision for life assurance (...) is calculated on the basis of sufficiently prudent prospective actuarial valuation taking into account future premiums payable and all future liabilities (..)'. A prudent valuation is not a 'best estimate' valuation, but shall include an appropriate margin for adverse deviation of the relevant factors. This would especially apply to probability systems (mortality, disability) and expenses.

A provision has to be established for liabilities for bonuses to which policyholders are entitled, irrespective of whether guarantees have been given with regard to the amount of these bonuses. Both the so-called explicit method and the so-called implicit method are allowed. The first method would imply that the insurance company holds a provision for bonuses. The latter means that no such provision is held; this must have implications for the discount rate to be applied. In the case of the implicit method, which applies to most of the assurance companies, the discount rate applied to value technical provision should not be more than 4 per cent. As from 1 August 1999 the technical provisions regarding life assurance policies concluded after that date must be discounted at a rate of 3 per cent. From 1 August 1999 the discount rate of 3 per cent also applies to the calculation of tariffs of life assurance policies.

Investments

In accordance with the third generation EU Insurance Directives the *WTV 1993* specifies categories of assets that an insurance company may hold in cover of its technical provisions. Furthermore, the *WTV 1993* stipulates rules as to the diversification and spread of investments. Specific rules apply to investments held as assets to cover technical provisions where the investment risk is borne by the insurance company. These rules include maximum limits in relation to gross technical provisions, such as:

- one single real estate of one single mortgage loan: 10 percent,
- non-quoted shares: 10 percent,
- shares, bonds and loans in one single debtor - not being a government body (or related body): 5 percent, conditionally to be extended to 10 percent provided that such investments in one single debtor exceeding 5 percent as a total do not exceed 40 percent.

It is allowed to use derivatives as an 'asset' covering technical provisions, provided that they are used for hedging or that derivatives are aimed at an efficient portfolio management. In 1994 the Verzekeringskamer issued a *Guidance Note on the use of derivatives.* This Guidance Note does not impose specific limits on the use of derivatives. Investments in derivatives should comply with the generally applicable guiding principles of investments

The specific rules just mentioned do not apply to investments held as assets in cover of technical provisions where the investments risk is borne by the policyholder (including tontine insurance policies).

Assets covering the technical provisions must be localised within the European Union. As a rule assets covering the technical provisions must be held in the same currency as in which the technical provisions are denominated, allowing for a mismatch of 20 percent. A branch office of an insurer with its head office outside the European Union must localise the assets covering the technical provisions in the Netherlands.

Solvency

In addition to technical provisions, insurers must also have a liability capital of a certain minimum size, the solvency margin. This is necessary, for instance, to absorb a deficit in the technical provisions. Such a deficit may arise as a result of unexpected loss experience. One third of the required solvency margin constitutes the guarantee fund.

The solvency margin for non-life insurers is determined by means of two calculations. The first relates to the premium income and the second to the amount of claims incurred. The higher of the two results determines the solvency margin. The level of the minimum guarantee fund required differs for insurers in different branches and varies from euro 200,000 to euro 1,4 million. If the amount of the minimum guarantee fund exceeds the calculated solvency margin, the higher amount will apply.

The solvency margin for life insurers is determined on the basis of a number of calculations in which a distinction is made between types of assurance contracts, namely assurance policies whereby the insurer does or does not bear the investment risk, tontine assurance policies and pure risk assurance policies. The same criteria apply to supplementary insurance as apply to non-life insurance. In the case of life insurers the minimum amount of the guarantee fund is euro 800,000

An insurer with head office outside of the European Union, having a branch office in the Netherlands, must hold for its entire business as well as regards its business in the Netherlands an available solvency margin, which equals the solvency margin of insurers with head office in the Netherlands.

Annual reporting

Insurance companies must submit annually supervisory returns to the Verzekeringskamer. These returns, which have to be submitted before the 1July following the financial year, include a balance sheet and a profit and loss account (including specifications of premiums, benefits paid, etc.) and supplementary forms on: investments, returns on investments, technical provisions, actuarial report, analysis of technical results. The returns have to be certified by an external auditor and an actuary. As part of the supervisory returns the actuary must supply the Verzekeringskamer with a so-called adequacy test regarding the technical provisions. As from the financial year 2003 the supervisory returns have to be submitted to the Verzekeringskamer before the 1 May following the financial year.

Some of the supervisory returns, especially those concerning the (consolidated) balance sheet and profit and loss account, the technical results and profit sharing and the actuarial report have to be disclosed.

Apart from the supervisory returns to be submitted to the Verzekeringskamer, an insurance company must, in accordance with the Dutch Civil Code, deposit - and disclose - its Shareholders' Accounts at the Registry of Companies. The regulations on the shareholders' accounts of insurance companies are in accordance with the Directive 91/674/EC on Annual Accounts and Consolidated Annual Accounts of Insurance Companies. As regards the valuation rules it is required to disclose market value when assessing at cost in the accounts and vice versa. The same valuation rules apply to the supervisory returns as well. Not only on this point, but also with regard to the balance sheet and profit and loss account, the supervisory returns are to a large extent reconciled in conformity with the shareholders' accounts.

Information to policyholders

The *WTV 1993* contains a number of regulations with regard to the information an insurer has to provide to policyholders. The *Regeling Informatieverstrekking aan Verzekeringsnemers 1998* (Regulation regarding the Provision of Information to Policyholders 1998) provides further rules in respect of life assurance and non-life insurance. The requirements in these regulations relate, for instance, to the identity of the insurer and the claims representative, the contents of and amendments to the policy conditions, the level of premiums, complaints procedures and the right of termination of life insurance contracts, surrender value, paid-up value, costs and withholdings, fiscal treatment of premium and claims. As regards unit linked policies more detailed information on the investment risks, the investment policy and the management of the investments must be supplied to the (prospective) policyholders.

Pursuant to the before mentioned Regulation regarding the Provision of Information to Policyholders 1998 the Verzekeringskamer released more detailed rules in January 1999. These rules prescribe the provision of adequate information on eligibility for dividends, surrender or paid-up value, the investment risks involved, etc. Where relevant it must also be expressly stated that investment returns earned in the past are no guarantee of similar future earnings. In order to ensure the clarity of the information life insurers must provide the policyholder with a so-called Key Features Document.

C. Financial Conglomerates

The first wave of mergers in the Dutch financial sector dates back to the 1960's. These mergers were almost merely sectoral, i.e. resulting in insurance groups and banking groups. In reaction to these developments De Nederlandsche Bank (Dutch Central Bank), the prudential supervisor of credit institutions, introduced the so-called segregation policy in the 1970's. According to this policy rule a credit institution was not allowed to participate in a credit institution or in an insurance company unless it had been granted a certificate of no objection. This policy rule was pursued to protect the solvency of credit institutions and to maintain the competitiveness of the banking industry. In the 1980's this segregation policy rule was extended to the legal supervision of insurance companies as well.

In 1990 the Netherlands government decided to relax the segregation policy rule. The legal regulations on a participation by a credit institution in an insurance company and vice versa were not lifted, but there was a policy shift from ‘no…unless’ to ‘yes….provided that’. Such participations still need a certificate of no objection, that will be granted on the condition that the credit institution and the insurance company that are part of a group must provide the respective supervisory authorities with additional information. In 1990 the Verzekeringskamer and De Nederlandsche Bank - in consultation with the Ministry of Finance - agreed on a so-called Protocol Agreements on the manner in which financial conglomerates are involved in the supervision of credit institutions and insurance companies. On several occasions the Agreements have been amended.

The Protocol Agreements contain:

- definitions on a financial conglomerate, the primarily banking variant, the primarily insurance variant and the mixed conglomerate variant,
- the procedures regarding the granting of a certificate of no objection,
- the conditions for a certificate of no objection,
- provisions concerning the organisational transparency of a conglomerate,
- provisions on abuse of inside information, affinity of names and supervisory arbitrage.

The conditions for a certificate of no objection relate in particular to the detection of possible double gearing and of risk concentration.

D. Supervisory powers

A starting point for a possible supervisory action of the Verzekeringskamer are the prudential returns that an insurance company must submit to the Verzekeringskamer annually. If needed, in addition to these returns the Verzekeringskamer may request an insurance company to supply any further information it deems necessary to execute its supervisory tasks. The Verzekeringskamer is also empowered to call and hear persons as a witness, an expert or to hear and call members of the managing or supervisory board of an insurance company.

In the interest of policyholders the Verzekeringskamer has the power to give an administrative directive regarding any aspect of the business policy of the insurance company. The company in question has to comply with this administrative directive. If the Verzekeringskamer is of the opinion that the insurance company does not comply with the administrative directive it may, by way of sanction, disclose the directive in the Official Gazette. The Verzekeringskamer may also appoint one or more persons whose consent (members of) the board of managing directors need when effecting their powers (so-called hidden trustee(s)).

As from 1 January 2000 the Verzekeringskamer has the authority to impose fines and penalties. A fine can be imposed if an insurance company has committed a violation which can no longer be rectified. A penalty has a more conditional character and can be imposed to prevent a (recurrence of) violation of rules.

III The organisation of solvency supervision

A. Verzekeringskamer (Insurance Supervisory Authority of the Netherlands)

General background

As indicated in section II, the Verzekeringskamer is in charge of insurance supervision. Its history dates back to 1923, when the Verzekeringskamer was founded and was entrusted with the supervision of life assurers. In 1966 the non-life insurers were added to the scope of supervision of the Verzekeringskamer, and in 1996 the funeral in kind assurers were placed under supervision of the Verzekeringskamer.

Apart from insurance supervision, the Verzekeringskamer is also in charge of the supervision of pension funds. Supervision of pension funds started in 1950 with the regulation of a compulsory participation in a pension fund for a branch of industry. In 1953 this supervision was extended to a full (solvency) supervision of pension funds for a branch of industry and company funds as well. In 1972 the Verzekeringskamer was entrusted with the supervision of compulsory pension funds for a profession.

Originally, the Verzekeringskamer was founded as a separate ‘agency’ of the Ministry of Justice (from 1986 of the Ministry of Finance). The employees of the Verzekeringskamer, however, had the legal position of a civil servant. The Board of the Verzekeringskamer had its own discretionary powers – within the legal powers as laid down in the respective supervision acts and other subsequent regulations - to carry out prudential supervision of insurance companies and pension funds. The costs of the Verzekeringskamer are covered by levies on the insurance companies and pension funds.

In the second half of the 1980’s it was decided to put the Verzekeringskamer more at arms length from the central government through privatisation. Eventually, in 1992 the Verzekeringskamer was privatised as a foundation. This operation was accompanied by a restructuring of the organisation of the Verzekeringskamer.

Organisation of the Verzekeringskamer

The Verzekeringskamer has a Management Board of three members, one of these being the chairman. The Management Board of the Verzekeringskamer is supervised by a separate Supervisory Board.

The Verzekeringskamer consists of four departments: the Insurance Supervision Department, the Pension Supervision Department, the Research & Advisory Department and the Facilities Management Department. Below the Insurance Supervision Department and the Research & Advisory Department are described in more detail.

The *Insurance Supervision Department* is primarily responsible for the supervision of insurance companies. The Insurance Supervision Department has some twelve Account Managers, each of them being primarily responsible for the supervision of specific portfolio of insurance companies. An Account Manager generally is a Registered Auditor or an Actuary. Employees of the Insurance Supervision Department are trained in the field of either the auditing or the actuarial discipline. Insurance supervision is explained in more detail in section III.2.

The *Research & Advisory Department* has four sections, i.e.: the *Research*, *Policy Affairs*, *Legal Affairs* and *Integrity*. The *Research* section supports the Management Board and the supervisory departments of the Verzekeringskamer by carrying out research in various fields. A recent major project refers to the modernisation of the actuarial principles issued by the Verzekeringskamer. The Research section is also responsible for compiling the statistical reports of the Verzekeringskamer. The *Policy Affairs* section is in charge of preparing and monitoring regulations and supervisory policies of the Verzekeringskamer. It advises the Management Board of the Verzekeringskamer on these subjects. The Policy Affairs section also advises the Management Board on subjects of co-operation with the other financial supervisors, i.e. De Nederlandsche Bank (Dutch Central Bank) and the Stichting Toezicht Effectenverkeer (Securities Board of the Netherlands). Further, Policy Affairs maintains contacts with the relevant regulatory departments, i.e. the Ministry of Finance and the Ministry of Social Affairs and Employment. The *Legal Affairs* section provides the supervisory departments with legal advisory support regarding the day-to-day supervision of insurance companies and pension funds. Legal Affairs also deals with notices of objection and proceedings on behalf of the Verzekeringskamer. The *Integrity* section takes care of the development and enforcement of the integrity supervision of the Verzekeringskamer. A main part of this relates to the assessment of expertise and trustworthiness of managing and supervisory directors and of shareholders of insurance companies and pension funds.

Co-operation with other supervisory authorities

As explained in section II.3 as from 1990 on the basis of the mentioned Protocol Agreements the Verzekeringskamer co-operates with De Nederlandsche Bank as regards the joint supervision of insurance companies and credit institutions being part of a financial conglomerate. The main domains of co-operation relate to the joint advice of the Ministry of Finance on a request by a financial conglomerate for granting a certificate of no objection and to the joint assessment of semi-annual reports that the financial conglomerates must submit to the Verzekeringskamer and De Nederlandsche Bank. As from 1997 the Verzekeringskamer and De Nederlandsche Bank also co-operate as regards the testing of the fitness and propriety of members of the managing board of a financial conglomerate.

In the spring of 1999 the Minister of Finance sent a note to Parliament on the Institutional Structure of the Supervision of the Financial Market-sector in the Netherlands. Based on an analysis of important developments on the Dutch financial markets, such as the introduction and expansion of financial conglomerates and the shift from traditional savings, investments and insurance products to more complex products of a hybrid nature, it was advised that the prudential supervisory authorities on the financial market, i.e., the Verzekeringskamer (insurance), De Nederlandsche Bank (banking) and Stichting Toezicht Effectenverkeer (securities) should co-operate more closely in the field of issuing rules and policies of a non-sector specific nature. This resulted in a decision of the prudential supervisory authorities to establish the *Raad van Financiële Toezichthouders (RFT)* (Council of Financial Supervisors).

The *RFT* started its activities in August 1999. The *RFT* has already identified three domains of a non-sector specific nature, for which separate committees have been created, i.e. Financial Conglomerates, Consumer Affairs (provision of information to buyers of financial products) and Integrity (fitness and propriety of managers, suitability of shareholders). During the first year of its existence the *RFT*:

- presented an Outline Note on the Prudential Supervision of Financial Conglomerates (upon which the Ministry of Finance based its Note on the Prudential Supervision of Financial Conglomerates, that was sent to Parliament in July 2000),
- agreed on a common policy rule on the assessment of the trustworthiness of managers and shareholders of financial institutions,
- decided to co-operate closely in the handling of requests by the general public for information on suppliers of financial products and on financial product themselves.

In September 2000 the RFT sent an Interim Report August 1999 – August 2000 to the Minister of Finance. This Interim Report was made available to the general public in November 2000.

Co-operation with auditors and actuaries

The *WTV 1993* stipulates that the appointment agreement or contract between the insurance company and the auditor, who will certify the prudential supervisory returns of the company, includes the authorisation of the auditor to notify the Verzekeringskamer immediately of any information that the Verzekeringskamer may need in order to carry out its supervisory tasks.

Further, pursuant to the so-called BCCI Directive (Directive 95/26/EC), the auditor must inform the Verzekeringskamer of any circumstance that may:

- violate the legal requirement to an insurance licence,
- violate the legal requirement to carrying out the insurance business,
- threaten the survival of the insurance company,
- prevent the auditor from certifying the prudential supervisory returns.

In addition, a tripartite general co-operation agreement has been concluded between the Verzekeringskamer, the Verbond van Verzekeraars (Association of Insurers in the Netherlands) and the Koninklijk Nederlands Instituut van Registeraccountants (Royal Chartered Auditors Association). This agreement requires that for every insurance company licensed in the Netherlands there shall be a model agreement signed by the Verzekeringskamer, the insurance company and its auditor about the provision of information by the auditor to the Verzekeringskamer.

The extension of the above mentioned general co-operation agreement to the actuaries is still being discussed.

B. Instruments and methods of solvency control

Prudential supervisory returns

The prudential supervisory returns must be submitted to the Verzekeringskamer before the 1 July following the financial year. The returns include prescribed forms, including additional disclosures, regarding the balance sheet and the profit and loss account, the investments, the technical provisions and the technical and financial results. For life assurance companies and for some classes of non-life insurance a report of an actuary is required. The complete set of forms, presenting the annual accounts must be certified by an auditor.

The fact that the reports of the actuary and the certifying auditor both constitute an integral part of the annual accounts, influences the level of analysis of the accounts. Detailed checks of a variety of elements of the annual accounts are not executed by the Verzekeringskamer. The overall analysis aims at gaining an adequate opinion on the solvency of the insurance company. Investigations are made into the technical provisions, the valuation of the technical provisions, the run-off of technical provisions, the investments, and the technical and financial results. Moreover, these results are analysed over the past five financial years. If necessary specific aspects of the annual accounts will be analysed in greater detail.

Minor points resulting from the analysis of the annual accounts are communicated in writing to the insurance company. Results which might influence the solvency of the insurance company are discussed with the board of managing directors of the company.

Periodical consultation

This is a rather new instrument that emerged in the beginning of the 1990's. Each year the Account Managers will visit every insurance company by way of anon the spot investigation (normally one day). Subjects for discussion may be the results of the analysis of the annual accounts of the insurance company, the policy of the insurance company and recent developments relating to the company.

On the spot investigation

Results of the analysis of the annual accounts or the outcomes of a periodical consultation may have an impact on the programme for the on the spot investigations of the insurance company, which are carried out every 3-5 years. On the occasion of such an investigation different aspects of the annual accounts and in a broader sense of the management of the insurance company are subjected to more thorough analyses. These may include the investment policy, the technical provisions (assumptions, run-off), technical and financial results, and so on. The short and long term policy of the management of the insurance company is analysed as well. The results of these investigations are discussed with the board of managing directors of the insurance company in question.

Supervisory Inquiry

The instrument of a Supervisory Inquiry is rather new. A Supervisory Inquiry may regard all insurers or a specific group of insurers, e.g. life insurers or health insurers. Furthermore, a Supervisory Inquiry may take the form of an extensive questionnaire or just a quick scan inquiry. The purpose of a Supervisory Inquiry is to get a complete overview of the state of affairs of specific matters of supervisory concern. Analysis of the results of such inquiries may lead to additional supervisory actions, such as the introduction or change of policy rules, points of special interest of periodical consultations or on the spot investigations. Recently, the Verzekeringskamer carried out Supervisory Inquiries into the handling of the millennium problems (quick scan), the use of derivatives by life assurers, the implementation of rules on the information to policyholders and into the introduction of the euro.

Normally the aggregated results of Supervisory Inquiries will be made available to the insurance industry and other interested parties through publication in the research series of the Verzekeringskamer, *'vk studies'*.

FILM

The so-called FILM (Frequent Information Living Companies) is an internal, confidential rating-database of the Verzekeringskamer. On an ordinal scale this database includes supervisory assessments of an insurance company on items such as: solvency, technical and financial results, adequacy of technical provisions, investment portfolio and investment policies, underwriting risks, administrative organisation and internal control, organisation structure, state of the art of management, market orientation, strategy and policies. Any new information, resulting for instance from the analysis and assessment of supervisory returns, from periodical consultation, from on the spot investigation, etc. may lead to a review of earlier assessments.

The overall picture of the FILM assessment or specific items of supervisory concern may trigger additional supervisory actions through periodical consultation or on the spot investigations.

IV Measures when difficulties arise

A. The day-to-day concerns of a supervisor

Apart from the occurrence of catastrophes, difficulties that an insurance company may encounter are usually foreseeable. It is the aim of solvency supervision, and in a broader sense of supervision of insurance companies, including integrity supervision, to minimise the risk that such foreseeable difficulties, that might endanger the survival of the insurance company, would occur.

With this in mind, in the day-to-day supervision of insurance companies all kinds of signals may come up, which might indicate that difficulties could occur. Such signals may be the result of the analysis of the supervisory returns, of on the spot investigations or of any other information that has become available to the Verzekeringskamer.

In assessing these signals the Verzekeringskamer may call upon further inquiries into the insurance company. If necessary the subject is discussed with the board of managing directors of the insurance company. These inquiries or discussions may lead to the conclusion that specific measures are called for. If the company is not convinced of the necessity to take such measures, the Verzekeringskamer may urge it to take them. The ultimate power of the Verzekeringskamer, as set out in section II.D, is to give an administrative directive with which the insurance company must comply.

More serious problems arise when the solvency of the insurance company falls short of the required margin or the required minimum of the guarantee fund according to the relevant EEC Directives. The respective regulations (article 20 of the Directive 73/239/EEC and article 24 of the Directive 79/267/EEC) are incorporated in the *WTV 1993*.

Depending on the seriousness of the problems the insurance company has to submit a plan for the restoration of a sound financial position or a short term finance scheme, which are to be approved by the Verzekeringskamer. The Verzekeringskamer may also restrict or prohibit the free disposal of the assets of the insurance company.

B. Early Intervention Arrangement Life Assurers (EIALA)

In January 2001 a bill was enacted that introduces the so-called *Opvangregeling Levensverzekeraars* (Early Intervention Arrangement Life Assurers) into the *WTV 1993*. The EIALA gives the Verzekeringskamer an additional supervisory power to guide a life assurer through a financially difficult period or in any case to secure the continuity of the insurance portfolio. This support under the EIALA could be given at a point of time at which the assurer may still meet its (insurance) liabilities. In principle, this applies to the situation in which the guarantee fund, as defined under the European solvency rules, is threatened and the assurer, its shareholders or members are no longer prepared or have shown not to be able or willing to raise the solvency margin to the level required by law within a time-limit to be decided upon by the Verzekeringskamer.

The EIALA empower the Verzekeringskamer to:

- compel an insurer to enter into a reinsurance treaty and compel the joint life insurers to offer such a contract; or
- compel the insurer involved to transfer its portfolio to a special entity. This will be combined with a call upon the joint life insurers to provide financial support to this special entity in order to meet the solvency requirements.

The provision of reinsurance coverage and the acquiring of the portfolio will be effected through a ‘special purpose EIALA entity’, incorporated by the Verbond van Verzekeraars (Association of Insurers). The Verbond van Verzekeraars will guarantee that the initial financial support is available to realise an EIALA operation. The financial support under the EIALA will be limited to Dfl. 200 million in case of an insurer that has run into financial difficulties. In specific circumstances the support may be extended to Dfl 400 million in total.

The EIALA provides for the necessary checks and balances: for instance the Verzekeringskamer must consult the so-called Fiduciary Committee, a new – yet to be installed - committee of the Verzekeringskamer, before deciding on the application of the EIALA. This committee shall be composed of experienced persons who are not (any more) directly linked to an individual insurer, for instance former members of the board of management of insurers or of other financial institutions. The members are to be appointed by the Finance Minister.

C. Emergency Rules

If the measures mentioned in the section IV.B do not suffice, the Verzekeringskamer may withdraw the licence of the insurance company. Consequently, the insurance company must liquidate its business, still being supervised by the Verzekeringskamer.

If deemed necessary the Verzekeringskamer may, in the interest of the joint creditors of the insurance company, petition the Court within whose jurisdiction the insurance company has its head office, to invoke the Noodregeling Procedure (Emergency Rules) of the *WTV 1993*. According to these Rules the Court will, upon advice of the Verzekeringskamer, appoint one or more Trustee(s). The Trustee will be authorised by the Court to liquidate all or part of the insurance portfolio, or to transfer the insurance portfolio of the insurance company. Under these Rules the Trustee also has the power to liquidate the insurance company.

The Court may also authorise the Trustee(s), when he decides to transfer the insurance portfolio to another insurance company, to amend the rights and obligations of the insurer and the insured under the insurance contracts.

If under Emergency Rules of the *WTV 1993* the Trustee does not succeed in liquidating or transferring the insurance portfolio of the insurance company, he may petition the Court to declare the insurance company bankrupt. From then on the provisions of the Bankruptcy Act will apply.

NEW ZEALAND

I Introduction

There are two separate private insurance supervision regimes in operation in New Zealand – one in respect of fire and general insurance, and the other in respect of life insurance. Both regimes are presently under review, with the aim of updating them to cope with the issues raised in the modern commercial environment. The Accident Insurance Act 1998 provides for compensation by the State alone for personal injury by accident.

II Fire and general insurance

The supervisory regime for fire and general insurers is located in the Insurance Companies Deposits Act 1953 and the Insurance Companies Ratings and Inspections Act 1994.

A. Insurance Companies Deposits Act 1953

This Act provides:

a) All persons commencing insurance business after 26 August 1974 (with the exception of life insurance and insurance against earthquakes and accident insurance business) are obliged to pay a NZ$ 500,000 deposit to the Public trustee, or deposit approved securities to that value.

b) Mutual assurance associations carrying out employer's liability insurance must deposit securities of not less than NZ$ 2 000 per every NZ$ 5 000 or premium income, up to a maximum of NZ$ 45 000.

c) Companies carrying on fidelity guarantee insurance, mortgage guarantee insurance or personal indemnity insurance, and no other class of insurance business, may be exempted from the deposit requirements.

d) Persons required to make a deposit must prepare, in the form prescribed, the following accounts at the expiration of each financial year:

   – underwriting account;

- investment account;
- profit and loss account;
- appropriation account;
- balance sheet.

Each account is to be audited and filed with the Ministry of Economic Development.

B. Insurance Companies (Ratings and Inspections) Act 1994

This Act provides:

a) Any person must have a current rating if it is carrying on insurance business, except:

  - Life insurance or
  - Captive insurance business with members of its own group of companies.

But insurers who do not offer disaster insurance or general insurance may elect not to be rated. (These will usually be health insurers, credit contract insurers, mortgage guarantee insurers and professional liability insurers).

b) The rating must be obtained every year from an agency approved by the Registrar of Companies and must be registered with the Registrar, so it is available for public inspection. Currently two agencies are approved: A M Best and Standard & Poor's.

c) Notice must be given of a rating downgrade or credit watch warning.

d) The rating must be disclosed in writing to any insured person before a contract of insurance is renewed or finalised.

e) The Registrar of Companies has powers of inspection, to determine whether an insurer is unable to pay its debts. A report prepared in relation to such an inspection is admissible in evidence at any application to appoint a liquidator of the insurer.

C. Solvency monitoring by the insurance industry

As an informal measure, the Insurance Council of New Zealand Inc. monitors the solvency of its own members. Achievement of a satisfactory solvency ratio is a prerequisite for continued membership of the Insurance Council. It should be noted however that not all insurance companies in New Zealand are members of the Council.

D. Review of fire and general insurance

A review of the provisions of the Insurance Companies Deposits Act and the Insurance Companies (Ratings and Inspections) Act 1994 has been conducted. It recommended certain changes to those statutes but has not yet (in 2001) been followed by legislative changes.

E. Earthquake Commission Act 1993

All residential property owners who buy fire insurance from private companies automatically acquire the Earthquake Commission's seismic disaster insurance cover for their dwelling and personal effects, up to a certain minimum. The Commission's premiums are added to the cost of the fire insurance and passed on to the Commission by the insurance company.

The Commission is a crown entity, wholly owned by the government of New Zealand and controlled by a board of commissioners. Crown entities are not government departments or state-owned enterprises, but nevertheless belong to the government and are subject to public sector finance and reporting rules. The government guarantees that the fund administered by the Commission, comprising capital and reserves, will meet all its obligations.

III Life insurance

The relevant provisions in relation to life insurance are found in the Life Insurance Act 1908 and the Securities Act 1978.

A. Life Insurance Act 1908

The Life Insurance Act:

a) Requires life insurers to deposit approved securities of not less than NZ$ 500 000 with the Public Trustee.

b) Requires life insurers to maintain solely for the security of life policy and annuity holders, a separate life insurance fund, consisting of all receipt in respect of the life insurance and annuity contracts of the company. This requirement applies where a life insurer transacts other insurance besides life insurance.

c) Requires life insurers, at the expiration of each financial year, to deposit the following audited financial statements with the Secretary of Justice:

   – revenue account;

- financial position;
- financial performance;
- statement of its life insurance and annuity business.

In addition, the companies must file certain statements made by an actuary showing:

- valuation of the liabilities under life policies and annuities;
- consolidated revenue account;
- summary and valuation of policies;
- statement of financial position.

B. Securities Act 1978

This Act provides, among other things, specific rules governing the offer and allotment of securities. The definition of securities in the Act is very wide, and covers most forms of investment. Life insurance bonds and like investment products are considered to be securities. The Act contains a specific provision permitting life insurers to apply for an exemption form the restrictions imposed by the Act. It also permits the Securities Commission (which administers the Act) to impose standards and reporting requirements on the life insurer as a condition of grating the exemption.

C. Review

A review of the provisions of the Life Insurance Act 1908 is presently underway. Proposals under discussion include updating the reporting requirements to ensure that financial statements provide more meaningful information, and introduction of an appointed actuary regime similar to that presently in operation in Australia. Any legislative reform is unlikely to be enacted for at least twelve months.

IV Other relevant legislation

The following statutes also impact upon the supervision of private insurers:

Statute	Effect
Mutual Insurance Act 1955	Provides for incorporation and operation of mutual insurance associations
Marine Insurance Act 1908	Regulates conduct of marine insurance
Insurance Law reforms Acts 1997 and 1985	Reforms certain law governing contracts of insurance

NORWAY

I Introduction

The financial supervision of insurance undertakings is mainly based on rules and provisions laid down by the following Acts:

- the Act on Insurance Activity (AIA) from June 1988 with later amendments,
- the Act on Financing Activity and Financial Institutions (abbreviated as the Financing Services Act or FSA) from June 1988 with later amendments, and
- the Act Relating to the Banking, Insurance and Securities Commission (Kredittilsynet), originally from December 1956 but substantially revised as a consequence of the merging of several supervisors into one organisational body.

In this connection it may be noted that the provisions embodied in the AIA regarding e.g. capital adequacy requirements and asset management have been adjusted as a consequence of the EEA–agreement. Moreover, the AIA is supplemented by e.g. the supervisor's authority to intervene as laid down by the Act related to Kredittilsynet.

The insurance undertakings operating in the Norwegian market (as at May 2000) and supervised by Kredittilsynet may be grouped as follows:

- 9 traditional life insurance undertakings and 6 undertakings specialised within unit linked insurance.
- 50 non-life insurance undertakings (26 joint stock undertakings and 24 mutual undertakings).
- 129 private pension funds and 26 municipal pension funds. (The regulations concerning the life insurance industry apply – by and large – to the pension funds as well.)

It should be noted that the concentration of market shares is high within both the life insurance and the non-life insurance industry. Moreover, the largest life and non-life insurance undertakings are all members of complex financial groups (financial conglomerates).

II Regulations concerning the supervision of solvency

The basic building blocks of the solvency supervision are (1) the regulations on technical provisions, (2) the regulations on capital adequacy and solvency margin and (3) the regulations on asset management. An overview of these building blocks is given in sections II.A–II.C below.

A. Regulations on technical provisions

Due to the substantial difference between the life insurance industry and non–life insurance industry there are separate regulations regarding the calculating of the necessary technical provisions as well as the measures for controlling the adequacy of these provisions for undertakings operating within these two industries.

Life insurance

In the life insurance industry the requirements for technical provisions comprise requirements for the insurance fund, including the mathematical provisions and the so–called additional provisions, and the contingency fund.

The mathematical provisions are – with one major exception – calculated according to "traditional" prospective methods, that is as the capital value of future obligations less the capital value of the future premiums. However, a special feature of the Norwegian system is that the part of the generated profits to be allocated to the policyholders shall be distributed annually and with irreversible effect among the various contracts. As to the annually generated profits, the policyholders’ part will amount to at least 65 per cent, since the total of dividends to shareholders, company taxes and allocations to free funds cannot exceed 35 per cent of the profits which are left after deductions for expenses and allocations to the various elements of the insurance fund.

As a consequence of these procedures the buffers included in the insurance funds (along with the undertakings’ equity capital) may become scanty in situations of abrupt changes in the financial markets. However, since the end of 1993 the life insurance undertakings have been allowed to allocate a part of the surplus to so–called additional provisions being only conditionally distributed to the policyholders.

The introduction of a "buffer" in terms of additional provisions during the fall of 1993 has again made the life insurance undertakings able to resist a considerable fall in the bond and stock markets. According to the regulations on additional provisions, the upper limit for these provisions will be no less than 8 per cent of the actual mathematical provisions. However, for existing undertakings having a large portfolio of group pension insurance where the mathematical provisions are calculated by using a contractual rate of interest fixed at 4 per cent, the additional provisions constitute approximately 10–12 per cent of the mathematical provisions (and this percentage will only decrease at a slow rate).

As a follow-up on the regulations regarding additional provisions, Kredittilsynet has elaborated and entered into force a comprehensive set of supplementary rules regarding the calculation of the additional provisions, the distribution of these provisions on the various classes of insurance and contracts and finally the conditions to be satisfied before these provisions may be applied.

The purpose of the contingency fund (or safety fund) in life insurance is to meet fortuitous losses. The methods to be utilised when calculating the lower limit of this fund differ somewhat between the main lines of business in life insurance:

- In group life insurance the contingency fund is calculated by using methods that are similar to the methods applied when calculating the requirements for fluctuation provisions in non–life insurance.
- In individual life insurance the basis of calculation is fixed as an aggregated risk premium (i.e. the amount at risk multiplied by an adjusted force of mortality). The factor applied to this basis of calculation corresponds to the ratio of required contingency fund to risk premiums implicitly defined by the rules of calculation for group life insurance.
- In group pension insurance, individual pension insurance and life annuity insurance the contingency fund is stipulated as the total of 1 per cent of the guaranteed yearly benefits (less the disability benefits) and 2 per cent of the disability benefits.

The lower limit to be met by the undertaking equals the grand total of limits calculated for the main classes of life insurance. Moreover, it should be noted that the actual contingency fund may exceed this lower limit by 50 per cent.

As a part of its control measures Kredittilsynet has elaborated and implemented a method of calculation, including a rather detailed form, giving reliable estimates of the year–to–year development of the various elements of the insurance fund and other quantities. Any substantial deviations from these estimates will involve further investigations conducted by the supervisor.

Non–life insurance

According to the AIA the Ministry of Finance shall provide regulations related to technical provisions in non–life insurance, including contingency provisions and other provisions to cover risk factors derived from the insurance business.

The supervisory authorities have in fact implemented two sets of regulations regarding technical provisions for the non-life business:

- the main regulations as laid down by the Ministry of Finance in May 1991, and
- the supplementary regulations as laid down by Kredittilsynet in November 1992.

It should be noted that the requirements implemented by these regulations have been assessed against the general rules on technical provisions stipulated by the First EU Directive on non-life insurance (73/239/EEC) as well as the requirements regarding this kind of provisions implemented by the EU Directive on annual accounts of insurance undertakings (91/674/EEC). However, this assessment has entailed only minor adjustments of the national regulations.

The main regulations comprise general requirements regarding the technical provisions, stipulations of minimum requirements for the various components of the technical provisions as well as general guidelines as to the risk–theoretic methods to be utilised when calculating the requirements to be fulfilled by these provisions.

The minimum requirements for technical provisions are defined more precisely in the supplementary regulations outlined by Kredittilsynet. Moreover, these regulations include a detailed documentation of the methods to be applied by the undertakings when calculating the minimum requirements. Especially, Kredittilsynet has emphasised that the methods for calculating the minimum requirements for loss provisions and fluctuation provisions should be able to catch the following aspects of the risk processes generating the losses to be covered by the latter provisions:

- any differences between the insurance undertakings as to the size of their risk exposure and the distribution of this exposure amongst the classes of insurance where the undertakings actually write business,
- any differences between the classes of insurance regarding loss ratios (or claim frequencies) and development patterns of the various occurrence years not finally settled as well as the year–to–year fluctuations in these parameters,
- any differences between the undertakings and – for a given undertaking – any differences between the classes of insurance as to the risk–reducing effects of the actual reinsurance covers (including the application of suitable approximation methods).

The <u>minimum</u> requirements for the various components of the technical provisions may be summarised as follows:

- The premiums provisions should at least equal the greater of the unearned premiums and the premium liability (i.e. the expected future payments for covered but not incurred claims) where both amounts are calculated on a net basis.

- The provisions for outstanding claims should at least cover the loss liability calculated according to methods stipulated by Kredittilsynet. In this context the loss liability is defined as the (conditionally) expected value of future payments on a net basis related to both incurred but not reported claims and reported but not settled claims.

- The fluctuation provisions should at least cover the fluctuation liability which in principle is calculated by risk–theoretic methods including the utilisation of the well known NP method (Net Premium method). However, in classes of insurance where suitable risk–theoretic methods are not available, the minimum requirement equals 15 per cent of the greater of the earned premiums for the last accounting year and the total of the minimum requirements for premium provisions and provisions for outstanding claims.

- The reinsurance provisions should equal a company–specific ratio multiplied by a basis of calculation defined as the total of the unearned premiums, the loss liability and the fluctuation liability calculated on a gross basis less the total of the unearned premiums, the loss liability and the fluctuation liability calculated on a net basis. The company–specific ratio will vary between 2 and 20 per cent depending on the average credit rating of the undertaking's reinsurers.

- The administration provisions should equal 5 per cent of the total of the minimum requirements for premium provisions, provisions for outstanding claims and fluctuation provisions.

When assessing this system of minimum requirements for technical provisions, the following aspects of the regulations should also be considered:

- The requirements for premium provisions and provisions for outstanding claims apply to each class of insurance where the undertaking writes business.

- It is presupposed that the total of premium provisions, provisions for outstanding claims and fluctuation provisions at all times will cover the undertaking's overall future contractual claim payments with a high degree of probability (e.g. 99 per cent).

- The purpose of the reinsurance provisions is to cover costs which accrue if one or more of the undertaking's reinsurers fail to cover their shares of the overall (compensation) commitments.

- The purpose of the administration provisions is to cover claims settlement (and adjustments) costs related to all contractual claims (at the balance sheet day) to the extent that such provisions are not already included in the premium provisions and/or provisions for outstanding claims.

The calculated minimum requirements for technical provisions are documented in extensive reports submitted to Kredittilsynet. These reports should also contain detailed information regarding the undertakings' actual technical provisions.

B. Regulations on capital adequacy and solvency margin

The AIA stipulates that each insurance undertaking shall have:

1. a capital ratio which at all times constitutes at least 8 per cent of the assets and off–balance liabilities calculated according to the BIS principles for risk–weighting, and

2. a capital which at all times is sufficient to cover the solvency margin estimated on the basis of the undertaking's overall business.

It should, however, be stressed that these requirements are not additive. On the other hand, the Financing Services Act (FSA) contains some more general requirements stipulating that all insurance undertakings and credit institutions at all times shall maintain a satisfactory capital adequacy level and fulfil the minimum capital requirements ensuing from rules and regulations implemented by the Ministry of Finance.

Regulations implementing the BIS rules

It should be noticed that in Norway the BIS rules have been implemented for all insurance undertakings, banks and other credit institutions. In practice, the Ministry of Finance has stipulated regulations regarding:

- the rules for calculating the risk–weighted minimum requirement for capital (i.e. the minimum standard of capital adequacy),

- the list of items to be considered as capital according to the BIS rules (i.e. rules regarding the measurement of capital).

The methods constituting the regulations on the minimum standard of capital adequacy can be summarised as follows:

1. An insurance undertaking shall at all times maintain a capital ratio of at least 8 per cent of the basis of calculation, cf. no. 2 and 3 below.

2. The basis of calculation comprises both on–balance and off–balance sheet items, where the various items are risk–weighted according to the credit risk they are assumed to represent. The value of each on–balance sheet item and the converted value of each off–balance sheet item are multiplied by their respective risk–weights and the total of these products constitutes the basis of calculation.

3. The various asset items are classified into five main categories of credit risk where the associated risk weight range over the set {0 per cent, 10 per cent, 20 per cent, 50 per cent and 100per cent}.

According to the regulations on the measurement of the capital of insurance undertakings and credit institutions, the capital base consists of three main categories, that is 1) the core capital, 2) the supplementary capital and 3) the general provisions.

As to the insurance undertakings the most relevant items constituting the core capital are:

- the paid–up share capital,
- the paid up primary capital (in mutual companies),
- the distributable reserves,
- the guarantee fund in mutual insurance companies less the part of the fund that consists of subordinated loan capital, and
- other taxed reserves, e.g. the accumulated profits (the profits carried forward),

while the relevant items of the supplementary capital are:

- the assets revaluation fund,
- other instruments of debt/equity comprising items that have character of being both debt and equity and which satisfy a set of further specified conditions (i.e. capital items of a higher quality than subordinated loan capital), and finally
- subordinated loan capital.

The term general provisions is defined as "provisions to cover future losses on loans, guarantees etc, which could arise after the balance sheet day". This kind of provisions is, however, of minor importance to the insurance undertakings.

Moreover, the regulations on the measurement of capital contain rules on the items to be deducted from the core capital and the supplementary capital as a consequence of e.g. holdings of own shares or parts of capital in other insurance undertakings or credit institutions. Finally, the regulations introduce some restrictions regarding the composition of the capital base:

- The items constituting the supplementary capital cannot exceed 100 per cent of the total of the core capital and the general provisions.
- Subordinated loan capital with a fixed term cannot exceed 50 per cent of the total of core capital and general provisions.

As a supplement to the regulations implementing the BIS rules the Ministry of Finance has stipulated absolute lower limits for the capital base of insurance undertakings. At the present (May 2000) these limits are NOK 20.3 million (approx. 2.5 million Euro) for already established (on–going) insurance undertakings and NOK 31.8 million (approx. 3.9 million Euro) for newly established undertakings. These amounts are adjusted each year in accordance with the year–to–year development of the consumer price index.

Regulations implementing the EU–rules

As a consequence of the EEA agreement the Ministry of Finance has implemented a set of regulations on the solvency margins of insurance undertakings. However, the solvency system already in force (i.e. BIS rules for capital adequacy) has not been abolished, meaning that the Norwegian system may be characterised as a "two–track system".

The regulations on solvency margins contain both rules for calculating the solvency margin requirements and rules regarding the capital items that may enter into an undertaking's actual solvency margin capital:

- The implemented methods for calculating the solvency margin requirements are "blue prints" of the EU rules. In fact the EU Directives do not offer any options on this matter, cf. Article 16 of Directive 73/239/EEC (non-life insurance) and Article 19 of Directive 79/267/EEC (life insurance).
- On the other hand, there exist some freedoms of choice regarding the list of capital items to be taken into account when measuring the actual solvency margin. According to the implemented regulations, the solvency margin of insurance undertakings will consist of the items listed in the following table:

The items constituting the solvency margin capital.

Life insurance undertakings	Non–life insurance undertakings
The capital base measured according to the BIS rules.	The capital base measured according to the BIS rules.
The part of the actual contingency fund exceeding 55 per cent of the lower limit of this fund.	The part of the actual fluctuation provisions exceeding 55 per cent of the minimum requirements for these provisions.
50 per cent of the additional provisions.	Provisions providing coverage against natural hazards.

A comparison of capital requirements according to the BIS rules and the EU rules

As already mentioned, the Ministry of Finance has decided that the Norwegian regime for solvency control shall follow along two tracks. In this connection the question has been raised as to whether the "BIS scenario" or the "EU scenario" leads to the stricter requirements. In general, it is not obvious how to answer this question, since there are differences both between the methods for calculating the minimum capital requirements and the list of capital items that may be applied to cover these requirements.

However, it may be argued that the "BIS scenario" in certain circumstances can lead to the less strict requirement, because the insurance undertakings – at least within certain limits – may manipulate the capital requirement associated with this scenario by reallocating their assets towards categories with lower risk weights.

C. Regulations on asset management

With respect to asset management the AIA only contains a set of general rules on the insurance undertakings' management of their assets:

- An insurance undertaking shall provide a proper management of its assets.
- Especially, the undertaking shall see that assets corresponding to the technical provisions are invested in an adequate manner with respect to the art of obligations as well as to security, diversification of risks, liquidity and return.

In addition, the AIA stipulates that Kredittilsynet may instruct the undertaking to alter its investments, if the supervisor finds that the undertaking "has invested its assets contrary to statutory provisions or regulations or otherwise in an unsatisfactory or evidently unfortunate manner".

With a legal basis in the AIA, the Ministry of Finance has supplied further regulations on the management of the assets that are consistent with the EU rules on these matters. Accordingly, these regulations have implemented rules and guidelines covering the following aspects:

- Valuation of assets applied to cover the technical provisions. These guidelines are by and large an adaptation of the EU rules already implemented in the regulations on annual accounts of insurance undertakings.
- Categories of assets which may be used to cover the technical provisions.
- General restrictions on the investment of assets covering the technical provisions.
- An insurance undertaking's maximum exposure with respect to one single risk (that is restrictions as to the value of assets associated with one single risk). Similar rules apply to e.g. real property.
- Handling of the undertakings currency exposures and the organisation of the currency transactions.

A reasonable assessment of the rules and guidelines implemented by the regulations on asset management is that they – taken together – are probably somewhat stricter than the rules stipulated by the EU Directives. For example, the regulations have fixed restrictions on the investment of assets as percentages of the net technical provisions, while the EU Directives stipulate the gross technical provisions as an appropriate "yardstick" for such restrictions. In addition, the regulations stipulate that the overall value of shares and other securities treated as shares cannot exceed 35 per cent of the (net) technical provisions.

Moreover, in accordance with the general set of rules stipulated by the AIA, insurance undertakings are not allowed to participate in operations linked to financial derivatives that carry high risks. Thus, these undertakings may only use derivatives for hedging purposes or under certain conditions for yield–enhancing purposes (i.e. an efficient portfolio management).

It should, however, be stressed that some of the above mentioned rules are eased for or do not apply to some kinds of insurance undertakings, including the P&I undertakings and especially the unit linked undertakings.

III Practical organisation of the supervision

The main elements of the supervisory activities are (1) documentary supervision and analyses, (2) communications with the appointed actuaries and (3) on site inspections and bi–annual meetings regarding the financial performance of the largest insurance undertakings and insurance groups. Brief comments on these aspects are given in sections III.A–III.C.

A. Documentary supervision and analysis

The on–going supervision based on documents (the "off site" supervision) comprises control of the solvency requirements in a broad sense, including

- collection and review of annual accounts and other accounting data,
- collection, revision and analysis, on a quarterly basis, of data regarding technical provisions and capital adequacy,
- collection and analysis, on a quarterly basis, of key figures from the profit and loss account and the balance sheet, and
- control of various statutory requirements.

The financial status and trends are analysed for both single insurance undertakings and insurance groups. This part of the supervisory activities does also comprise in–depth analyses where the fulfilment of the various solidity requirements is evaluated in its entirety. Especially, quarterly reports are prepared reviewing the recent development of the financial situation, the capital adequacy and trends in key figures from the balance sheet for both the life insurance and the non–life insurance industry.

A brief overview of the various documents submitted by the insurance undertakings and insurance groups as a part of the documentary supervision is given in annex 1.

B. Communications with the appointed actuaries

The notification requirements regarding the technical bases for calculation of premiums (in life insurance) and the systems for controlling the technical provisions raise quite a few questions related to technical/statistical as well as to practical matters. As a consequence of this Kredittilsynet has an extensive communication with the appointed actuaries in both life insurance and non-life insurance undertakings, and the appointed actuaries play an important role in connection with the supervision of the insurance undertakings. According to the regulations related to actuaries the appointed actuary shall among other things ensure that:

- the undertakings' insurance business at all times is conducted in an actuarial prudent manner,
- the calculations of the insurance fund etc. (in life insurance) and the technical provisions (in non–life insurance) are done in accordance with the AIA,
- the distribution of the accumulated profits (in life insurance) to the policyholders and parties insured is done in accordance with the AIA and associated regulations, and
- the insurance premiums are not fixed in violation of the rules stipulated by the AIA and associated regulations.

In the life insurance industry there are frequent meetings between the appointed actuaries and actuaries representing the supervisor. Even if these meetings have no formal status within the supervisory system, the agendas have covered almost all aspects of the supervision of the life insurance industry, and the discussions in these meetings have in general contributed to a common understanding of actual issues as well as to practical methods and routines for the implementation of technicalities related to the regulations concerning life insurance.

As to the non-life insurance industry, Kredittilsynet has established a Technical Calculation Committee (TCC) to handle issues raised by or being consequences of the supplementary regulations on technical provisions. According to its terms of reference the TCC shall:

- make frequent analyses of the various technical aspects of the regulations on technical provisions, including the applied methods of calculation based on risk–theoretic considerations.

– analyse consequences of the regulations in force as well as proposals put forward regarding adjustments or changes of these regulations. All proposals for amendments put forward should be supplemented with analyses of the consequences of implementing these amendments.

The members of the TCC are the appointed actuaries from the largest non–life insurance undertakings, the chief actuary of the Norwegian Financial Services Association and actuaries representing the supervisor.

C. On site inspections etc.

The experience from the last 10–15 years has highlighted the essential role of on site inspections also for the insurance industry. In general, any analysis of the financial strength of the insurance industry should be confirmed by on site inspections of a number of carefully selected insurance undertakings.

The main aims of the on site inspections are to evaluate whether:

– the activities of the insurance undertakings is executed according to the relevant Acts and the regulations stipulated with legal basis in these Acts,

– the real values of the undertaking’s assets correspond to the values reflected in its balance sheet,

– the internal reports regarding e.g. the written business give the management and the board of directors all necessary information, and

– the reinsurance programmes give sufficient cover with respect to the undertakings’ risk exposures.

Moreover, the on site inspections make it possible to evaluate whether internal routines, operating systems and control systems are adequately designed and whether they are lived up to in practice. This part of the inspections comprises among other things an evaluation of the safety systems in event of computer failures and organisational aspects. Finally, the on site inspections encompass evaluations of the ability of the management.

As to the complementary work of an on site inspection the following main points should be emphasised:

– The inspectors that are responsible for carrying out the on site inspection, prepare a report containing the essential findings of the inspection.

– The report is sent to the undertaking’s board of directors to be commented on. A copy of the report is also sent to the control committee, the external auditors and the appointed actuary. This version of the report will not be made available to the public.

- On the basis of the report and any written comments from the undertaking's board of directors as well as the control committee, the auditors or the appointed actuary, Kredittilsynet prepares a set of concluding remarks regarding the on site inspection in question. These remarks may include instructions from the supervisor and will in general be official information and upon request be passed on to the public.

In addition to the on site inspections, Kredittilsynet has bi-annual meetings with the largest insurance undertakings and insurance groups. The main purpose of these meetings is to discuss the financial status and performance of the insurance undertaking or insurance group in question. Moreover, Kredittilsynet uses these meetings to get updated information regarding the budget and the financial projections as well as the insurance undertaking's or insurance group's strategies for the next 6–12 months.

IV Measures taken when difficulties arise

At the outset it may be appropriate to distinguish between the non-fulfilment of:

- the requirements for technical provisions,
- the capital adequacy requirements according to the BIS rules, and
- the requirements for solvency margin capital as stipulated by the EU rules.

According to the insurance legislation, the fulfilment of the technical provisions will in general have priority to the fulfilment of capital or solvency margin requirements. Accordingly, any non-fulfilment of the technical provisions will sooner or later be "transferred" to a reduction of the undertaking's capital base.

In this connection, it should be stressed that a life insurance undertaking will in practice be "out of business" if it enters a state of non–fulfilment of the requirements regarding the insurance fund, since the process of winding–up or transferring of the portfolio to other undertakings will be initiated more or less automatically. On the other hand the main regulations on technical provisions in non–life insurance state that *[t]he Ministry of Finance may in certain instances and for a limited period of time consent to an insurance company having lower technical provisions than stipulated in these regulations.*

In practice this rule will only apply in cases of non-fulfilment of the minimum requirements for technical provisions beyond premium provisions and provisions for outstanding claims. In such cases the insurance undertaking will have to present a short–term plan for the reconstruction of all components of the technical provisions.

A. *On cases of non–fulfilment of the capital adequacy requirements (the BIS rules)*

The measures to be taken in cases where an insurance undertaking does not fulfil the capital adequacy requirements, include the following options:

1. An inflow of capital funds from external sources.

2. A transfer of means from the contingency fund in life insurance. (With respect to non-life insurance this option is covered by the exemption rules referred to above.)

3. A change of the composition of the asset side of the balance sheet towards items with lower risk weights (i.e. a reduction of the minimum requirements for capital).

4. A temporary exemption from the capital adequacy requirements.

5. Cessation of the underwriting of new business.

6. Withdrawal of licence.

7. Public administration of the undertaking.

It should be noticed that options nos. 5, 6 and 7 are dramatic measures and will only be applied if the application of the other measures have failed and the supervisory authorities have no reason to believe that the undertaking in question will be able to restore a sound financial position. Moreover, it is rather obvious that an inflow of capital from external sources is the preferred measure. This inflow can constitute a combination of core capital elements and supplementary capital elements as long as the restrictions regarding the composition of the capital base is obeyed, cf. subsection II.B. *Regulations implementing the BIS rules* above.

All the other measures listed above have some restrictions or weaknesses as indicated by the following critical comments:

– According to the regulations regarding the contingency fund in life insurance, the share of the actual contingency fund exceeding the lower limit of this fund may be applied to cover a drop in the value of bonds and of shares classified as current assets.

– A "manipulation" of the composition of the asset side towards items with lower risk weights can only be a temporary solution, since the assets with low risk weights are associated with low expected yield (at least in the long run). Moreover, an important problem to be discussed in the actual cases is whether the new composition of assets is adequate with respect to the undertaking’s commitments.

– In general, temporary exemptions from the capital adequacy requirements will not be granted. Moreover, it may be argued that this measure should be evaluated against the more dramatic measures as stipulated by option nos. 5, 6 and 7.

- In principle, an instruction to stop the underwriting is a less serious intervention than a decision implying withdrawal of licence. The consequences for the undertaking may, however, easily become identical, especially if the cessation is not limited to a short period of time.

If it is decided to make use of option nos. 5, 6 or 7 as listed above, the supervisor will in any case take the following aspects into consideration:

- the dimensions of the non–fulfilment of the capital requirements,
- the technical bases of calculation and scales of premium rates applied by the undertaking, and
- the expectations regarding the future development of interest rates and the consequences on the expected earnings of the (life insurance) undertaking.

If the carrying out of one of these options eventually leads to a winding–up of the undertaking, it will in general be assessed whether it is possible to:

- merge the undertaking with another insurance undertaking,
- make an agreement with another insurance undertaking regarding transfer of the insurance portfolio in question, or
- transform the undertaking into a different type of undertaking, e.g. initiate a process of demutualization.

B. On cases of non–fulfilment of the solvency margin requirements (the EU rules)

The rules stipulated in the EU Directives regarding measures to be taken if the actual solvency margin capital of an insurance undertaking falls below the solvency margin requirement or below one third of this requirement, have been implemented into the Norwegian legislation. These measures can briefly be sketched as follows:

- If the actual solvency margin capital of an insurance undertaking falls below the solvency margin requirement, the undertaking shall prepare a plan for a restoration of its financial position.
- If the actual solvency margin capital falls below one third of the solvency margin requirement (the guarantee fund), the undertaking shall prepare a short–term financial scheme for the re-establishment of the solvency margin capital.

In both cases the plan shall be approved by Kredittilsynet. Moreover, Kredittilsynet may restrict or prohibit the undertaking's free disposal of its assets. It should, however, be noticed that it is not likely that the second case will arise unless the undertaking already has failed to fulfil the capital requirements according to the BIS rules and/or the requirements for technical provisions. As a consequence, the measure to be applied in this case will only be of minor practical importance within the Norwegian solvency system.

Annex 1: Documentary supervision – An overview of submitted information

A. The annual accounts etc.

Once a year all insurance undertakings and insurance groups submit information regarding their financial statements using a public reporting system for accounting and supervisory purposes that has been established by a collaboration between Statistics Norway, the Central Bank of Norway and Kredittilsynet (the so–called FORT–system). This information encompasses statements regarding e.g.

- the profit and loss accounts,
- the balance sheet, and
- premiums, claims and technical provisions related to the individual classes of insurance as well as other detailed information regarding "insurance technicalities".

In this context it should be noticed that the FORT–system contains information that is far more detailed than indicated by the requirements listed in the EU Insurance Accounting Directive (91/674/EEC).

On a quarterly basis the insurance undertakings have to submit a less extensive amount of information (but still applying the FORT–system).

Moreover, the insurance undertakings submit key figures from their profit and loss accounts and balance sheets on a quarterly basis by using special forms elaborated by Kredittilsynet. The deadline for submission of the latter information is normally one month after the end of the quarter in question.

B. Technical provisions

Once a year the life insurance undertakings submit detailed analyses regarding the development of the insurance fund and its components during the last accounting year. These analyses cover the development of both the overall insurance fund and the fund associated with the various classes of insurance. Moreover, within each class of insurance a similar analysis is carried out with respect to sub–classes being grouped according to the applied technical bases of calculation.

As to the non-life insurance undertakings the submitted reports cover various aspects of the estimation and measurement of the technical provisions, e.g.

- an overview of the calculated minimum requirements for all components of the overall provisions and the undertakings' own estimates regarding necessary provisions for outstanding claims,
- a detailed documentation of the calculation of the minimum requirements, including e.g. an overview of the minimum requirements for premium provisions and provisions for outstanding claims for each class of insurance as well as the minimum requirements for provisions for outstanding claims disaggregated according to the occurrence years not finally settled, and
- a special report prepared by the appointed actuary.

A complete version of these reports is submitted to Kredittilsynet twice a year (as at 30 June and 31 December, respectively), while a very simplified versions of the reports is submitted giving the status as at the end of the third quarter.

C. Capital adequacy requirements and requirements for solvency margin

A detailed report on the measurement of capital and the calculation of the risk–weighted capital requirements is submitted by each insurance undertaking on a quarterly basis using a reporting system (for both insurance undertakings, banks and other financial institutions) elaborated by Kredittilsynet in co–operation with the Central Bank of Norway and Statistics Norway. The insurance groups submit a similar report twice a year (as at 30 June and 31 December, respectively). It may be noticed that the latter reports are on a consolidated basis.

The calculation of the solvency margin requirements as well as the measurement of the actual solvency margin capital is carried out only once a year for the life insurance undertakings, but twice a year for the non–life insurance undertakings (based on preliminary and ultimate financial information, respectively). The required documentation is submitted on separate forms elaborated by Kredittilsynet.

D. Other aspects of the documentary supervision and analyses

The submitted reports regarding technical provisions and capital adequacy, as sketched above, will often constitute a basis for more detailed analyses of single insurance undertakings or insurance groups. These in–depth analyses can again be utilised as a part of the preparations of on site inspections.

POLAND

I Insurance legislation in Poland

Insurance activity within Poland is regulated by the following basic legislation:

- the Insurance Act of 28 July, 1990, as subsequently amended in 1995, 1997, 1998, 1999 and 2000,
- the Accounting Act of 29 September, 1994, as amended in 1997 and 1999,
- the Ordinance of the Minister of Finance, 29 December, 1994, on detailed accounting principles for insurance companies,
- the Ordinances of the Minister of Finance, 17 October, 1995, and 23 March, 1996, on calculating the solvency margin and guarantee capital for each kind of insurance business and for reinsurance.

The Insurance Act is the primary piece of legislation specifying the general conditions and procedures for undertaking and conducting the business of both life and other than life insurance.

Insurance undertakings may conduct activity in Poland only in the form of a joint-stock company or mutual insurance company. The Articles of Association of a joint-stock company are subject to approval by the Minister responsible for financial institutions prior to the court registration. The Minister also agrees to the acquisition of shares of an insurance company, or the rights conferred by such shares, where these would entitle the party concerned to over 25 per cent, 50 per cent or 75 per cent, respectively, of votes at a shareholders general meeting. In case of acquiring rights to over 10 per cent of votes at a general meeting, the party concerned is required to notify the Minister responsible for financial institutions of this fact within 7 days. The Minister responsible for financial institutions may refuse consent to the acquisition of shares of an insurance company, or the rights conferred by such shares, when:

- the investor fails to assure that he conducts the business in a manner that safeguards the interests of the insured,
- the funds assigned to the purchase of the shares originate from a loan or advance, or are subject to any other encumbrance,
- the acquisition jeopardises important economic interests of the state.

An insurance company may not be simultaneously engaged in the business of both life and non-life insurance.

The Insurance Act distinguishes between compulsory and voluntary insurance. It lists compulsory insurance as follows:

- third party liability for owners of motor vehicles,
- insurance of farm buildings against fire and other hazards,
- farmers' third party liability insurance,
- other insurance as provided for by acts or international conventions ratified by Poland.

The Minister responsible for financial institutions determines the general terms and conditions of compulsory insurance in an ordinance. It specifies the date at which the obligation to conclude an insurance contract arises, the basic scope of liability of the insurer, the minimum insurance cover required, and the rights and duties of both the insurer and the insured. The ordinance also specifies the basic system of premium discounts, depending on the length of the period applicable for no-claims bonuses. This system is designed to ensure comparability of the premiums charged by different insurers. An insurer conducting compulsory insurance business cannot refuse to conclude such a contract.

In the case of voluntary insurance, insurers are free to determine the level of premiums unless they are dumping prices set in order to eliminate competition. General terms and conditions are also established freely. They should specify, in particular:

- the subject and scope of insurance,
- the procedure for concluding an insurance contract,
- the scope and duration of the insurer's liability,
- the rights and duties of the parties to the contract and
- procedures for establishing the amount of damage incurred and for paying out compensation or benefits.

The general terms of insurance should allow insured parties to withdraw from the insurance contract within 30 days (individuals) or 7 days (juridical persons) in case of the contract concluded for a period of over 6 months. This withdrawal however does not mean the refund of the premium for the cover actually provided by the insurance company.

II Changes in insurance legislation

As the European Commission admitted in its Regular Report '99, the Polish insurance sector, on the basis of reciprocity, is open to competition. Also, in accordance with the Europe Agreement's provisions on the establishment of companies and supply of services, the EU entities may now operate in Poland enjoying the same rights as domestic firms (EU companies may open main branches in Poland). The treatment offered by the Polish side is in line with the country's commitments to the OECD and the WTO.

As stated in the Polish position paper, the present insurance legislation poses no requirements of having Polish citizenship, domicile, or mandatory membership of a self-government body. The Polish provisions on economic insurance are fully in line with EU directives of the so-called first generation. The regulations permitting the operation of foreign insurers in Poland in the form of representation offices/main branches came into force on 1 January, 1999.

According to the position paper and to the 2000 National Programme of Preparation for Membership, the incongruity resulting from the domicile requirement imposed on insurance intermediaries under the present Insurance Activity Act will be removed by the end of 2002. Detailed rules were also introduced on supervision over finance/insurance groups.

On 4 April, 2000, the Council of Ministers approved the new package of insurance legislation and submitted the following acts to Parliament:

- The (amended) Insurance Activity Act,
- The Insurance Intermediation Act,
- The Act on Compulsory Insurance, National Guarantee Fund, and Polish Transport Insurance Bureau.

The package provides for comprehensive regulation of the insurance business and adjusts the Polish insurance legislation to the EU requirements. When the acts are passed, all incongruities will be removed by 31 December, 2002.

The New Insurance Activity Act introduces the following major changes.

1. The supervisory body, the Commission for Insurance Supervision (KNU) is to have a collegiate form.
2. The definition of insurance activity is provided.
3. Terms of access to insurance secrecy are specified in detail.
4. Requirements to be met by managing board members are listed with greater accuracy, and it is provided that these members must receive approval from the Commission for Insurance Supervision.

5. The offering of services via the Internet is regulated for the first time.
6. The rules are specified which will govern the purchase of insurance firms' stock after Poland's entry into the EU.
7. The regulations on mutual insurance associations are broadened; these associations will be allowed to transform into a joint-stock company (in compliance with the proposed Commercial Companies Code), but the rules governing their establishment and operation will remain unchanged.
8. New regulations will govern the issuance of insurance licenses, to be issued by the Commission for Insurance Supervision in co-operation with the minister in charge of financial institutions.
9. Regulations governing the launch and conduct of insurance activity by foreign insurers and pronouncing the freedom to render services and set up firms will be introduced in accordance with EU directives; these regulations will take effect upon Poland's accession to the EU.
10. New rules governing insurers' finance management along the EU lines are introduced.
11. The scope of regulations on the status of the actuary is broadened.
12. Insurers' reporting requirements are broadened.
13. More detailed provisions are introduced on insurers' mergers (in accordance with the proposed Commercial Companies Code) and on the transfer of insurance contracts.
14. Financial-rehabilitation procedures for insurers and the appointment of the receiver will be governed by new rules.
15. The regulations on the appointment and activity of the Spokesperson for the Insured are specified in greater detail (e.g., his/her activity is to be financed by the state).
16. The Civil Code is proposed to be amended, to include provisions on general terms of insurance, etc.

The provisions of the Insurance Intermediation Act are adjusted to EU requirements, including those laid down in a draft directive on the subject. The definition of insurance intermediation, provided in the act, is broad and flexible, covering not only the conclusion - but also some aspects of the discharge - of contracts. The act retains the division of insurance intermediaries into agents and brokers, while sanctioning the so-called multi-agents, acting for more than one insurer. The requirement for persons performing the agency services to obtain a licence from the supervisory body is abandoned in the act; they will only have to register with the Polish Chamber of Insurance (PIU). Agents' activity is to be supervised by the insurers. Additionally, the KNU will inspect insurers' operations with regard to their use of agents' services. As far as brokerage activity is concerned, the act retains the major existing provisions, while making them more up-to-date. The licence requirement for brokerage activity and the condition that the broker must buy third-party liability insurance are retained. On the other hand, the Polish domicile requirement for agents and brokers is removed. The brokerage and agency activities are clearly separated, and the broker's real independence from the insurer is reinforced. Supervision over brokerage activity will be conducted by the KNU. Two registries are to be established - one for agents (kept by the PIU) and one for brokers (kept by the KNU),

The Act on Compulsory Insurance, Insurance Guarantee Fund and Polish Transport Insurance Bureau takes into account the relevant provisions of three so-called "communication" directives of the EU. Included in the document are also many provisions previously contained in implementing regulations.

Under the act, compulsory insurance will be equivalent to the obligation to enter into insurance contract, and the parties will have more freedom to shape the contents of the contract. Restrictions will be confined to major provisions specifying the duties of the insurer and the insured and protecting the interests of the injured party and the eligible applicant. The act contains the definition of compulsory insurance, which includes:

- third-party liability insurance against damage emerging in connection with the movement of motor vehicles,
- third-party liability insurance of farm owners,
- theft and accident insurance of farm buildings,
- third-party liability insurance introduced under other statutes or international agreements ratified by Poland.

The act provides that the general terms of compulsory insurance introduced under other statutes are to be issued by the insurers. A major novelty is the extension of third-party motor vehicle liability insurance cover to the territory of countries signatories to the Multilateral Guarantee Agreement. Other changes are related to:

- the setting of a fine payable on failure to meet the statutory obligation of entering into a compulsory insurance contract,
- the organisation of, and operating procedures for, the Insurance Guarantee Fund and the Polish Transport Insurance Bureau, including the requirement of mandatory membership of insurers involved in the relevant lines of insurance business.

The uniform insurance licence and the full freedom of transborder supply of services (single passport issues) will be possible after Polish accession to the EU. This is motivated by the fact that EU members are not required to provide the same treatment for Poland unless it is a member of the EU.

Work has been carried out on changes in legal acts regulating insurers' accounting. New standards of insurance accounting practices are to be introduced in an amendment to the Accounting Act of 29 September, 1994 (published in Dziennik Ustaw of 19 November, 1994). So far, these practices have been regulated by the Finance Minister's Ordinance on detailed rules of insurers' accounting, dated 29 December, 1994 (Dziennik Ustaw No. 140 of 1994, item 791, as amended). But not all questions were sufficiently regulated in the document. The Accounting Act introduces the obligation for insurers to have their annual financial reports audited and published. The auditor's statement, in addition to finding the report to be true and fair, should also confirm the creation by the insurer of technical reserves at a level guaranteeing full discharge of current and future obligations under the concluded insurance contracts. The auditor should also state that the reserves are backed by investments in accordance with the regulations on insurance business, and that the solvency margin is properly computed and financially covered by the insurer. The proposed amendment to the Accounting Act also changes the extent of information disclosed by insurers in their financial reports. Other important proposals, which will directly influence the insurance business in Poland, are for:

- providing a new definition of investments, to be treated as assets acquired with a view to certain economic benefits, which in practice may lead to a situation where the real property used by insurers for their own needs may be treated by them as investment;
- allowing the funds on interest-bearing running accounts and intangible assets to be treated as investment;
- changing the manner of securities valuation (e.g., shares listed on the stock exchange, and treated as short-term paper, will be valued according to their market prices, etc.) and the manner in which individual items are presented in financial reports (e.g., treating revenue from long-term investment revaluation as capital);
- regulating the questions related to exchange-rate differentials on insurers' investments.

Consideration is also given to an arrangement whereby the level of gross technical reserves would be taken into account in the process of computing the degree to which the insurance fund is covered with the insurer's investments. Actually the insurance-fund cover has been computed on the basis of net technical reserves, i.e., after allowing for the re-insurer's share.

III The model chart of accounts for insurance companies

Accounting principles for the insurance industry are set out in the aforementioned Ordinance of the Minister of Finance of 29 December, 1994. Up to now there has been no standardised chart of accounts for insurance companies - they were compelled to develop their own charts of accounts on the basis of generally accepted accounting standards. In practice, companies often used a draft version of a model chart of accounts prepared in 1991 by the Banking and Financial Institutions Department at the Ministry of Finance. However, this draft was never officially approved as mandatory. The official model chart of accounts has now been put in place in order to standardise the accounting practices of insurance companies.

The model chart of accounts for insurance companies has been developed with the reference to the provisions of the Accounting Act of 29 September, 1994, the Insurance Act of 28 July, 1990, and the Ordinance of the Minister of Finance, 29 December, 1994, on detailed accounting principles for insurance companies. It is also compatible with the principles and provisions of the European Union: the Directive of 19 December, 1991.

The model chart of accounts consists of the following parts:

- an introduction, together with general provisions (a description of the format of the model chart of accounts, a brief overview of entries to particular general ledger accounts, including off balance sheet accounts, definitions of basic insurance and accounting concepts, and a presentation of the principles applicable in recognising income and expense),
- a listing of general ledger accounts (control accounts),
- a commentary (explanations) on particular classes of the accounts (and also on individual general ledger accounts).

The commentary to the chart of accounts comprises, in particular:

1. An overall introduction to particular classes of the accounts, setting out the general characteristics of the accounts within a given class, and definitions of basic concepts and general valuation principles, and also of the principles governing general ledger entries.
2. Comments on particular general ledger accounts, presenting:
    - the purpose of a given account,
    - introductory explanations, giving the necessary definitions and valuation methods,
    - the principles applicable to general ledger records,
    - the principles applicable to subsidiary ledger records,
    - a discussion of closing balances (calculating these balances, the significance thereof, the item they are to be included under, and the financial statement in which they are to be shown),
    - tables illustrating typical credit and debit entries.

The model chart of accounts consists of the following ten classes of accounts:

Class 0 - investments,
Class 1 - other financial assets, and bank loans and advances,

Class 2 - settlements, and accrued income and expense,
Class 3 - intangible and tangible assets,
Class 4 - net technical income,
Class 5 - net technical expense,
Class 6 - movements in technical reserves,
Class 7 - other income and deductions from income,
Class 8 - technical reserves,
Class 9 - capital, and other reserves and external funding.

Class 0 of the accounts is used to record the investments of the insurance fund (regardless of their duration) and the investment of other available funds. These investments are presented in the balance sheet under item "B. Investments" (with the exception of item "B.IV. Deposit claims on ceding insurers") and under item "C. Investments of life assurance funds, where the investment risk is borne by the insured party". The general ledger accounts are structured by type of investment (as these are shown in the balance sheet), while subsidiary ledgers provide a detailed breakdown of investment by maturity, and by investment in subsidiaries, associates or other undertakings. Class 0 thus includes all accounts recording real estate, the associated accumulated depreciation, structures in course of construction, capital investments and other related assets.

Class 1 of the accounts is used to record funds held (the assets shown under items E.II. and E.III. of the balance sheet), and also bank loans and advances (liability item G.IV. of the balance sheet). Class 1 contains the general ledger accounts recording cash on hand and balances at banks, bank loans, Treasury stock, and other cash equivalents such as acts of exchange and cheques (if payable within three months of issue), letters of credit, funds in course of collection, and short-dated securities.

Class 2 of the accounts is used to record settlements and claims (including loans received and extended not treated as investments), and also accrued income and prepaid expense, and deferred income and accrued expense. Class 2 contains the general ledger accounts recording all claims and liabilities (including shorts and surpluses), advance payments, accrued income and prepaid expense, deferred income and accrued expense, and foreign exchange differences.

Class 3 of the accounts is used to record purchases and supplies, the residual amounts from loss adjustment, intangibles and tangible moveable assets. Class 3 contains the general ledger accounts recording intangible assets and the amortisation thereof, tangible moveable assets and the depreciation thereof, assets in course of construction other than structures, inventories, and purchases in course of collection and non-invoiced supplies.

Class 4 of the accounts is used to record premium income and deductions from income in the form of reinsurance; other technical income (e.g., appropriations from profit, insurance commitments, releases of provisions established against doubtful insurance claims, foreign exchange gains on insurance and reinsurance settlements, investment income shown in the technical insurance account, or all income from investments within the class of life assurance).

Class 5 of the accounts is used to record the expense of settling claims and deductions from such expense (amounts receivable under recourse and the reinsurers' portion of compensation paid), and other technical expense, which may include the expense of provisioning against doubtful claims and against expected insurance and reinsurance losses, foreign exchange losses on insurance and reinsurance settlements, and in the case of life assurance - the expense and losses incurred on investments. Thus, net technical expense includes, for example, acquisition costs, reinsurance commission expense, reinsurance and retrocession commission fees received, administrative costs, etc.

Class 6 of the accounts is used to record movements in technical reserves. Entries here are performed periodically, with the balance sheet accounts showing the difference between the opening and closing balances on gross technical reserves, and the reinsured portion of the reserves. These items are shown in the technical insurance account.

Class 7 of the accounts is used to record income and expense, and other deductions from income. The general ledger accounts in Class 7 record the income and expense of investment activity, other financial income and expense, other operating income and expense, extraordinary gains and losses, income tax settlements and other statutory deductions from earnings. These items are shown in the company's general profit and loss account.

Class 8 of the accounts is used to record technical reserves, provisions against doubtful insurance and reinsurance claims, and provisions against expected technical insurance losses.

Class 9 of the accounts is used to record capital and other reserves, and special-purpose funds (liability items A., E. and G.VI. of the balance sheet). The accounts in Class 9 record the capital of the insurance company, profit/loss and the distribution/absorption thereof (including statutory deductions from earnings), special-purpose funds, and other reserves not related to insurance and reinsurance activity.

The model chart of accounts closes with off balance sheet accounts, which form the basis for the notes to the published accounts. These contain information on:

- fixed assets employed by the company yet owned by external parties,
- the value of land held in perpetual usufruct,
- contingent claims,
- contingent liabilities,
- the value of liabilities secured by the assets of the insurance company.

IV Conditions for undertaking and conducting insurance activity

Providing insurance services in Poland requires a licence of the Minister responsible for financial institutions. The issuing of the licence has to be consulted with the State Office for Insurance Supervision. The following documents have to accompany the application:

- operating plan;
- documentary evidence of possessing sufficient funds, free of all encumbrance, to cover the declared amount of authorised capital and initial organising capital;
- information on the qualifications of persons intended as members of the managing and supervisory boards, and of the person responsible for insurance, financial and statistical mathematics (the actuary);
- the company’s Articles of Association; and
- the general terms and conditions of the insurance business specified in the application.

The amended Act (Title 4) provides for the undertaking and conduct of the business of insurance by foreign insurers within Poland on a reciprocal basis. These organisations must, of course, fulfil the same formal requirements (listed above) as Polish insurers in order to obtain the appropriate licence from the Minister responsible for financial institutions.

The important change introduced to the Insurance Act, is the right of foreign insurance companies to undertake and conduct the business of insurance within Poland through branches. This right was introduced to the Polish law on 1 January, 1999.

Foreign insurance companies may undertake and conduct insurance activity within Poland only through their main branch (subsidiary). The main branch is to operate on the basis of Polish regulations and of its own Articles of Association, as formulated by the foreign insurer. The Articles of Association should be drawn up in the form of a notarial deed. The Minister responsible for financial institutions should approve the Articles of Association and amendments to it. In particular, the Articles of Association of the main branch of a foreign insurer should provide the following information:

- the organisational structure of the main branch,
- procedures of establishing regional offices and the way of representation,
- the kinds of technical reserve established by the main branch, and the way of their calculation,
- procedures of settlements with the foreign insurance company.

The main branch is required to keep all the above-mentioned documents referring to its activity at its Polish registered office.

The application by a foreign insurance company for a licence to conduct insurance activity through the main branch should contain the following:

- the name and registered office of the foreign insurance company and the country in which the insurer is domiciled,
- the registered office and scope of activity of the main branch to be used by the foreign insurer to provide insurance services,
- the names of persons intended for the posts of director of the main branch, deputy directors, and actuary (where the performance of actuarial responsibilities is stipulated in the Insurance Act).

The foreign insurer should append the following documents to the application:

- the Articles of Association and names of members of the management board of the foreign insurance company,
- information on the level of qualifying capital of the foreign insurer,
- information on the education and professional experience of persons intended for the posts of director of the main branch, deputy directors, and actuary (where the performance of actuarial responsibilities is stipulated in the Insurance Act),
- a certificate issued by the supervisory agency of the country in which the foreign insurer is domiciled stating that the foreign insurer holds a licence to conduct insurance activity, with information on its qualifying capital and financial condition,
- evidence that insurance companies operating within Poland are authorised to undertake insurance activity within the country in which the foreign insurer is domiciled (this requirement does not refer to countries with which Poland has signed the relevant international agreements),
- balance sheets and profit and loss accounts for the last 3 years of the foreign insurer’s operations, along with the auditor’s opinions on the accounts,
- the general terms and conditions of the insurance business which the foreign insurer is to conduct in Poland via its main branch,
- an operating plan with a simulation of the financial performance of the main branch in Poland, which in particular should contain information on methods of calculating technical reserves, maximum risk tolerances and how these are determined, administrative and acquisition costs, and methods of calculating premiums,

- a draft of the Articles of Association of the main branch,
- information on the level of initial organising capital earmarked for establishing the administrative infrastructure of the main branch and setting up field offices.

A licence for a foreign insurance company to conduct insurance activity is issued for one or more insurance groups or one or more types of insurance business as defined in the Insurance Act. Issuing the licence is contingent on the foreign insurer conducting insurance activity in the country in which it is domiciled as a joint-stock company or a mutual insurance company. The foreign insurer is required to hold an appropriate licence to conduct the same scope of insurance activity in the country of domicile.

Providing insurance activity through the main branch is contingent on entry in the central register of main branches. Pursuant to the Act, the central register of main branches is kept by the Warsaw Regional Court. The register is a document of public record, with the principles and procedures referring to the register, the information registered, the procedure for maintaining the register and access to the register all specified in an ordinance issued by the Minister of Justice. Notice of entry in the register of main branches should be placed in Monitor S•dowy i Gospodarczy [the Court and Commercial Gazette], with the cost borne by the main branch. After registration, the main branch of the foreign insurer is considered a juridical person, which means that it is empowered to acquire rights and undertake liabilities, to sue and be sued.

The Insurance Act requires that a director who is resident in Poland manage the main branch of a foreign insurance company. This person has the right to represent the main branch on his/her own. Two deputy directors acting together may also hold Right of representation. In addition, the foreign insurer may designate a person authorised to represent it in Poland. The director of the main branch, deputy directors and person authorised to represent the foreign insurer should be named in the register of main branches. The person chosen by the foreign insurer, as its representative does not acquire the rights accorded to that organisation until it is entered in the register of main branches.

Any changes in the persons holding the posts of director of the main branch, deputy directors or actuary should be notified to the Minister responsible for financial institutions and the State Office for Insurance Supervision within 30 days. The change in the scope of insurance business conducted by a foreign company may only take place after obtaining an appropriate licence from the minister responsible for financial institutions. The foreign insurance company should submit a suitable application to the minister for a licence to conduct insurance activity of changed scope, similar to the original licence application. Furthermore, a foreign insurer is required to commence operations within one year of issue of its licence. If operations are not commenced by then, the licence expires.

Pursuant to the provisions of the Insurance Act, a foreign insurance company conducting insurance activity in Poland within groups 10 and 13 of non-life insurance automatically becomes a member of the Insurance Guarantee Fund and the Polish

Transport Insurance Office. This is associated with the payment of contributions to both these organisations. These contributions are calculated on the basis of the gross written premiums of the main branch of the foreign insurer.

A foreign insurance company providing insurance services, which operates in Poland, is required to deposit security as surety for future commitments. This level of the deposit is set at the 50 per cent of minimum guarantee capital. It is recognised as a part of the qualifying capital of the foreign insurer and should be deposited on a separate, interest-bearing account with a (domiciled in Poland) bank and having capital equivalent to at least 100 mln euro. When the activity of the main branch is terminated, the security, together with accrued interest, is returned to the foreign insurer providing that it has met all claims ensuing from insurance contracts concluded by the branch in Poland. The security cannot be seized against debt, and may be used to settle claims only with the approval of the supervisory agency in the course of a liquidation of the main branch.

The foreign insurance company is required to establish technical reserves against liabilities that may arise from insurance contracts concluded by the main branch within Poland. The foreign insurer is also required to hold qualifying capital in Poland amounting to no less than the solvency margin, as calculated on the basis of the written insurance premiums or compensation and benefits of the main branch. The minimum guarantee capital for a main branch represents 50 per cent of the minimum guarantee capital required for insurance companies.

A licence to conduct or expand insurance activity by a main branch by a foreign insurer in Poland will not be issued where any of the following circumstances prevail:

- the licence application and appended documents do not fulfil the requirements mentioned above,
- the director of the main branch and at least one deputy director lack the education and professional experience necessary to run an insurance business,
- the foreign insurance company fails to give due assurance that it will conduct the business of insurance in a suitable manner,
- the foreign insurer fails to furnish evidence that it possesses the necessary funds to guarantee its solvency,
- important interests of the state are jeopardised,
- the operating plan and simulation of the performance of the main branch do not provide assurance that the foreign insurer has the lasting capacity to fulfil the commitments arising from insurance contracts it writes in Poland,
- there is no evidence that insurance companies operating within Poland are authorised to undertake insurance activity within the country in which the foreign insurer is domiciled.

The Minister responsible for financial institutions revokes the licence of a foreign insurer to conduct insurance activity within Poland if the insurer's licence has been revoked in its country of domicile or the insurer has been put into liquidation or declared bankrupt.

The Minister responsible for financial institutions, acting at the request of the supervisory body, may revoke the insurer's licence to conduct insurance activity, with reference to one or more types of insurance, if:

- the foreign insurer no longer fulfils the conditions necessary to obtain the licence,
- the main branch is conducting insurance activity in violation of the law,
- the foreign insurer has filed an application with the supervisory body to surrender its licence (in this case the interests of policyholders should be safeguarded, in particular as regards payment of compensation and benefits).

The winding up of the main branch occurs after its liquidation. The liquidators are required to submit reports on the liquidation process every 3 months, and the supervisory body may also require more frequent reports and additional information. Once the liquidation of the main branch has been announced or ordered, new insurance contracts cannot be concluded, old ones continued and insured sums increased. If the foreign insurer decides to wind up its insurance activity within Poland, or the insurer's licence has been revoked in its own country, the role of liquidator of the main branch is performed by its director.

The director of a main branch is required to notify the minister responsible for financial institutions of the revocation of the foreign insurer's licence or of the fact that the insurer is in the process of liquidation or bankruptcy. He is also obliged to announce this in a national newspaper within 14 days of the licence being revoked, the liquidation proceedings being commenced, or bankruptcy being declared three times. If the company's insurance fund is not sufficient to meet all its liabilities, the claims remaining unfulfilled may be met using the security deposited, subject to approval by the supervisory body. The Commercial Code defines the principles and procedures applicable to the liquidation of the main branch of a foreign insurer.

The Minister responsible for financial institutions, at the request of the supervisory body may order the liquidation of the main branch, if:

- the activity of the foreign insurance company is in violation of the law or contrary to the insurer's operating plan,
- the foreign insurer is not meeting insurance claims in Poland, or is doing so with delay or only partially.

Should a liquidation order be issued, the supervisory body appoints a liquidator who is required to submit reports on the liquidation process in the manner described above.

Should the foreign company be declared bankrupt, claims ensuing from insurance contracts written by the main branch within Poland have the priority with regard to the company's assets in Poland. The provisions of the Bankruptcy Act, issued as an Ordinance of the President of the Republic of Poland on 24 October, 1934 govern the liquidation process of the main branch.

The foreign insurance company is responsible for the liabilities of the main branch with all its assets. The director, jointly and severally with the foreign insurer, is personally liable for any loss caused to creditors in case of failure to inform the minister responsible for financial institutions that the foreign insurer's licence has been revoked, or that it has been placed in liquidation or declared bankrupt, or in case of not announcing it in the press.

V The finances of insurance companies and insurance funds

Under the provisions of the Insurance Act, an insurance company is required to possess qualifying capital no lower than its solvency margin. Should this qualifying capital be lower than the solvency margin, the insurer is required to notify the State Office for Insurance Supervision and to submit on request a capital recovery plan ensuring that the solvency margin is met.

A. The Qualifying Capital of Insurance Companies

Pursuant to the provisions of the Insurance Act (Title 5), the qualifying capital of an insurance company is composed of the assets of that company, excluding intangible assets and those assets held against all foreseeable liabilities. The following items are included in the calculation of qualifying capital:

- paid-up share capital (+),
- the capital surplus (+),
- the revaluation reserve (+),
- other reserve capital (+),
- intangible assets (-),
- prior years' undistributed profit or unabsorbed loss (+ for profit, - for loss),
- net profit or loss for the current reporting period (+ for profit, - for loss),
- in the case of joint-stock companies - half of the payments due on share capital (+),
- in the case of mutual companies - half of the payments due on authorised capital, if at least 25 per cent of that capital has already been paid up (+).

In the case of mutual companies operating in non-life insurance, qualifying capital may also include 50 per cent of the unpaid additional contributions which may be required by these companies from their members under the Articles of Association (with the value of these contributions not exceeding 50 per cent of the solvency margin as calculated).

At the request of an insurance company, the State Office for Insurance Supervision may allow the inclusion of the following items:

- the difference between the book value of assets and their current realisable market value, provided that this is not of an extraordinary character,
- loan stock as qualifying capital.

B. The Solvency Margin

Detailed methods of calculating the solvency margin by insurance companies are specified in the Ordinance of the Minister of Finance, 17 October, 1995, on calculating the solvency margin and guarantee capital for each kind of insurance business and for reinsurance.

In submitting their annual balance sheets to the State Office for Insurance Supervision, insurance companies are required to attach a calculation of their solvency margin and provide evidence that they possess qualifying capital that meets the solvency margin.

Calculation of the solvency margin for life assurance

In the case of insurance companies operating in life assurance, within groups 1, 2 and 4 (life assurance, dowry insurance, children's maintenance insurance and pension insurance), the solvency margin (SM) is equal to the sum of two components, S1 and S2, as follows:

a) S1 is calculated according to the following formula:

$S1 = 4\% \times A \times \max(85\%, B)$ where:

B - a coefficient which gives the percentage ratio of the sum of (the net unearned premiums reserve, the net unexpired risks reserve and the life assurance reserve in direct insurance and participating reinsurance) to the sum of (the gross unearned premiums reserve, the gross unexpired risks reserve and the life assurance reserve in direct insurance and reinsurance on the last day of the reporting period), A - a coefficient which represents the sum of the gross unearned premiums reserve, the gross unexpired risks reserve, and the life assurance reserve in direct insurance and reinsurance;

b) S2 is calculated according to the following formula:

$S2 = W \times C \times \max(50\%, D)$ where:

D - a coefficient which gives the percentage ratio of net risk to gross risk on the last day of the reporting period,

W - a coefficient equal to 0.1 per cent (in whole life assurance where the insurance contract has been written for a period not exceeding 3 years), 0.15 per cent (in whole life assurance where the insurance contract has been written for a period exceeding 3 years but not exceeding 5 years), or 0.3 per cent (other life assurance),

C - a coefficient representing the gross amount of risk undertaken by the insurance company (construed as the difference between the contractual insured sum in whole life assurance or endowment insurance and the sum of the gross life assurance reserve, the gross unearned premiums reserve and the gross unexpired risks reserve, where these reserves concern the risk of death or endowment of the policyholder).

In group 3 of life assurance (investment-linked life assurance), the solvency margin (SM) is calculated as follows:

$SM = (4\% \times E1 + 1\% \times E2) \times \max(85\%, F)$ where:

F - a coefficient which gives the percentage ratio of the net life assurance reserve to the gross life assurance reserve on the last day of the reporting period,

E1 - a coefficient representing the gross life assurance reserve where the insurance company bears the investment risk (i.e., the profit/loss of the insurance fund is attributable to the insurer),

E2 – a coefficient representing the gross life assurance reserve where the insurance company does not bear the investment risk, the insurance contract has been written for a period exceeding 5 years, and the administrative costs assigned to cover the management expenses of the insurance company, as specified in the insurance contract, are amortised over a period exceeding 5 years.

If an insurance contract covers the risk of death and the value of the gross risk of the insurance company is not negative, the above calculation of the solvency margin is supplemented by an additional component, S1, calculated according to the following formula:

$S1 = 0.3\% \times C \times \max(50\%, D)$ where: coefficients C and D are as described above.

Calculation of the solvency margin for non-life insurance

In non-life insurance, the solvency margin (SM) is set as the greater of two values, SM1 and SM2, where SM1 is based on the underwritten premiums and SM2 is based on the average annual sum of claims over the last 36 or 84 months, or over the whole period of the insurer's operations, if this is less than 36 or 84 months.

$SM = \max(SM1, SM2)$ where:

a) $SM1 = 18\% \times G \times \max(50\%, H)$, if $G \bullet 10$mln euro

or $SM1 = [18\% \times P1 + 16\% (G - P1)] \times \max(50\%, H)$ where:

P1 - the zloty equivalent of 10 mln euro,

G - a coefficient representing the amount of premiums underwritten (including reinsurance premiums) over the last 12 months,

H - a reinsurance coefficient calculated on the basis of data collected over the last 12 months (approximately equal to the ratio of net claims to gross claims);

b) $SM2 = 26\% \times J \times \max(50\%, H)$, if $J \bullet 7$mln euro,

or $SM2 = [26\% \times P2 + 23\% \times (J - P2)] \times \max(50\%, H)$, if $J > 7$mln euro, where:

P2 - the zloty equivalent of 7mln euro,

J - a coefficient representing the average sum of claims (the sum of gross compensation in direct insurance and reinsurance, less refunds, payments under recourse and recoveries, paid during the whole period in question, plus the outstanding claims reserve at the end of the period, less the outstanding claims reserve at the beginning of the period, divided by the length of the period),

H - the reinsurance coefficient.

C. Guarantee Capital

Guarantee capital constitutes one third of the solvency margin, yet no less than the minimum guarantee capital for every group of insurance and for reinsurance.

Joint stock companies

For joint-stock companies, the minimum amount of guarantee capital is determined as follows:

1. For life assurance - the zloty equivalent of 800,000 euro.

2. For non-life insurance:
   - groups 1-8, 16 and 18 - the zloty equivalent of 300,000 euro,
   - groups 9 and 17 - the zloty equivalent of 200,000 euro,
   - groups 10-13 and 15 - the zloty equivalent of 400,000 euro,
   - group 14 (credit insurance) - the zloty equivalent of 400,000 euro.

If the amount of premiums underwritten in group 14 (credit insurance) exceeds 4 per cent of the total amount of premiums underwritten in the remaining groups in non-life insurance, or the amount of premiums underwritten in group 14 has exceeded the zloty equivalent of 2.5mln euro in each of the last three years, the minimum guarantee capital should constitute the zloty equivalent of 1.4mln euro.

Mutual insurance companies

For mutual insurance companies, the minimum amount of guarantee capital is determined as follows:

1. For life assurance - the zloty equivalent of 600,000 euro.

2. For non-life insurance:
   - groups 1-8, 16 and 18 - the zloty equivalent of 225,000 euro,
   - groups 9 and 17 - the zloty equivalent of 150,000 euro,
   - groups 10-13 and 15 - the zloty equivalent of 300,000 euro,
   - group 14 (credit insurance) - the zloty equivalent of 300,000 euro.

If the amount of premiums underwritten in group 14 (credit insurance) exceeds 4 per cent of the total amount of premiums underwritten in the remaining groups of non-life insurance, or the amount of premiums underwritten in group 14 has exceeded the zloty equivalent of 2.5mln euro in each of the last three years, the minimum guarantee capital should constitute the zloty equivalent of 1,050,000 euro.

VI Technical reserves

In line with the Ordinance of the Minister of Finance, December 29, 1994, on detailed accounting principles for insurance companies, each insurance company is required to establish the following technical reserves:

- the unearned premiums reserve,
- the unexpired risks reserve,
- the outstanding claims reserve including the reserve for capitalised annuity value,
- the risk equalisation reserve,
- the life assurance reserve,
- the life assurance reserve where the investment risk is borne by the insured party,
- the bonus reserve,
- other technical reserves envisaged in the insurer’s Articles of Association.

Technical reserves are intended to meet current and future liabilities, which may arise from written insurance contracts. To limit the amount of any single insured risk, a restriction has been set stipulating that the net value of any single policy cannot exceed 25 per cent of the total net technical reserves and capital of the insurance company. In particularly justified cases, the State Office for Insurance Supervision may approve an alteration of this limit.

An insurance company using the following methods establishes technical reserves:

1. the individual method, based on an estimation of individual claims or losses reported and registered by the insurer, or using a method set individually for each insurance contract,
2. the lump sum method, where the reserve is established for the whole insurance portfolio or part of the portfolio as a percentage of premiums or of compensation and benefits paid,
3. the actuarial method, where the reserve is established using insurance mathematics and statistics.

In practice, the choice of a method for calculating technical reserves depends on a number of factors, such as the level of detail and availability of statistical and accounting information on premium income, compensation and benefits paid, the amount of claims in each insurance group and their volatility over time, the duration of insurance contracts, and average level of compensation and benefits. The methods adopted for calculating technical reserves must be specified in the insurer's chart of accounts.

The technical reserves listed above are established as follows:

– The unearned premiums reserve

This reserve is established on the basis of written premiums less acquisition costs, allocated to future reporting periods proportionally to the period to which the premium applies or in relation to the risk expected in future reporting periods. The reserve is calculated using the individual method for each insurance contract. The reserve may also be calculated using the lump sum method. The latter method may be applied to extensive portfolios with a small divergence of premiums.

– The unexpired risks reserve

The unexpired risks reserve is established separately as a supplementary reserve to the premiums reserve, to cover compensation, benefits and costs which may arise from future losses ensuing from insurance contracts remaining unexpired on the last day of the reporting period. The reserve constitutes the difference between the expected amount of future claims, benefits and costs which may occur as a result of future events ensuing from insurance contracts unexpired at the end of the reporting period, and the amount of the premiums reserve and possible premiums which may be added to these insurance contracts during the same period of insurance cover. The reserve is calculated using the actuarial method or the lump sum method for each group of insurance.

– The outstanding claims reserve

This reserve is established to correspond to the determined or expected level of future compensation and benefits resulting from losses already incurred, plus claim adjustment costs. In particular, this refers to:

- reported claims where the amount of compensation or benefit has been determined, or where the information is sufficient to determine that amount,
- reported claims where the information available is insufficient to determine the amount of compensation or benefit,
- damages already incurred, where the claim has not yet been reported.

The outstanding claims reserve is calculated using the individual method, the actuarial method or the lump sum method. The lump sum method may be applied to those kinds of insurance where there are extensive claims and a small divergence of compensation and benefits. Part of the reserve, referring to claim adjustment costs, should be established on an individual basis for each insurance group.

– The risk equalisation reserve

The risk equalisation reserve is established at a level ensuring that the volatility of the claims ratio in the future will be neutralised. The reserve is set up for all groups of insurance with the exception of group 14 in non-life insurance, where the claims ratio is likely to be subject to substantial volatility. The risk equalisation reserve is established at the end of the financial year. The level of the reserve should ensure that, where the reserve is changed, the claims ratio for a given financial year (calculated for the amount of claims adjusted to the change in the reserve) will be equal to the average claims ratio for the last 5 financial years, excluding the current year, for which the claims ratio is calculated without taking account of any change in the risk equalisation reserve. The risk equalisation reserve is not calculated if an insurance company has been operating for less than 5 years. In calculating the reserve, the reinsured portion of premiums written is not considered (unless a reinsurance agreement states otherwise). If an insurer writes insurance policies in group 14 (of non-life insurance), it is required to establish a risk equalisation reserve to cover negative technical earnings within group 14 in the given financial year, or to equalise a higher than average level of the claims ratio for this group in the financial year, prior to taking account of the change in the reserve.

– The life assurance reserve

This reserve is calculated using the actuarial method (prospective or retrospective) with the possibility of factoring in the costs of policy administration and claims adjustment costs. The life assurance reserve is calculated by an actuary. It is established on an individual basis for each insurance policy. The reserve may be set up on an aggregate basis for a specific group of policies where the result will be approximately that obtained by the individual method.

An insurance company is required to calculate this reserve using the individual method at least once every five years. Where the investment risk is borne by the insured party, the life assurance reserve is established to correspond to the value of the investments made under the provisions of the relevant life assurance contract.

– The bonus reserve

The bonus reserve is established to correspond to future increases in claims or reductions in premiums under the terms of the relevant insurance contract.

VII Reinsurance

The principles applicable to reinsuring risks abroad are set out in the Ordinances of the Minister of Finance, 7 December, 1995, and 23 March, 1996, on procedures for reinsuring risks abroad. An insurance company may not cede abroad more than 15 per cent of gross premiums underwritten in a given financial year or 20 per cent if the reinsurer is part of the same group of companies. An additional restriction here is a limit of 25 per cent on gross premiums underwritten that may be ceded to organisations domiciled in one country. This limit is not applied to OECD countries.

VIII The investment policy of insurance companies

An insurance company should invest its funds in a manner guaranteeing the highest safety and return, while at the same time preserving liquidity. If the investment policy of an insurance company could threaten its solvency, the State Office for Insurance Supervision may impose restrictions on its investment. If the equity acquired in a given business organisation exceeds 10 per cent of the nominal value of the share capital, or if investments are made in subsidiary or parent undertakings of the insurance company, the company is required to notify this to the State Office for Insurance Supervision. If the acquisition of equity in a given entity jeopardises the insurer’s solvency, the State Office for Insurance Supervision may forbid the acquisition of further equity. The State Office for Insurance Supervision may also prohibit or restrict the acquisition of equity if a member of the management board or supervisory board of the insurance company is also a member of the management board of the entity involved, or a principal shareholder of this entity, or has significant influence on its management policies.

The investment policy of insurance companies is regulated by the Insurance Act through appropriate limits. The limits are not valid in relation to:

- Treasury acts,
- Treasury bonds,
- other securities issued or guaranteed by central government, Treasury deposits, and loans extended to or guaranteed by the Treasury,
- municipal bonds,

in which insurance company may invest its funds without any limits.

The limits also do not apply to investment-linked life assurance.

Investing abroad is possible only with the consent of the Minister responsible for financial institutions.

IX Supervision of the Polish insurance sector

The direct supervision of the whole Polish insurance market is exercised by the State Office for Insurance Supervision, a central government agency established to protect the interests of policyholders and prevent situations where an insurance company is unable to pay out claims to those insured. The powers of the State Office for Insurance Supervision include:

– taking steps to ensure the proper functioning of the insurance market and the protection of the insured,
– issuing permits to insurance agents and brokers,
– inspecting the activity of insurance companies and brokers,
– taking other measures outlined in the Insurance Act.

The Minister for financial institutions also plays a very important role. He

– issues the licences to conduct the business of insurance in Poland.
– approves the merger of insurance companies,
– at the request of the State Office for Insurance Supervision may order the compulsory liquidation of an insurance company.
– specifies, by ordinance, the calculation method and regulatory level of the solvency margin and minimum guarantee capital for every kind of insurance and reinsurance business.
– approves a company's Articles of Association and changes in a company's ownership structure,
– proposes candidates for the post of President of the State Office for Insurance Supervision.

The State Office for Insurance Supervision may at any time perform on-site inspections of the operations and assets of insurance companies and of organisations providing brokerage services. During such inspections, the Office:

– determines that the company is applying true and fair accounting principles, and is accurately maintaining its books of account,
– reviews the company's organisational structure and management processes, including oversight over intermediaries,
– establishes whether the company fulfils the formal conditions required for a licence to conduct the business of insurance,
– reviews the investment policy of the insurance company, with special regard to the safety, return and liquidity of investments and their covering the insurance fund,
– determines the company's assets and liabilities, and assesses the managing of its funds (reviewing the level of those funds and fulfilment of the solvency margin), also reviewing issues concerning reinsurance agreements concluded by the company,
– assesses technical earnings, profit/loss and profitability,

- reviews methods of setting rates, the level of insurance premiums, and methods of calculating technical reserves,
- reviews how an insurance company is fulfilling its liabilities to policyholders under the insurance contracts it has written, and its methods of loss adjustment.

The supervisory agency may request that an insurance company provide additional clarification and information concerning its operations and finances, and may order the provision of the requisite data. It may also issue recommendations to remedy shortcomings that have been determined and ensure compliance with the provisions of statute. If the company fails to implement recommendations issued by the State Office for Insurance Supervision, is in violation of statute or its own Articles, or refuses to present the clarification and information requested, the Office is empowered to impose financial penalties on members of the management board or their attorneys up to the equivalent of three months gross remuneration of the person penalised. The Office may also:

- impose financial penalties on the company of up to 0.5 per cent of gross premiums from the previous financial year.
- apply to the appropriate directing body of the company for the recall of a member of the management board or attorney thereof, or their suspension pending consideration of the application for recall. In practice, the State Office for Insurance Supervision attempts to avoid imposing financial penalties, and restricts itself to presenting the appropriate requests to the directing body of the insurance company or to referring issues directly to the relevant government institutions (the courts or prosecutor's office).

The powers of the State Office for Insurance Supervision also include a right to demand a bankruptcy of an insurance company if the company:

- has ceased to pay its debts or
- its assets are insufficient to meet those debts, and
- if the administrators appointed have failed to restore the company's solvency.

The Office may also appeal against court rulings on a bankruptcy.

X Expected lines of insurance market development

The changes to be made in Polish insurance legislation will further liberalise the launch and conduct of insurance business in Poland by foreign entrants. Polish arrangements are compatible with the EU's so-called first generation insurance directives; and the changes needed to comply with the second and third generation directives are of a technical character. As a result, the inflow of foreign capital to Poland will increase and the offer of insurance services will broaden. Right now, Polish insurers are engaged in fierce competition for capital - from the domestic market and from abroad. The sector will inevitably move towards consolidation, following the example of the first mergers in 1999. In the future this will lead to cost reductionand improvement in the quality of services.

Technological change will no doubt result in the expansion of services rendered via the Internet, and this, incidentally, will require some adjustment effort on the part of insurers. The fight for the client is going to intensify soon, focussing on keeping the client and encouraging him/her to buy other insurance products of the company. Insurers will also seek to expand the distribution of their products through banks (to reach clients sooner, and cut costs), and they will offer semi-banking products.

The Polish insurance sector will be greatly influenced by the introduction of a package of insurance acts, which regulate the insurance business in a comprehensive manner and adjust Polish legislation in the field to EU requirements. What is still lacking is adjustment to the third-generation directives, regulating the single insurance market and introducing a single licence and single supervision by the state, which issued the licence. Poland promised to adopt these standards by the end of 2002, but they may only be observed on the basis of reciprocity. This means that they will be enforced only when the country enters the European Union. Poland also has to adjust to the so-called transport directives, which regulate motor vehicle insurance. Here, Polish law lags far behind, also as compared with other candidates for EU membership.

PORTUGAL

I Introduction

Supervision of insurance companies in Portugal, as in other European countries, responds primarily to the need to protect policyholders and those entitled under them, with due regard to the specific nature of the insurance contract.

Since the liberalisation of insurance business in Portugal, in 1994, the old system of supervising prices and products has been abandoned in favour of more stringent solvency controls.

At present, the general purpose of supervision is, therefore, to minimise the risk that an insurance undertaking may not meet its commitments to the insured, namely through an effective solvency control.

II Regulation concerning the supervision of solvency

The supervision of insurance companies in Portugal is regulated by the Order in Council n. º 94-B/98, which is in conformity with the EC Directives and foresees the relevant provisions regarding the supervision of solvency margins.

The supervision of solvency comprehends, not only the control of the solvency margin, calculation and valuation of the minimum level of company's own funds to face the randomness of the business, but also the adequacy of technical provisions, which must be fully covered by equivalent assets.

The above mentioned law, together with some specific rules issued by the Portuguese Supervisory Authority, includes general provisions about the methods for calculation of the various technical provisions (mathematical provision, provision for bonuses and rebates, claims outstanding provision, provision for unearned premiums, provision for unexpired risks, equalisation provision and ageing provision), as well as some investment rules to be fulfilled, namely concerning standards of prudent valuation and diversification.

III Practical organisation of supervision

The liberalisation of the insurance business lead, from a prior supervision, based mainly on prior and systematic control of policies and premium rates, towards an ex post supervision, based mainly on the analysis of the economic and financial side of the insurance undertakings.

The Supervision Department of the Insurance Supervisory Authority (Instituto de Seguros de Portugal) is responsible for that supervision, both of insurance companies (life and non-life) and pension funds.

The Supervision Department is organised in teams, with technical specialists in financial analysis and/or actuarial issues, which have the responsibility to control the compliance of the financial guarantees.

The analysis of the current activity of the insurance companies is done, in the first place, through the analysis of the annual accounts and complementary financial information that is submitted in the form of prescribed forms, reporting the balance sheet, profit and loss account, investments, technical provisions and the technical and financial results. Some statistical information is also collected for analysis.

The report from the responsible actuary, as well as the certification of the external auditor, is required as an integral part of the annual accounts, and may be of significance in the analysis of the accounts.

The insurance supervision is, subsequently, conducted by the supervisors based on the analysis of the abovementioned documentation, through the checking of consistency and reliability of the information received, the analysis of the level of coverage of the technical provisions and the solvency margin and the evaluation of early warning signals.

Whenever the results of the analysis so require, "*in-loco*" controls are carried out, in the course of which investigations of the management of the insurance undertaking are subjected to more thorough analyses.

IV Recovery measures when difficulties arise

An insurance undertaking is considered to be in an unsound financial situation when, under the terms of the legislation in force, it does not provide adequate financial guarantees.

In the event that technical provisions are inadequate or are incorrectly established or covered, the insurance undertaking shall take the necessary remedial action in accordance with the supervisory authority instructions, as correcting the technical provision established or submitting to its approval a short-term finance scheme based on an adequate plan of activities.

When an insurance undertaking's solvency margin is inadequate, even if the shortcoming is circumstantial or foreseeably temporary, a recovery plan to restore the sound financial position should be presented for approval to the supervisory authority.

The supervisory authority may, in these circumstances of inadequacy of the financial guarantees, decide to apply, for a period it shall set and to the extent considered appropriate, any of the following recovery measures:

- Restrict or prohibit the free disposal of the insurance undertaking's assets;
- Restriction on the activities exercised, namely the pursuit of certain insurance classes and types of operations;
- Restrictions on the acceptance of credit and on the applying of funds to certain types of assets, particularly in regard to operations with branches, with the parent undertaking or with branches of the parent undertaking;
- Ban or restriction on dividend payments;
- Requiring prior authorisation from the Supervisory Authority to carry out certain operations or acts;
- Suspension or discharge of members of the undertaking's governing bodies, and appoint a board of management;
- Closure and sealing of establishments.

When, after adopting recovery measures, it is clear that recovery of the undertaking is not possible, authorisation to pursue the respective activity shall be withdrawn, and consequently the company shall be wound-up.

V Future challenges for the supervision

The implementation of an efficient supervisory framework, which takes into account the new problems posed by a more competitive financial system and which contributes to increase the level of consumers' trust has to be continuously consolidated.

The growing globalisation of the markets and the innovation at the level of product design and management techniques requires a continuing adaptation of the supervision framework, namely in what concerns the perspective of supervision of financial conglomerates.

The scope of the supervisory framework has, therefore, to be redefined putting the accent on the determination of the risk profile of the supervised entities and taking into account the analysis of their financial capability and risk management tools.

SLOVAKIA

Supervision of private insurance in Slovakia is carried out by the Financial Market Authority (hereafter FMA), which was established on 1 November, 2000. Untill this date the Ministry of Finance was in charge of insurance supervision. FMA was established by the Act on Financial Market Authority. The establishment of the Authority resulted from numerous factors. As a matter of fact, it is a trend currently accepted in the whole of Europe. The situation on the Slovak insurance market at present corresponds with conditions that have been created for its development in the last ten years. As for basic quantification, there are 29 commercial insurance companies in total that have the licence to operate in the area of insurance industry in Slovakia. Foreign capital participates in the registered capital of twenty insurance companies. Foreign investors have majority interests in 17 commercial insurance companies. Generally speaking supervision of insurance companies aims at the protection of the interests of – present and future – policyholders and insured.

I Legal bases of supervision

Supervision of insurance companies is mainly based on the provisions of the Act on the Insurance, Act on the Financial Market Authority, Securities Act, both Civil Code and Commercial Code and the others regulations on insurance.

II Areas coming under financial supervision

Financial supervision starts with the process for authorisation of an insurance company to carry out insurance business. During this process specific attention is given to adequate share capital. In addition, the insurance companies have to submit evaluations of commission expenses and other general operating expenses, expected claims expenses and expected liquidity position in the first three years. Further supervision is of two kinds:

– The thorough examination of statistical and accounting documents including solvency which insurance companies must provide to <u>FMA on a yearly, quarterly or eventualy on a monthly basis.</u> This analysis makes it possible to check the economic, financial and liquidity situation of insurance companies and is fundamental for an early warning system. Information about the situation of insurance companies is necessary for drawing up "supervisory plans" used to determine which insurance companies should be selected for on-site inspection.

– On site inspection during which the appointed inspector makes an in-depth analysis of the economic and financial situation and the structure of the company.

In both cases the information collected is used by the supervisory authority to specify the economic adjustments which companies must make and, if necessary, the improvements to their economic and financial solvency.

III Solvency control

Solvency regulations follow the EC Directives. According to article 14a of the Act on the Insurance the insurance companies are required, for the purpose of securing their ability to meet their liabilities under insurance policies at any time. The insurance company is obliged to prove its solvency to the supervisory authority yearly. Solvency requirements depend on a company's volume of business and the minimum amounts are given by the Act on the Insurance (life: 80 mil SKK, non-life: 50 - 150 mil. SKK composite: 130 – 230 mil. SKK). The method for determining and documenting the solvency of an insurance company has been regulated by the Order of Ministry of Finance.

IV Measures when difficulties arise

Apart from occurrence of catastrophes, difficulties with which an insurance company might be confronted are usually predictable. It is the aim of solvency control, and in a broader sense of supervision of insurance companies, to minimise the risk that such predictable difficulties, that might endanger the survival of the insurance company, would occur. With this objective in mind, in the day- to- day supervision of insurance companies all kinds of signals may come up, which might indicate that difficulties could occur. Such signals may be the result of the analysis of the annual accounts, of on-site inspection or any other information available to FMA.

In case of violation of the duties established by the Act on the Insurance, the supervisory authority shall instruct the insurance company to carry out measures eliminating such violation within a specified deadline. In case of failure to carry out these measures the supervisory authority shall hand out fines, introduce receivership, order transfer of the whole or part of the portfolio or withdraw the licence. In reasonable cases these sanctions can be imposed without applying measures. FMA may also hand out fines for the violation of duties established by the Act of Financial Market Authority.

SPAIN

I Regulations concerning the supervision of solvency

Spanish solvency legislation is in line with the European Union Directives. Law 30/1995, of 8 November 1995, on Regulation and Supervision of Private Insurance has introduced in our legislation the EU provisions. This law has been developed by a Royal Decree of 20 November 1998.

This regulation includes provisions concerning:

- The procedure and requirements that must be fulfilled in order to get an authorisation to transact insurance business (capital requirements, business plan, fit & proper requirements for shareholders and managers).
- The requirements that must be complied in the development of such activity.

The following are considered the key points to assure the financial solvency:

a) minimum solvency margin (determined either by a claims index or by a premium index)

b) adequate calculation of technical provisions

c) investment rules applicable to the coverage of the technical provisions with appropriate assets (following the principles of security, profitability, liquidity, diversification and dispersion)

The regulation contains provisions that specify which items constitute the solvency margin, lay down the methods for calculating the various technical provisions and include a list of admissible assets to cover the technical provisions.

No prior approval of rates by the supervisory authority is required.

II The "practical organisation of supervision"

The Spanish insurance supervisory authority is the Insurance and Pension Funds General Directorate within the Ministry of Economy.

Supervision of an insurance company starts before granting its licence, then it follows while it carries out its activity and finalises with its winding up. The main aim is to assure the correct development of the insurance market and to protect policyholders' interest.

The regular supervision is carried out following this procedure:

- The analysis of the financial returns and annual accounts that insurance companies must provide to the directorate General for Insurance on a quarterly (in some cases) and on a yearly basis. This analysis is based on ratios (losses/authorised capital, claims provision/premiums written, debts/liquid assets, underwriting losses, etc.) and makes it possible to check the economic, financial and liquidity situation of insurance companies. This information is indispensable for drawing up "supervisory plans" used to determine which insurance companies should be selected for on-site inspection.
- On-site inspection during which the appointed inspector either makes an in-depth analysis of the economic and financial situation and the structure of the company or focuses the analysis on a special item.

In both cases the information collected is used by the supervisory authorities to specify the economic adjustments which companies must make and, if necessary, the improvements to their economic and financial solvency.

On-site inspections mainly focus their attention in verifying the adequacy of the calculation of the technical reserves, their coverage, the solvency margin, the adequacy of premiums rates, reinsurance programme, internal control procedures and risk subscription policy.

Changes in ownership, mergers and acquisitions, changes in management, transfer of portfolio, are also studied carefully and require the authorisation of the insurance supervisory authority.

Meetings with shareholders and managers are held when necessary.

III Measures when difficulties arise (recovery measures)

Law30/1995, of 8 November 1995, provides in Section 39 for the Insurance General Directorate to implement recovery measures in the following situations:

- Accumulated losses in excess of 25 per cent of the paid-up authorised capital of the company or mutual association fund or the permanent fund with the parent company.
- A deficit in excess of 5 per cent in the calculation of each of the technical provisions, a deficit in excess of 10 per cent for the outstanding claims provisions.
- A deficit in excess of 10 per cent in the coverage of the technical provisions.
- Inadequate solvency margins or guarantee funds.
- Liquidity problems which have resulted in late payment or non-payment.
- Problems found during supervisory inspection which jeopardise the solvency of the company, the interests of policyholders or the company's ability to meet its commitments, or inadequate or irregular accounting or management procedures which make it difficult to determine the assets and liabilities of the company.
- Inability to carry out their activity or inadequate functioning of the corporate institutions.
- If the supervisory authorities of companies located in other Member States of the European Economic Community or of insurance companies domiciled in any country of the Community which are authorised to cover risks located in Spain by free provision of services, notify the Ministry of the Economy that interim protective measures have been taken or that the licence of such a company has been revoked.

In the above cases, regardless of any penalties that may be imposed, the supervisory authorities may take the following precautionary steps as appropriate:

- A recovery plan requiring the company to specify the financial, administrative or other improvements it intends to make, to set clear goals and time limits for achieving them. The Directorate General for Insurance must accept the plan.
- A short-term financing plan in which the company must specify the nature, amount, and scheduling of new financial resources for improving the situation. The plan should be accepted by the Directorate General for Insurance.
- The issue of new insurance policies or acceptance of reinsurance can be suspended. This suspension will only remain in force until the recovery or financing plans mentioned above have been adopted.
- To prohibit the adoption of managerial and disposal decisions without the prior approval of the Insurance General Directorate, paying dividends, writing new insurance contracts or admitting new members.

- To prohibit the disposal of certain assets which will be placed in the custody of a financial manager approved by the supervisory authorities. This can be accompanied by other appropriate measures aimed at informing the public of this prohibition, such as notifying institutions holding the company's assets or securities and entry in the appropriate public registers. The decisions of the Ministry of the Economy can also be published in these registers.
- To prohibit insurance activities abroad if they are held to aggravate the situation which led to the precautionary measures.
- To convene the management bodies of the company and to appoint a proper person to chair the meeting and report back on the situation.
- To suspend the company's managers. The decision should appoint an individual or individuals to act as provisional managers.
- To intervene in the insurance company in order to assure the enforcement of the recovery measures adopted by the Insurance General Directorate.

These measures will be adopted in the framework of an administrative procedure where the insurance company has the right to explain its point of view.

SWEDEN

I Introduction

The first form of legislation in Sweden regulating private insurance was to a large extent instigated by the insurance industry itself. Prior to this legislation, almost any entity could act as an insurer. The initial regulation in this area was a general law on contracts of insurance. The Insurance Contracts Act was enacted in 1927, after in-depth studies made in collaboration with other Scandinavian countries. The Act covers all direct insurance contracts to which a private insurance company is a party. Motor vehicle third-party and nuclear reactor insurance are, however, regulated by other, more specific, laws.

Further legislation regulating foreign insurance companies operating in Sweden was adopted later. These acts are still valid laws but they have been revised numerous times since their original enactments. The Insurance Business Act was enacted nationally in 1982. This act contains not only provisions relating to the supervision of the insurance industry, but also provisions corresponding to other general legislation governing commercial undertakings.

Prior to 1985, Swedish licensing authorities would not admit any new insurance company proposing to do business along traditional lines unless there was a need for more competition in that company's particular field (principle of need). After 1985, a change in laws resulted in the licensing authorities considering only whether a new or extended license would promote sound development of the insurance industry in general. Thus, it has become easier for new companies to obtain licenses and for already existing companies to obtain extended licenses. These rules apply similarly to both Swedish and foreign insurance companies. Beginning from 1994 the Insurance Directives of the European Union have been implemented and the principles have been reviewed accordingly.

The Swedish laws in general were developed in the 1970s in an attempt to increase the protection of consumers. Because these concerns for consumers carried over to the insurance sector, the Swedish Government found there was a need to improve the Insurance Contracts Act of 1927. As a result, the Government enacted the Consumer Insurance Act of 1980.This regulation on private contracts of non-life insurance has been revised and amendments including life insurance are expected in the near future. Other important provisions are contained in a 1975 act on compulsory motor vehicle third-party liability insurance, which regulates the operation and supervision of insurance companies.

Significant changes have been enacted during the last decade. An Act on Unit-Linked Insurance came into effect in 1990. The Act on Insurance Brokers was also introduced in 1990. This law allows for supervision of insurance brokers. The Supervisory Service was merged with the authority supervising banks and other credit institutions in 1991 and became the Financial Supervisory Authority (FSA). Also, since late 1990, a committee under the Ministry of Finance has reviewed certain aspects of the Insurance Business Act. The most important concern so far has been amendments needed for the implementation by 1 January 1994 of the EC directives required by the Agreement on the European Economic Agreement and the implementation of the third generation EC directives on 1 July 1995, when Sweden had already joined the European Union. The review of the Insurance Business Act was completed 1 January 2000 when important amendments opened the possibility of paying dividends to shareholders in traditional life insurance companies.

II Basic concepts

The main principles of insurance legislation after amendments to the Insurance Business Act in 2000 are solidity, transparency of policy conditions and compliance with good insurance standards. A principle of equity still holds for motor vehicle liability insurance.

Swedish insurer legislation lays down a number of general principles as well as detailed provisions concerning a variety of matters with which insurance companies must comply and which at the same time will serve as a basis for supervision. For example, insurers have to produce financial statements of various kinds in prescribed forms.

The FSA has clearly defined powers to examine the accounts of a company and all relevant documents and to take measures in certain specified situations. It appoints auditors for large companies and has a special responsibility for supervising the investment of assets covering the technical reserves for life insurance and similar insurance. There are otherwise no detailed rules regarding the manner in which supervision has to be exercised. The FSA consequently has been allowed wide discretion.

III Regulation and supervision

A. Scope and organisation of supervision

Private insurance is mainly provided by insurance companies, but there are also some friendly societies. These societies fill a certain, though diminishing, place in the sphere of life and health insurance.

They are subject to the Act on Friendly Societies of 1972 and are, as are insurance companies, under the supervision of the FSA. They are legally distinguished from insurance companies by a provision stating that they may not transact insurance business on commercial lines.

Supervision of insurance companies and of the friendly societies is the responsibility of the FSA as an independent State agency. Its work is governed only by legislation and by Government Executive Orders, which must be published. Most matters including authorisations can be decided by the FSA, but questions bearing on important principles are usually lifted to the Government. Complaints over decisions by the supervisory authority can be handled in courts. The Director-General has the sole right of decision in all matters which are not presented to the Board of the FSA[1].

The Insurance Business Act does not define insurance business. Application of the legislation will determine whether a particular activity is classified as insurance. In uncertain cases it is a task for the FSA to determine whether a license is necessary for an intended business. The FSA is authorised to prohibit unlicensed activities and may impose fines against those who carry on unlicensed activities.

The Insurance Business Act does in most cases not distinguish between direct insurance and reinsurance business. It does, however, make an important distinction between life insurance (including life insurance as well as annuities and pension insurance) and non-life business. There are a number of special requirements relating to life insurance.

Supervision covers all classes of direct insurance as well as reinsurance. Furthermore, it covers all private insurance companies, but only to a limited extent certain small local companies undertaking livestock insurance.

B. Foreign insurers

Supervision of foreign insurers is limited to direct insurance. No licence is needed for a foreign insurer to transact exclusively reinsurance business in Sweden, nor is there any objection if a branch of a foreign concern licensed for particular classes of direct insurance is transacting reinsurance as well. For direct insurance, the Swedish branch must be managed by a general agent as representative of the company. The branch is not regarded as an enterprise of its own, but merely as a part of the whole company.

Thus the general agent is not required to submit annual accounts of the branch business. Certain data regarding the volume of Swedish business is required merely for statistical purposes, while other data regarding life insurance is needed for ascertaining whether the assets destined for covering the mathematical reserve are of sufficient value and of

1 There are no advisory bodies, but the FSA has the liberty to call in independent experts when it so desires. This has been done occasionally in the past.

prescribed standing. The FSA has the right to make unannounced inspections. For EEA insurers in Sweden home country supervision principle applies from 1 July 1995.

C. Supervision of business

It is incumbent upon the FSA to ensure that insurance companies remain solvent and conduct their business in accordance with the Swedish laws and regulations. Supervision implies consideration of legal, financial, technical, and economical matters. Investment regulations in accordance with the third generation EC directives apply from 1 July 1995 to assets corresponding to technical provisions of life insurance as well as non-life insurance.

Solvency is monitored by means of annual and quarterly returns. The annual returns are to be sent in to the FSA no later than July-August[1]. A solvency statement according to EC rules is required annually by 15 May since 1994. Apart from EC solvency statement, the annual returns in particular are analysed. Quick solvency tests based on various ratios are being developed as part of a more comprehensive assessment of solvency. Big insurance groups and conglomerates are analysed with high priority.

The FSA monitors the excess of total market value of assets over policyholders' reasonable expectations on a quarterly basis. Only in the case of motor vehicle third-party insurance are there any legal provisions empowering the FSA to interfere with the setting of premiums scales, as regards administration costs.

Supervision of the business of a licensed insurance company involves mainly examinations of the returns which must be submitted to the FSA quarterly and annually (one month after the Company Meeting) and inspections at the insurer's place of business in order to review the whole company's affairs. Each major company has an auditor appointed by the FSA and each company having technical reserves for life insurance or similar insurance must register the amount and composition of the assets representing the reserves in a special record. The FSA has issued regulations concerning such registration.

D. Inspection at the place of business

At unspecified intervals, normally every three to five years, companies may be inspected by representatives of the FSA's headquarters staff. The inspectors have access to all information available in books, correspondence minutes, contracts, internal statistical and costs analysis.

The power of the FSA to obtain information is generally unlimited, with the exception of its own capacity to use the obtained information and the moral obligation not to

1 An acceleration of this process is currently being discussed.

burden the companies in a manner that would be harmful to the interest of the policyholders.

The duty to provide information and to keep documents available for inspection also applies to rating bodies, claims settlement committees, and similar organisations of the companies.

The FSA may issue such directives concerning the conduct of an insurance company as it finds necessary. If the FSA finds that any of the following conditions are fulfilled, then it shall direct the company to take remedial measure within a specified period of time, as each case requires:

- There has been a default in complying with the law, with any regulations based on the law, with the company's articles of association, or with the technical bases, if any.
- The company's articles of association or technical bases are no longer adequate in view of the size or the character of the business.
- The assets representing the technical reserves are insufficient.
- The business in force is insufficient for such diversity of risks as is required.
- There is any other reason for serious criticism of the conduct of the company.

The FSA must report the matter to the Government if the company fails to comply with the direction within the specified time and the matters complained of are not otherwise rectified. The FSA can, after hearing any representations by the company, withdraw the company's licence to undertake insurance business.

The corresponding rules regarding foreign (non-EEA) companies are basically the same, except that they are limited to the Swedish branch and omit the references to the articles of association and the requirement that business in force be sufficient for such diversity of risks.

The power to issue directives is rarely exercised. The fact that the FSA has this power, however, gives it more weight in negotiations.

The usual measure is to send an admonition to the companies. These admonitions are usually public documents which any newspaper or any citizen has the right to see. In a severe case, an admonition may contain an order that it be read aloud at the next company meeting (shareholder's meeting in a joint-stock company). The FSA has the right to send its own representatives to any company meeting.

Also it may order a special meeting of the board of directors to be convened and send its representatives to the meeting. Finally, it may require the board of directors to convene an extraordinary company meeting, and, if the board fails to comply, it may convene such a company meeting directly.

Almost all correspondence and other documents received by the FSA, as well as outgoing documents, are public and any person is entitled to see them. The only major exceptions from this rule concern reinsurance treaties, business secrets in companies' documents, and information pertaining to the relations between a company and individual policyholders.

IV Financial conditions

There are no detailed rules as to the amount of a company's share capital. The minimum sum required will be settled by authorities in each individual case, taking into consideration the class of insurance, the prospective amount of business and other relevant circumstances. Initial guarantees are required for foreign insurers.

A foreign non-EEA insurer must make a deposit at a Swedish bank before obtaining a licence. This deposit must be made on terms approved by the FSA, in securities which the FSA has accepted, and in an amount equivalent to 300 times the basic amount (approximately 0.9 million EURO for year 2001)[1]. A foreign non-EEA company applying for a licence must also submit the statements of account and auditors' reports for its whole business covering the last ten years or the time the company has been in existence, if less than ten years.

V Insolvency determination

Today, the determination of insolvency is to a large extent the responsibility of the Board of Directors of each corporation, and is most clearly defined for a joint-stock insurance company. If more than two-thirds of the share capital is lost or judged to have been lost, a special balance sheet for liquidation purposes must be established. If this balance sheet verifies the presumed loss, the question of liquidation is remitted as soon as possible to the company meeting for decision. If the ordinary company meeting is too far away in time, an extraordinary company meeting is summoned. The decision to liquidate may be made at the company meeting. If so, the district court must be notified.

Another decision that may be made at the company meeting is to postpone liquidation and order management to restore the capital to half the original share capital. This respite is set to last until the ordinary company meeting of the following accounting year. If the capital is not restored to half the original after the respite, the decisions to liquidate will be made by the company and the district court notified. If such a decision to liquidate is not made by the company meeting, an application for liquidation may be

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1 The basic amount is a unit related to inflation and consumer prices. For 2001, 300 times the basic amount equals SKr 11 070 000.

handed in to the district court by the Board of the company, a member of the Board, the managing director, an auditor of the company, or a shareholder. The FSA may also notify the district court of the situation. On the whole, the responsibility rests with the Board. If the regulations are not followed, some personal liability may be the result.

If the district court receives such an application for liquidation, it has the power to rule that the company must go into liquidation. It may resolve otherwise, however, if during the processing it can be verified that the capital has been restored to half the original share capital according to the balance sheet scrutinised by the auditors and accepted at the company meeting. The Court also appoints liquidators, unless this has already been done at the company meeting. If the liquidators find that the company is insolvent, they shall present the Court with a petition for bankruptcy. After this, the common bankruptcy procedure is started.

Bankruptcy is governed by the ordinary insolvency legislation and is to be registered with a district court. A petition for bankruptcy may also be handed in by a creditor. The FSA should be kept informed about a bankruptcy and has the right to appoint a representative. Such an appointment is mandatory in the case of bankruptcy of a life insurance company. There is liquidation or winding-up procedure if the bankruptcy proceeding results in a surplus which the creditors could use to satisfy their interest.

If a mutual insurer suffers a loss in its direct non-life business that cannot be covered, it demands additional contributions from the policyholders. The next step is to reduce technical reserves and amounts paid during the year when the loss occurred. This, however, does not apply to life and health annuities arising out of accident or liability insurance because they enjoy the same protection as life business. There are no fixed rules as to when a mutual insurer must be wound up. In addition, the EC rules on solvency margin and guarantee fund apply since 1994.

VI Suspension and cessation of business

A. Voluntary suspension

There are no provisions in Swedish legislation regarding suspension of business. If a company suspends the writing of new business in some or all classes of insurance, it is under no formal duty to report this step to the FSA, but such a report will probably be made in practice. There will be no consequences with regard to the licence. There is, however, an exception from these general rules in case of motor vehicle third-party insurance.

There are also no provisions in Swedish legislation stating directly any consequences of a voluntary cessation of a part of the business, thus the position will be mainly the same as in the case of suspension. The licence will stand, provided that the articles of association are not altered as to exclude any classes of insurance specified in the licence. If, however, the articles of association should be so altered, then the licence will lapse automatically with respect to such classes.

B. Compulsory suspension

A licence may be withdrawn by the Government if the company fails to comply with an injunction of the FSA. For a new company, the licence must be withdrawn by the Government if the company either fails to apply to the FSA for registration within six months of the Government's sanction or does not start business within three months of the registration day. It is the task of the FSA to inform the Government of such matters.

Moreover, a company must be wound up if the entire insurance portfolio has been transferred to another insurer, or if the licence to undertake business has been granted for only a limited time and such time has expired without a new licence being granted. In the case of non-life classes, business may continue as necessary for a proper winding-up. Thus, current insurance will continue to be administered, i.e. premiums will be collected and claims paid, until the contracts expire. A transfer of the portfolio may be arranged during the winding-up.

C. The right of appeal

The decision to withdraw a licence can only be made by the Government. Appeal can be made to the Supreme Administrative Court. The withdrawal of a licence, except where the licence is temporary or the company's articles of association have stipulated only a temporary period of business, presupposes that the FSA has notified the Government that the company has failed to comply with an injunction. Thus, the company has the opportunity to make representations publicly at both stages.

Swedish law deals with the voluntary transfer of insurance portfolio. There are no special provisions regarding the transfer of the company as such. If a transfer comprises a company's entire insurance portfolio, it will be deemed equivalent to the transfer of the company, and will be followed by the compulsory winding-up of the company.

D. Winding-up

There is some overlap between bankruptcy under ordinary insolvency legislation and liquidation under the Insurance Business Act. The winding-up procedure is essentially the same when the bankruptcy proceeding leads to a surplus. The FSA should be kept informed about a bankruptcy and has the right to appoint a representative. In the case of a life insurance company, such an appointment is mandatory.

If a company decides to stop business voluntarily and the portfolio is not transferred to another company, the company may allow its policies to expire and decide to wind up the company afterwards, or it may decide to wind itself up immediately. In the case of the latter, business in non-life classes may continue so far as necessary for a proper winding-up.

A voluntary winding-up requires a resolution of general meeting of the company. Even in the case of a compulsory winding-up, the law assumes that it is the company itself that has made the decision. In this case, however, only one company meeting is required. If more than two-thirds of the share capital of a joint-stock company is lost, the company must be wound up, unless the loss is made good within a certain time or a deduction of the share capital is resolved.

The procedure for winding-up is basically the same for non-insurance companies, whether the winding-up is compulsory or voluntary. One or more liquidators must be appointed at a general company meeting. The same meeting must appoint one or more liquidation auditors as well. The FSA may appoint an additional liquidator and an additional auditor in non-life insurance companies. The FSA must always appoint an additional liquidator when dealing with life insurance companies. The liquidators will be appointed by the court if the company does not do so within a certain time. The liquidators must administer, liquidate, and realise all assets and settle liabilities. As soon as this has been done they must draw up a report which, after being scrutinised by auditors, will be presented at a general company meeting.

If a foreign company winds up its branch in Sweden, it must appoint a party to represent it in relation to the policies in force in Sweden. If the company fails to meet its Swedish liabilities, the initial and additional deposits may be used. These deposits may not be released until the company has proved that all liabilities arising out of the Swedish business have been settled, unless other guarantees are substituted for the deposits and are approved.

There are special rules with regard to foreign life insurance. If the licence for this class of business is withdrawn there will be separate administratorship by the FSA. Also, in the case of the voluntary cessation of a branch business in life insurance, a separate administratorship may be prescribed by the FSA, if the representative of the company does not carry out his duty in accordance with the law, or if such a step is otherwise considered necessary in order to protect the interest of the policyholders.

E. Preferential rights

A preferential right is a right of life insurance policyholders and beneficiaries to assets covering the technical reserves. An insurer must maintain a register of assets on which there is a preferential right because there are restrictions on how such assets may be invested. These restrictions are being revised to encourage prudent portfolio management instead of dictating detailed prescriptions.

As far as domestic companies are concerned, there is a preferential right in Sweden only on the registered or recorded assets corresponding to the technical reserves for life insurance or in other insurance involving annuities arising out of accident and health insurance or motor vehicle third-party insurance. In these cases the preferential right is absolute. With regard to other classes of insurance, in general non-life classes there are no preferential rights at all for the benefit of policyholders. Thus, policyholders have no greater right to the assets than other creditors.

No distinction is made between Swedish citizens and foreigners, nor between property located in Sweden or abroad. Thus all creditors, regardless of nationality, may enforce their rights on all assets of the company, including property located abroad, with only such restrictions as may be the consequences of the preferential rights mentioned above or, with regard to branches of Swedish companies abroad, of preferential rights due to the legislation in the other countries.

In the case of foreign insurers, initial and additional deposits may be used only for payment of claims under insurance contracts belonging to the Swedish branch, for payment of fines, etc. These fines may be imposed on the Swedish branch or its general agent or any other representative, or, in the case of a separate administratorship for life insurance, to meet the administratorship's claim against the company.

VII Conclusion

The regulation of the insurance industry has changed partly as a result of the Agreement on the EEA. The third generation directives were implemented by 1 July 1995. The issue whether Sweden should create a system for policyholder protection is still being discussed.

SWITZERLAND

I General remarks

Supervision of private insurance in Switzerland is carried out by the Federal Department of Justice and Police and the Federal Office of Private Insurance. The Office has general supervisory authority and is empowered to take decisions except when the Supervisory Law explicitly names the Department.

Until now supervision of the solvency of insurers in Switzerland has primarily consisted of verifying the "traditional" conditions of financial soundness: equity capital at the time of starting business, security margins in premiums, adequate reinsurance, prudent choice of investments, etc.

The solvency margin laid down by the EC directives only began to be used with entry into force of the Insurance Agreement between Switzerland and the EC on 1 January 1993 for non-life insurance and in 1994 for life insurance, when the Swisslex project adapted the country's legislation to Community Law.

II Regulating supervision of solvency

A. Life and non-life insurance companies

Equity capital

For a licence to be granted, the paid-up capital when business is begun must be between SF 600 000 and SF 10 million for non-life companies, and between SF 5 and 10 million for life insurance companies. The amount of equity capital required is determined according to the type and expected volume of insurance class operated.

To obtain a licence, the company's owners, as well as having the required capital, must constitute an organisation fund of readily convertible assets, to an amount ranging from20 to 50 per cent of the paid-up capital, on the basis of a budget plan for the first three years of business. In the first years in business newly established insurance companies most often show a loss due to considerable organisation and starting costs (data processing, distribution network, initial commissions in life insurance). The organisation fund is intended to cover these losses so that the capital need not be used immediately. The supervisory authority can require that the organisation fund be replenished if necessary.

The insurance company must allocate part of its yearly profit to the statutory reserve in order to create additional capital resources. This reserve is set up "according to a plan of management approved by the competent supervisory authority" (Article 671, Paragraph 6 of the Swiss Code of Obligations). As a rule, non-life insurance companies must allocate 20 per cent and life-insurance companies 10 per cent of their annual net profit to the statutory reserve until it amounts to a sum equal to 50 per cent of the company’s capital.

Insurance companies’ uncommitted equity capital must not be less than the solvency margin; provisions on solvency margins and guarantee funds which are in line with those of the EC have been in force since 1 January 1993 for non-life insurance, as stipulated in the Agreement on Direct Insurance Other than Life Insurance between Switzerland and the EC. Special solvency margin provisions for life insurance companies are included in the new federal legislation on direct life insurance which entered into force on 1 January 1994 in the framework of the Swisslex project.

Adequate reinsurance

The supervisory authorities’ requirement is simply that there be adequate reinsurance of the portfolio in order to limit risks and to provide protection in the event of an unfavourable trend in claims. During the first years of business of an insurance company in particular, the joint financing of starting costs by the reinsurer also plays a role. The reinsurance policy proper, that is the choice of one or several reinsurers, the form of the reinsurance treaty (excess of loss, damage excess, etc.), the amount of the retention limit, and so on, is left to the discretion of the company concerned. However, a retention limit cannot be ruled out.

Technical reserves

In Switzerland technical reserves must be established on the basis of a compulsory business operation plan approved by the supervisory authority. While reserves for unexpired risks and mathematical reserves for annuity and capital payment linked to the life of one or several persons are relatively easy to determine using actuarial rules, establishing adequate reserve for outstanding claims, and especially belated claims, is much more difficult to determine for property and third party liability insurance.

In life insurance, the uncontested principle until now was that the mathematical reserve should be computed on the same basis of prudent calculation as premiums. In this way income from premiums can finance the investments which are necessary to cover the mathematical reserve over a relatively long-term average. A life insurance company could not be allowed to calculate the mathematical reserve on a lower basis than that used to calculate premiums.

Premium rates

In Switzerland, the supervisory authority must approve new or modified premium rates for certain risks (life and sickness insurance, third-party liability cover for lake and inland waterway vessels, mass risks incurred in other categories of compulsory insurance). The supervisory authority ensures that premium rates, established on the basis of calculations and statistics which must be submitted to it, remain within certain limits which guarantee the solvency of individual insurers while protecting policyholders against excessive rates.

Future policy on rates

In the near future in Switzerland, it is planned to lift not just partially but completely the requirement of prior approval of rates by the supervisory authority. This should have the effect of increasing competition, which is not undesirable. Usually, fiercer competition means tighter security margins for rates and technical reserves. Thus, the role of the owners' equity in limiting risks will be much more important in the future: hence the minimum equity requirement based on type and volume of business.

Investments

Inasmuch as they serve to cover technical reserves (guarantee fund, tied assets), investments should be chosen in Switzerland as required by law, with due consideration for security and spread of risk, returns and liquidity requirements. Shares in foreign companies and receivables denominated in foreign currencies or imputable to foreign debtors are subject to quota. Just how meaningful such general quotas are in the light of modern portfolio management theory is another matter. On the other hand, limiting by law the proportion of securities or receivables imputable to a single enterprise or debtor, so that the insurer does not put all his eggs in one basket, seems more judicious.

Swiss insurance legislation also contains several provisions on the maximum allowable evaluation of certain investments so as to prevent misrepresentation of the solvency position through unrealistic balance-sheet assessment of assets.

B. Professional reinsurers

Foreign professional reinsurers are exempted from any supervision if reinsurance is their only business in Switzerland.

For Swiss professional reinsurers, the required capital is SF 10 million, fully paid up (an indicative order of magnitude) with an organisation fund of 20 to 50 per cent of capital. Technical reserves must be established on the basis of a compulsory business operation plan by the supervisory authorities.

III Practical organisation of supervision

A. Life and non-life insurance companies

Examination of operating plans

When the supervisory authority initially processes the application for a licence, it examines the applicant insurance company's business operation plans, looking especially at the principles for calculating technical reserves, reinsurance regulation, plans or share participation, the general conditions of insurance and premium rates, as well as the company's organisation.

Once the licence has been granted, the supervisory authority monitors all aspects of the company's business activities on an on-going basis, examining yearly reports and conducting on-site inspections. Supervision focuses on business operations primarily from the technical, financial and legal standpoints.

Examination of yearly reports

Insurers are required to file a report every year on an official form, requiring detailed information on all aspects of business. It is primarily on this document that companies' solvency is judged. The supervisory authority monitors with special care the following factors of solvency:

- status of the statutory reserve and payments into it;
- evaluation of overall balance sheet data and analysis of the profit and loss account compared with the previous year;
- volume, appropriateness, completeness, and correct calculation of technical reserves;
- estimate of securities;
- total claims experience; levels of underwriting results and financial results;
- evaluation of operating costs and depreciation.

Annual inspections of insurance companies

For each insurance company, the supervisory authority verifies as a rule at least once a year:

- whether the amount of technical reserves (security fund, tied assets) is calculated correctly, whether it is covered by the assets allocated, and whether these assets meet the investment requirements and actually exist;
- trend of income and expenditure in relation to reinsurance, what profit and loss on risks declared. According to the trend (for example, if reinsurance expenditures exceed reinsurance income over several years), the company in question is asked to reappraise its reinsurance treaties;
- at the time of inspection the supervisory authority also monitors policy rates and claims records; the company's accounts and organisation are also examined.

B. Professional reinsurers

Swiss professional reinsurers are also required to file a yearly report on an official form. On-site inspections are carried out approximately every five years. The emphasis is on the report, the accounting organisation, active and passive reinsurance, etc.

IV Measures taken in case of difficulties (recovery plan)

A. Life and non-life insurance companies

Swiss legislation on the supervision of private insurance provides for precautionary measures to be taken if the interests of the policyholders seem to be threatened and for measures in case of liquidation of an insurance company. The ordinary rules for the liquidation of enterprises in the Code of Obligations and the rules of the federal legislation on proceedings for debt and bankruptcy hold in principle, although there are certain modifications; in particular, the supervisory authority is competent in matters which would normally lie within the jurisdiction of the courts.

Recovery measures

If policyholders' interests are threatened, the Federal Council requires the company to take steps to correct the situation. If the insurance company does not comply with this injunction, the supervisory authority on its own initiative takes the necessary measures to protect policyholders. It can in particular transfer to another insurance company the portfolio and the security fund (or the tied assets covering the latter); or it may decide to realise, through a forced sale, the assets allocated to the security fund or the tied assets. The Federal Department of Justice and Police ("Department") can demand a general meeting of shareholders or other body able to decide on the necessary measures for the recovery of a Swiss company. It can demand to be represented at the meeting of such a body.

Breach of rules on technical reserves

If the company fails to comply with the provision of insurance supervision law or with the supervisory authority's decisions on the establishment and coverage of technical reserves, the authority can take any measures it sees fit to safeguard the interests of the policyholders. It can in particular prohibit the free disposal of the company's assets in Switzerland, or order that they be placed on deposit or frozen.

Insufficient capital endowment or organisation fund

If the minimum capital and organisation fund conditions are not respected, the supervisory authority requires the insurance company to put matters right by a given date. If the company disregards this injunction, the Department withdraws its licence.

Breach of solvency margin rules

If a Swiss insurance company's own equity no longer covers the solvency margin, the supervisory authority calls on the company to submit a recovery plan for approval. The supervisory authority can in each case lay down the recovery plan requirements and set a deadline for the plan's completion. If the insurance company fails to implement the plan in the time allotted, the Department withdraws its licence without further notice.

Insufficient guarantee fund

If a Swiss insurance company's owner's equity no longer covers the guarantee fund, the supervisory authority requires it to submit a short-term plan of financing for its approval. The supervisory authority can also restrict or prohibit free disposal of the insurance company's assets and take all appropriate measures to safeguard policyholders' interests.

Measures by the supervisory authority

The authority may either forbid the company to surrender policies or to raise loans or advances on them (and in some cases also forbid payment of mathematical reserve), or it may allow the company time to meet its obligations and permit policyholders to suspend premium payments.

While premium payments are suspended, insurance may not be cancelled or reduced except at the written request of the policyholder.

Appointment of a liquidator

If the company is liquidated, the Department can appoint a liquidator.

B. Professional reinsurers

The above measures do not apply to Swiss and foreign reinsurers (the latter are exempted form all supervision if reassurance is their only business in Switzerland). In that case adequate measures and powers are provided for, primarily in the Federal Code of Obligations and Federal law on proceedings for debts and bankruptcy, Swiss professional reinsurers are subject, in addition, to the Insurance Supervision Act (which lays down the conditions in which a licence may be withdrawn).

TURKEY

I General framework concerning the supervision

The Turkish insurance sector is regulated and supervised by the Undersecretariat of Treasury. Two units of the Undersecretariat, Directorate General of Insurance and Insurance Supervisory Board, are empowered.

The former unit has the duty to draw up and implement regulations concerning insurance matters, to oversee and guide the parties concerned in their implementation, to take the measures conducive both to the development of the country's insurance industry and to the protection of the insured; while the latter one has been entrusted with the task of enforcing and finalising duties of on-site supervision, examination and investigation.

Rules governing the sector are laid down by Insurance Supervision Law (No.7397 with the amendments made by Statutory Decree No.539, dated 1994) and related regulations. All insurance and reinsurance companies, irrespective of foreign or domestic, are subject to the same legislation.

A. On-site inspections

Insurance and reinsurance companies, as well as natural persons and legal entities, concluding insurance transactions or operating in the field of insurance are subject to the supervision of the Board as per the provisions of the Law as well as other legislations relating to insurance business.

Activities, assets, participations, receivables, equities and debts of insurance and reinsurance companies and all other elements which effect the financial and administrative structure are determined and analysed by the Board.

Supervision staff are authorised to demand all the information and to examine all the books, registers and other documents, which they deem to be in relation with the provisions of the Law, of the insurance and reinsurance companies, their subsidiaries operating as insurance intermediaries including the banks and other natural persons and legal entities who, in return, are obliged to present and make ready all the information required to be examined.

B. Financial reporting

Quarterly account abstracts, prepared in accordance with the principles and format determined by the Undersecretariat; and charts pertaining to solvency margin, prepared as of the end of semi-annually periods, must be forwarded to the Undersecretariat within two months by insurance companies and within four months by reinsurance companies.

The Undersecretariat is authorised to require insurance and reinsurance companies as well as agencies and other insurance and reinsurance intermediaries to record certain transactions in special books other than those keeping of which is made obligatory by the Turkish Commercial Code and the Tax Procedure Law, and to determine the rules and procedures relating to the preparation of such books.

The Undersecretariat is also authorised to:

- make arrangements in relation with the financial structures and the use of resources of the insurance and reinsurance companies and to establish ratios,
- determine the necessary amount of equity capital/shareholders funds in order to meet the solvency margin,
- determine the amounts and rates of the insurance and reinsurance companies' resources that can be invested in the subsidiaries, securities, real estates and other valuables,
- require all kinds of information, tables, reports and financial tables according to the procedures and specimen which the Undersecretariat will stipulate and have the financial table published if deemed necessary,
- ask for setting a reserve in proportion with the premiums and losses,
- to determine the procedures and rules of the same in the cases where the solvency margin could not be established,
- make the necessary arrangements for the preparation of consolidated financial tables and ascertain the direct or indirect subsidiaries as well as the partnerships managed and controlled by the insurance and reinsurance companies which are subject to consolidation and determine the rules and procedures relating to the publishing of the consolidated financial tables,
- arrange the supervision of the insurance and reinsurance companies by the independent external auditors.

II Regulations concerning solvency

Insurance Supervision Law and Regulation on the Establishment and Principles of Operation of Insurance and Reinsurance Companies cover a wide rage of issues related to the solvency of insurance and reinsurance companies. Basic highlights concerning the solvency are as follows:

A. Minimum capital requirement

The establishment of an insurance or reinsurance company, and the opening of a class of foreign insurance or reinsurance company is subject to the prior permission of the Ministry of State to which the Undersecretariat is attached. Establishment also requires a minimum paid-in capital which is currently approximately 4.7 million $. Following the establishment, companies must obtain license for each class of the insurance they intend to operate.

With the aim of ensuring that the companies operate in financially sound conditions, the amount of capital required for the establishment is subject to an increase by the Ministry not exceeding the rate of the Wholesale Price Index.

B. Deposits

Insurance companies are obliged to establish deposits proportional to the premiums, in order to meet their obligations arising from insurance contracts. In non-life, the amount of deposit amounts to 15 per cent of the premiums less terminations and cancellations at the end of each accounting period. Deposit to be established in life is the total of the amount remained after deducting loans made on life contracts from the total of mathematical reserves retained from net premiums of life insurance and the amount of life outstanding losses, as well as the amount of accrued profit shares reserves.

The Undersecretariat may further require establishment of deposits in proportion to the insurance contracts in force without being bound to the accounting period, and is authorised to abolish partially or completely the deposits established in the life insurance group.

Newly established companies are required to form an initial deposit equal to 20 per cent of their paid-in capital. Deposits to be established may not, in any case, be less than 20 per cent of the paid-in capital.

Assets representing deposits must be lodged in banks operating in Turkey, which are approved by the Undersecretariat.

Deposit constitutes against the credits of the insured and in the events of liquidation or bankruptcy of the insurance companies, it is allocated firstly for the payment of the insured’s credits in the class for which it is established, and the remaining part is then added to the deposits of the other classes.

Deposits may not be subject to suits or executions for any other kind of credits, as well as those related with liquidation or bankruptcy estate, unless the payment of the insured’s credits is fully done. In order to ensure the protection of the rights and interests of the insured, the Undersecretariat may request that the deposit be utilised to liquidate claims.

If an insurance company wishes to terminate its insurance operations in one or more classes or in all classes, its deposit in the relevant class will be released on condition that all liabilities due to the insured have been fulfilled.

C. Technical reserves

Aside from deposits, insurance and reinsurance companies are also obliged to put aside technical reserves. In this context, insurance and reinsurance companies are required to:

- set aside "reserves for unearned premiums" for their commitments under any of the insurance classes other than earthquake, and life insurance with a duration of more than a year,

  Reserves for unearned premiums constitute the portion of the sum which remains after the commissions are deducted from the premiums for the policies in force extending over the following year, on a daily basis. However, in the cases when this reserve cannot be set aside on the basis of policy, the reserve corresponds to the rates of 25 per cent in marine insurance and 33.5 per cent in the other classes on the amounts remaining after deducting the premiums relating to the contracts which have been cancelled and terminated.

- set aside "reserves for outstanding losses" consisting of the amounts of losses which are already due and taken into account, or if not yet accounted consisting of the amounts of estimated losses,
- hold the premiums they receive and retain in return to the earthquake risks they cover under fire and engineering insurance classes together with the net incomes derived therefrom as "reserve for earthquake loss" for a period of fifteen years.

Moreover, insurance companies operating in the life class must set aside "mathematical reserves" on the basis of the generally accepted actuarial principals approved by the Undersecretariat. Mathematical reserves consist of the total of "actuarial mathematical reserves" and "profit share reserves" calculated separately for each contract in force, in accordance with the technical principles of the tariff.

In addition to technical reserves, insurance companies have to constitute "reserves for premium receivables" for their premium credits which are due to be paid by their agents and insured.

Assets in which the technical reserves could be invested and restrictions thereto are determined in detail by the Undersecretariat. Assets representing technical reserves in life insurance should be localised in Turkey, separately from free assets.

D. Solvency margin

Net worth of insurance companies, cannot be less than their solvency margin.

Solvency margin is calculated separately for non-life and life insurance classes. Solvency margin is, in case of non-life insurance classes, the higher of the amounts determined on the basis of premiums or claims; and in case of life insurance, the sum of the results pertaining to the obligations and the risk. For companies which operate in both classes, solvency margin is the sum of two results calculated separately for both non-life and life classes.

In determining the solvency margin for non-life insurance, the following methods are used:

- ***on the basis of premiums:*** the amount determined by multiplying the sum of the results obtained by multiplying up to TL 1000 billion of the premiums (excluding taxes and charges) written in the previous year, after cancellations and annulments have been deducted, by 18 percent and the remainder by 16 percent; by 50 percent, if in the last one year the proportion of the amount of claims that rested on the company to gross claims is under 50 percent, or if it is higher, by the percentage that was found.
- ***on the basis of claims:*** the amount found by multiplying the sum of the amounts obtained by multiplying the first TL 750 billion of the sum of the gross claims paid in the last one year and the reserves for pending claims, less the claim indemnities collected by means of recourse and the reserves set aside in the previous year for outstanding loss reserves by 26 per cent and the remainder by 23 per cent; by 50 per cent, if in the past one year the proportion of the amount of claims resting on the company to the gross claims amount is less than 50 per cent, or if it is higher, by the percentage that was found.

Amounts related to the premiums and gross claims can be increased by the Undersecretariat in consideration with the Wholesale Price Index

With regard to life insurance, solvency margin is determined in terms of:

- ***result pertaining to obligations:*** the amount determined by multiplying the four percent of the sum of the mathematical reserves for life insurance and the reserves for unearned premiums set aside for life insurance with the duration of one year by 85 percent, if the proportion of the sum of the net (excluding reinsurance) mathematical reserves set aside in the previous year and the net (excluding reinsurance) reserves for unearned premiums set aside in the last one year for life insurance with a one year term to the sum of gross (before ceding) mathematical reserves and the gross (before ceding) reserves for unearned premiums set aside for life insurance with a one year term is under 85 percent; or if it is higher by the percentage that was found.
- ***result pertaining to risks:*** the sum of the amount determined by multiplying, each portion of the risk capital determined by means of deducting the mathematical reserves from the sum to be paid to the insured in case of death,
  - by 0.1 per cent for those with a duration of up to maximum three years,
  - by 0.15 per cent for those with a duration of more than three and less than five years,
  - by 0.3 per cent for those with a duration of more than five years,
  - with 50 per cent, if the proportion of the total risk capital in the previous year after the ceding to the total risk capital before the ceding is less than 50 per cent; or by the percentage that was found, if it is higher.

If, as of the end of the year, the premiums due for non-life insurance classes including health and personal injury, and life insurance excluding endowment insurance with profit share exceeds 30 per cent of the amount of premiums written in these insurance branches, 50 per cent of the exceeding amount is added to the solvency margin.

In cases when the solvency margin cannot be satisfied, the Undersecretariat may ask the company to create additional deposit apart from existing deposit, on the condition that it does not exceed the amount of the outstanding loss reserves.

E. Investment restrictions

Apart from life insurance companies, the amount of the shares of an insurance company in a single company and in a financial group can not exceed 10 per cent and 20 per cent respectively of their net worth. The total amount of the assets that these companies can invest in shares not quoted on the stock exchange can not exceed 10 per cent of their paid-in capitals.

Insurance companies' mortgage amounts, excluding mortgage to their insured in life group, should not exceed 20 per cent of their technical reserves.

The amount of insurance companies' real estates that are not included in their net worth should not exceed 20 per cent of their real estate and securities portfolio total, and the investment in a single real estate unit should not exceed 50 per cent of their net worth.

Insurance and reinsurance companies cannot allocate their assets as deposit and cannot act as guarantors or warrantors as long as this is not related with their own debts.

F. Acquisition of shares

Acquisition of shares representing 10 per cent or more of the capital of an insurance and reinsurance company by a natural person or legal entity, as well as acquisition resulting with the shares of a shareholder exceeding 10, 20, 33, or 50 per cent of the capital of these companies and transfer of shares belonging to one of the shareholders resulting below the said percentages are subject to the permission of the Undersecretariat.

G. Prohibition on asset reducing operations

Insurance companies may solely operate in insurance related fields. In this context, companies cannot enter into transactions and commitments which have no relation with their field of operation.

Shareholders and employees of the insurance companies may not directly or indirectly use the company's assets and may not carry out any transaction which will reduce the value of assets other than the payments, aids or advance payments to the personnel which are carried out according to the resolutions of the company's statute or general assembly or board of directors.

Moreover, insurance companies may not put the companies' assets into guarantee, act as guarantor or provide credit in favour of their personnel, shareholders, subsidiaries or other persons or organisations other than their own debts or those arising from insurance transactions.

H. Prohibition on capital reducing operations

Participations of insurance and reinsurance companies cannot buy, accept as collateral, make a loan against the share certificates of the insurance and reinsurance companies which participate in their capital; and insurance and reinsurance companies can not buy, accept as lien, or make a loan against the share certificates of their partners. Partners, owning maximum 10 per cent of the shares of insurance and reinsurance companies, the share certificates of which are quoted in the stock exchange, and companies the share certificates of which are quoted in the stock exchange and in which insurance and reinsurance companies have a maximum participation of 10 per cent are excluded from this application.

III Recovery measures in case of difficulties

As a consequence of the on-going supervision by the Directorate General and on-site supervision by the Board, if an insurance or reinsurance company appears to be unable to establish deposit or reserves, or to fulfil its obligations arising from contracts, or if the financial structure of the company is deemed to weaken so as to endanger the insureds' rights and interests, the Minister, pursuant to Article 20 of the Law, by allowing a suitable period of time, may ask for;

- the increasing of the capital, payment of its unpaid portion if any, payment to be made on account of the capital to the company or, the suspension of the dividends,
- disposing of, partly or entirely, its participations or fixed assets,
- alteration of the percentages and amounts of shares of reinsurance contracts and of the retention,
- convention of general assembly on the basis of an agenda to be determined,
- taking of other similar measures aimed at strengthening the financial structure.

Boards of directors or executives have to take necessary measures following these directions and report the same monthly to the Undersecretariat.

In the cases where it is ascertained that the measures listed above cannot be fulfilled, or the weakening of financial structure still continues, or it is impossible to improve the weakening in the financial structure despite the application of these measures, the Minister is authorised to:

- discharge all or a part of the members of the board of directors or auditors or executives, or to appoint to the same new members by way of increasing the number of the members in the cases when weakening of the financial structure has occurred due to the decisions and transactions of the board of directors and executives,
- cancel the authority of the insurance or reinsurance company to conclude new insurance or reinsurance contracts,
- decide on the transfer of the insurance portfolio pertaining to one or more insurance classes in which the company is operating to another company or companies together with the related deposits and reserves.

Additionally, license of the related class or licenses of the whole classes may be cancelled permanently or for a temporary period not exceeding one year by the Undersecretariat in the case that it is deemed necessary pursuant to the measures listed above.

The Undersecretariat is entitled to re-determine the amount of the deposit, as of a certain date, of the companies against which an action has been taken pursuant to the said article, or of an insurance company ceasing premium production. In such cases, the additional deposit should be set up within one month.

IV Ceasing operation and liquidation

In the cases where the insurance and reinsurance companies decide to cease their operations and liquidate their transactions, they are obliged to obtain permission from the Ministry and to notify their such intent to their policyholders and creditors through publishing the same in at least two daily newspapers printed and distributed Turkey-wide.

The Undersecretariat may, if necessary, demand the replacement of bankruptcy and liquidation officials. Necessary measures are taken by the Undersecretariat during carrying out the ceasing operation and liquidation in order to assign the deposits, as well as the claim amount to be recovered by way of reinsurance before all else for the credits of the insured.

In the event of liquidation, the deposits may only be released after a year has lapsed following the date of latest publishment and by documenting that all the obligations are fulfilled. Insured participate in the bankrupts estate in the third rank to collect their credits that could not be met out of the deposits.

At the time of the termination of the operations and while liquidation formalities are carried out, the Undersecretariat takes the necessary measures for the allocation of the deposit to the payments due to the insured.

UNITED KINGDOM

I Regulations concerning the supervision of solvency

The current legislation is the Insurance Companies Act 1982, and the more detailed regulations made under it. The powers to authorise and supervise insurance companies contained there were transferred in 1998 from the Department of Trade and Industry to Her Majesty's Treasury (the UK's finance ministry). Since the beginning of 1999, the exercise of these powers has been carried out by the Financial Services Authority (FSA) on the Treasury's behalf, under the terms of a contract. Further details of the FSA and the future regime are given in section IV below.

The Act requires a company to obtain authority from the Treasury before it may carry on insurance business in the UK. (Insurers with a head office in another member State of the European Economic Area may do so on the basis of their authorisation in that State, subject to certain notification procedures.) Treasury has the power to refuse an authorisation if it appears that any director, controller, manager or main agent of the applicant is not a "fit and proper" person to hold the position held by him.

The Act establishes two critical requirements:

- insurance companies must maintain a prescribed level of assets in excess of their liabilities, prudently assessed. This margin of solvency is based on a common EU definition; and
- detailed financial information must regularly be made available to both the Treasury and the public.

The Act also gives supervisors power to intervene in policyholders' interests when it is appropriate. These intervention powers are discussed in Section III below.

A guiding principle of the legislation is to allow insurance companies the maximum freedom of operation, whilst ensuring that their activities are publicly reported. This is achieved by having the detailed audited annual returns which companies have to provide for the Treasury placed on the public record. (These returns are separate from, and additional to, the shareholders' or members' report and accounts, which are usually less detailed.) Thus, policyholders, competitors, brokers, market analysts and financial journalists have access to the information the annual returns contain. This has resulted in a growing number of comparative analyses of data, and an increasing market in insurance information – producing a more informed market in insurance products.

Among many other issues the regulations prescribe the form in which the returns should be made, and the prudent asset valuation methods which must be used in the returns. They also provide for significant shareholders, directors and managers to be notified to the Treasury so that their fitness can be considered. For life companies, the regulations also require the appointment of an actuary who is responsible each year for determining the company's long term liabilities based on prescribed valuation rules. The Appointed Actuary's responsibilities go far wider than the legislative requirements: he is bound by professional guidance notes to be satisfied that, should he carry out a valuation of the company's liabilities at any time, the financial position of the company would be satisfactory.

UK reinsurance companies – unlike those in many other countries – are supervised in the same way as direct insurers.

A separate statute, the Policyholder Protection Act 1975, provides for some policyholders (mainly private individuals) to benefit from a protection scheme if their insurer fails. Payments are funded by a levy on authorised insurance companies.

Special arrangements currently apply to Lloyd's, which largely regulates itself under the Lloyd's Acts 1871 to 1982. However, Lloyd's as a whole is required to report its solvency to Treasury annually on a basis comparable to insurance companies; and its auditor must certify that each underwriter at Lloyd's is solvent.

II The practical organisation of supervision

All insurance supervision is carried out by officials of the FSA on behalf of the Treasury; but exercise of the powers of intervention is carried out by the Treasury on the advice of the FSA. Treasury Ministers are consulted on, or notified about, policy issues and developments in significant cases, and they are answerable to Parliament on any issue which may be raised there. But they do not become involved in day-to-day supervision.

Insurance & Friendly Societies Division of the FSA employs about 125 staff, most of whom are former Treasury civil servants. A number, who tend to be managers of teams of supervisors each with a set portfolio of companies, are professionals with accountancy, actuarial and insurance market place experience. Authorisation of new undertakings is handled in a separate part of the organisation.

The Division has access to legal advice from the FSA's General Counsel's Division, and to actuarial advice – especially on the solvency of life companies, but increasingly also on general business – from the Government Actuary's Department (GAD). A team of 20 actuaries there works full time on insurance issues.

All of the costs of supervision are recovered from insurers through a fee which has to be paid when the annual return is deposited. The fee is calculated by reference to the insurer's premium income. The insurance industry has a vested interest in the effectiveness of insurance supervisions in the UK, because companies have to contribute towards compensation in the event of another insurer's insolvency.

Monitoring compliance with the solvency requirements is achieved through the examination of the annual returns. There is closer supervision of newly-authorised undertakings, or undertakings where there has been a change of control, by means of more extensive - or more frequent – reporting requirements. Supervision is also exercised by maintaining personal contact with the companies' management teams, including through visits to companies.

A. Examination of returns

An important feature of the returns is that they have to be audited. The auditor has to be satisfied that acceptable accounting and control systems are in place in the company, and that the assets have been valued in accordance with the regulations. This means that the supervisor does not have to check on the spot in the company that the records are adequate and that the assets truly exist.

In addition, although only for life companies, the Appointed Actuary's professional obligations provide comfort about the reliance which may be placed on the return.

Returns from life companies, and the life funds of composite companies, are examined by the GAD, while general business returns are examined by supervisors in the FSA, at least in the first instance.

The supervisors examine each of the general business returns closely on receipt. The first step is to look for any early warnings of problems using ratio tests covering, for example, solvency, profitability, growth rate, liquidity, *etc*., and looking at other key risk areas such as reinsurance protection, and sources of additional capital. As necessary, additional work on the adequacy of reserving can be done using computer support; or the company can be referred to an actuary at the GAD for a more detailed examination.

For life company returns, a similar process – an initial review, followed by more detailed examination, as needed – is also followed at GAD.

In both cases, concerns and queries arising from examination of the returns will be followed up with the companies. This process usually leads on to a discussion of the companies' problems, both current and potential, and future plans.

B. More extensive reporting requirements

In order to anticipate solvency problems arising, and where possible to prevent them materialising, it is common practice to require potentially vulnerable companies to provide additional information. Unlike the annual returns, this information is confidential between the company and the supervisor. Such requirements are almost invariably imposed on authorisation and following a change of control, and can remain in place for up to 10 years. In addition, similar requirements are imposed on companies which appear to be financially weak. The additional information would typically include more frequent (e.g. quarterly) reporting; notification of any investment in, or transactions with, connected parties; actuarial reports additional to the standard one required from life companies; the provision of, and notification of changes to, a business plan; or other requirements tailored to the circumstances of the individual company.

C. *Personal contact*

In addition to meetings with companies which are seeking supervisors' approval when required by the legislation, or where there are financial or other difficulties, Insurance & Friendly Societies Division and GAD make regular visits to companies. These are not detailed inspections, but rather opportunities to meet the senior management to form a view about their quality, and to discuss their future plans. The annual returns are inevitably backward-looking and out of date by the time they arrive. The visits therefore help to keep supervisors up to date with developments in the market. Also, by establishing personal contact, the visits help to encourage management to let their supervisor know about plans or issues likely to be of concern to the Division at an early stage. This will allow the supervisor to influence how they are handled.

III Recovery measures when difficulties arise

Effective supervision, although in a free market it can never prevent all companies getting into difficulties, should at least allow time for steps to be taken to avoid problems becoming critical to the solvency of insurers. The approach described above is designed to allow this to happen without the use of the formal intervention powers prescribed in the legislation. Much of Treasury's insurance supervision is conducted in this flexible and informal way. Nevertheless, this approach is backed up by a wide range of intervention powers which are defined quite specifically in the legislation, together with the grounds for their possible use.

The main grounds for the use of formal powers are:

- that the company has failed to satisfy an obligation under the Insurance Companies Act, for example, in the case of financial difficulties, a failure to maintain the required minimum margin of solvency;
- that it appears that the company has furnished the supervisor with misleading or inaccurate information, such as deliberately concealing a weak financial position;
- that reinsurance is inadequate;
- that controllers, directors or managers are unfit.

However, intervention powers that involve taking over control of a company's assets may only be used if:

- the company's authorisation to write new business has been withdrawn;
- its solvency margin is seriously eroded to well below the required minimum; or
- its liabilities have not been calculated according to the regulations.

The requirement for specific grounds is designed to prevent the arbitrary misuse of the powers, but does occasionally cause difficulties where, for example, a company has met the minimum EU solvency margin but is, nevertheless, in the supervisor's view inadequately capitalised.

The most common ground, or trigger, for intervention when a company encounters financial difficulty is a failure to maintain the required minimum margin of solvency. This may become apparent at any point, not simply when the annual return is submitted. The supervisor will then require a plan for the restoration of a sound financial position. In some cases this can be achieved simply, by the injection of additional capital from a parent. Often the solution is less straightforward, and the supervisor will work with the company to develop a plan which may entail the sale of part of the business, withdrawal from certain lines of business, restriction of premium income, or complete cessation of underwriting new business.

However, a complete stop can destroy the goodwill in the business, which reduces the amounts for which parts or all of the business or its assets can be sold. This in turn jeopardises the interests of existing policyholders. In taking intervention action, the supervisor has to have regard to the classic regulator's dilemma – intervention that turned out to be premature could damage the interests of existing policyholders, while intervention too late can permit more damage in the interim, particularly for new policyholders.

Once a plan is agreed, the company is required to implement it, and the supervisor will impose requirements such as those mentioned in II.B above to assist it in monitoring progress.

Even if a company ceases to write new business and has its authorisation to write withdrawn, it continues to remain subject to the Treasury's financial supervision until all existing obligations to policyholders have been met, which may take many years. During this period it can become apparent that the company will fail to complete a solvent run-off, perhaps because of unanticipated claims or because assets, such as reinsurance recoverables, become unrealisable. In such cases the supervisor would intervene again to ensure that the directors are aware of their responsibilities not to continue trading while insolvent. It would be an unfair preference to pay policyholders' current claims in full when it is clear that claims falling due at a later date cannot be met. The Treasury recognises, however, that it is rarely in the interests of policyholders for an insurance company to be wound up, largely because of the costs and time involved in liquidation. The legislation provides in any event for every effort to be made to transfer life business to another insurer. Similar efforts would be made for a general business insurer, but, if this fails, it is becoming the practice to try to arrange a scheme of arrangement with creditors, sanctioned by the Courts. This allows the insurer to pay a conservative percentage of claims as they fall due, so ensuring that all policyholders, regardless of when their claims mature, receive the same proportionate pay-out. The percentage can be increased or decreased as further information on the company's position emerges.

If recovery measures fail, supervisors do have powers, in the last resort, to petition the Court for the company to be wound up. Even at this point, private policyholders remain protected because their policies will either be transferred, or their claims met, through the Policyholders' Protection Board levy.

The legislation provides other intervention powers, for example when a senior figure appears not to be fit and proper for their position. The appointment of directors, controllers and managers must be notified, and if a person is considered unfit for a post, on appointment or subsequently, there are statutory procedures for objection. After hearing representations, the Treasury can issue a formal notice of objection, and then, if the company refuses to take appropriate action, could use its wider powers of intervention. The Appointed Actuary must be notified, and is also subject to the disciplinary procedures of the actuarial profession.

IV New departures

A. The creation of the FSA

In May 1997 the Government announced its intention to unify all the existing structures for regulating financial services (deposit taking, insurance, investments, *etc*.) under a single regulator – the FSA. There were a number of reasons for this decision.

In the UK market, the boundaries between financial services are becoming increasingly blurred. Considering this development from a purely insurance perspective, it is particularly evident in relation to life insurance where for some time there have been products on offer in the UK market that are almost identical to banking bonds, and others that are almost identical to unit trusts. But the trend is not confined to the life insurance sector. In non-life insurance and reinsurance, alternative forms of risk transfer including the securitisation of risk are developing rapidly. The overlap between products offered by different institutions potentially raises questions of regulatory arbitrage between various regulatory regimes.

In addition to changes in products and their structure, the UK market has not been immune from the trend towards the formation of complex groups and conglomerates - as previously noted. This activity has been driven by a number of factors, but not least the desire to attain a critical mass to compete globally in an increasingly international financial services market. New entities have been created by a combination of both diversification and take-overs, and the relative ease with which mergers and acquisitions can be concluded in the UK means we are in the vanguard of such activity.

The existence of a complex group or conglomerate introduces new risks deriving in particular from intra-group transactions and exposures. Whilst co-operation between regulators in different sectors can help address this problem, there are clearly advantages in a single unified approach.

The Government also considered there were gains to be had in terms of consumer protection, and clarity over the responsibility for supervision, in merging the 10 predecessor organisations into the FSA. In the supervision of investment products, in particular, the structure created under the Financial Services Act 1986 - involving a designated agency, three self-regulating organisations, and a number of recognised professional bodies - was considered too complex to deal both speedily and effectively with market abuses. In merging the regulatory authorities there was also clear scope for efficiency gains and greater accountability.

The FSA as a single regulator is not unique. There are other unitary bodies both within the European Union and elsewhere. Its creation responds to developments in the UK market, and is not necessarily a model that would work elsewhere. However, from the UK perspective it offers two key advantages: one-stop shopping for both regulated firms and consumers, and an ability to take a consolidated view of risks.

B. Structure and scope of the FSA

In shaping a positive regulatory environment within the UK the intention has been to create clear accountability between the key financial institutions with responsibility for financial stability in the UK:

- the Treasury will remain responsible for the public finances and the legislation under which the FSA, and the financial services industry, will operate.
- the Bank of England will be responsible for monetary policy and the payments system. It will also continue to act as the lender of last resort in the event of a potential banking failure.
- the FSA will take full responsibility for regulation, both prudential and conduct of business.

To ensure that each of the institutions has all necessary information available to it, and in order to reinforce financial stability, a Memorandum of Understanding has been developed between the three parties. Regular high level contacts on a formal basis have been established, in addition to the day-to-day contacts maintained at working level.

The FSA will regulate around 10,000 firms responsible for a significant portion of the UK's GDP. In addition to banks, insurers and fund managers the Authority will regulate financial advisers and brokers. Part of the Authority's role will consist of developing and maintaining appropriate rules to supplement the core legislation. The FSA will also be responsible for market-led rescues should these prove to be necessary and warranted.

C. The Financial Services and Markets Act 2000 (FSMA)

The FSMA received the Royal Assent in June 2000, and its provisions are expected to be implemented by the middle of 2001. The Act confers on the FSA, a company limited by guarantee, its functions and powers. The Authority's general functions are the making of rules under the Act, preparing codes under the Act, the giving of general guidance, and the function of determining the general policy and principles by which it will operate.

There are four regulatory objectives laid down in the FSMA. The FSA is obliged first to maintain confidence in the financial sector - to ensure, amongst other things, that UK markets are a clean environment in which to do business. This will be achieved through preventing material damage to the soundness of the UK financial system caused by the conduct or collapse of firms, markets or financial infrastructure; and through explaining the basis on which confidence in the UK financial system is justified. This will include stating explicitly what the regulator can and cannot achieve. It does not imply a zero failure regime. Where companies do fail the Financial Services Compensation Scheme (see F below) will be available to meet the liabilities of certain policyholders and other consumers.

The FSA's second statutory objective is to promote public awareness of the financial system. There is a strong belief that a financially aware and educated community will in itself make a major contribution towards ensuring that the companies operating in the market apply high standards, and that the products on offer meet genuine needs. The FSA will continue to seek to improve general financial literacy and the information and advice available to consumers.

Third, the Act requires the FSA to provide an appropriate level of protection to consumers of financial services. Again, there is no suggestion that the FSA should regulate in a manner that would prevent any failures amongst the regulated community, or any conceivable conduct of business problems. There remains - rightly - the element of *caveat emptor*. For the FSA to seek to avoid any chances of failure would require a level of control that would immediately stifle the market and kill innovation. In applying this objective the FSA will take into account the different degrees of expertise and experience of consumers. Accordingly, business to business transactions such as reinsurance should attract a lighter regulatory touch.

Finally, the FSA is required to contribute towards reducing financial crime. This is an important objective that will involve closer liaison and co-ordination with the criminal authorities. Regulated firms will need to be made aware of the risk of their businesses being used in connection with the commission of financial crime, and must take appropriate measures to prevent this.

The direction in the Act does not end with the statement of regulatory objectives. In discharging its general function, the FSA is also required to take into consideration:

- the need to use its resources in the most efficient and economic way. Regulation will be paid for by the industry and this in itself will encourage accountability;

- the responsibilities of those who manage the affairs of authorised persons. The clear presumption is that management should and must take responsibility for their actions, and be accountable for these;

- the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction. There should, in effect, be a positive cost-benefit in what the FSA does;

- the desirability of facilitating innovation in connection with regulated activities. For the UK to remain a leading financial centre it is necessary to maintain an environment in which innovation is encouraged. Regulation can play a role in ensuring that the innovation that occurs is directed towards creating positive consumer benefit. However, there is a constant need to be on the guard against over-regulation.

- the international character of financial services and markets and the desirability of maintaining the competitive position of the UK. Many of the firms operating in the UK are part of global groups and conglomerates, and a sizeable portion of income of UK-based firms derives from their overseas activities;

- the need to minimise the adverse effects of competition that may arise from anything done in discharge of its functions; and

- the desirability of facilitating competition between those who are subject to any form of regulation by the Authority. The FSA will not be the arbiter of mergers and acquisitions. That is the responsibility of the separate competition authorities in the UK. But the Authority in its dealings with firms and markets should seek to ensure that the rules it promulgates, and the actions it takes, do not unduly restrict competition and where possible encourage it.

In considering the conduct of firms, the FSA will seek to create a culture of compliance in which those firms that have the necessary controls in place and operate them effectively will find the burden of regulation less onerous than the non-compliant. Part of this concerns open communications with the regulated community. The rules the FSA adopt are subject to full consultation, and in the Authority’s day to day dealing with individual firms the intention is that they should be confident of our approach.

D. Risk-based supervision

In the further development of its regulatory regime for the future the FSA will seek to address, and reflect in regulatory requirements, the real risks to which firms are exposed, and to adopt a coherent risk-based approach across financial services whilst recognising the genuine differences that do exist between the sectors. In doing so, the requirements of the relevant European directives will clearly be incorporated.

The first stage in the process, which it is intended to implement fully in the 2001/2 planning cycle, is to identify the risks to the FSA's statutory objectives. In doing so the FSA will draw on a wide range of sources, including intelligence gathered in the course of supervision of firms and direct contacts with consumers, and through economic and market monitoring. It is also the intention to draw on information from the Financial Services Ombudsman (see G below) on industry trends and particular problems revealed through complaints.

The next stage is to assess and prioritise the risks. The FSA will use a standard risk assessment process applied consistently across all its activities. This involves scoring the risk against a number of probability and impact factors. The probability factors relate to the likelihood of the event happening, and the impact factors indicate the scale and significance of the problem if it were to occur. A combination of the probability and impact factors gives a measure of the overall risk posed to the FSA's objectives. This will be used to prioritise the risks, inform decisions on the regulatory response and, together with an assessment of the costs and benefits of using alternative regulatory tools, help determine resource allocation.

For firm specific risks there is a common set of probability factors grouped into three categories – control risk (systems and controls, management, culture, *etc*.), business risk (strategy, environment, capitalisation) and consumer relationship risks (nature of products relative to the target market, sales practices, *etc*.). For product specific risks other probability factors will need to be identified.

The risk assessment process will apply equally to all firms, although the details required will vary from firm to firm. High impact firms are likely to require a more detailed assessment. Consistency will be ensured through a peer review process and internal audit. The outcome of a risk assessment will be communicated to the firm concerned, providing them with opportunities to discuss the issues and remedy any problems.

In addition the FSA intends to carry out more thematic regulation and to carry out a number of focused theme projects each year. Pilot themes currently being looked at include e-commerce, the implications of a low inflation environment, money laundering, treating customers fairly and harnessing market forces.

E. The regulatory toolkit

Once the risks have been assessed and prioritised, it is then necessary to decide on the response. The emphasis is on trying to avert problems arising. A number of possible responses to a particular risk may be available, and in the case of firm specific action "intervention" will more often than not be in the form of persuading the management of an insurer to take action rather than through the exercise of formal intervention powers.

The variety of regulatory responses available include measures directed towards consumers in general, for example providing consumers with better and clearer information; measures directed towards the industry as a whole, such as training and competence requirements or the introduction of specific rules; and measures directed towards specific institutions. This last category covers the full range of traditional intervention powers in relation to insurers, including action to revoke their authorisation to carry on business. The FSA's disciplinary powers will in future include private warnings, public censure and financial penalties. In addition, where the failure of an insurer to comply with regulatory requirements has resulted in profits accruing to the business or losses or other adverse effects for consumers, the FSA will have the power to apply to the court for an order for restitution. The FSA will also have an administrative power, where a regulated insurer has breached a regulatory requirement, to require it to compensate customers for any consequent losses.

In supervising financial services groups, the FSA aims to create an integrated approach to regulation, and is pursuing the concept of lead supervision in order to make it easier to co-ordinate supervision of groups with multiple authorisations. "Group supervision" is a further initiative aimed at testing, on an experimental basis, whether any additional benefit might be gained by bringing into single teams all the resources needed to supervise complex groups.

F. The Financial Services Compensation Scheme

As noted above, the FSA's approach is not based on seeking to eliminate all failures. In the event that the various intervention actions prove ineffective, and a firm becomes insolvent, there is scope for compensation for the more vulnerable categories of those who lose out as a consequence. The Financial Services and Markets Act requires the FSA to make rules establishing a single compensation scheme for the compensation of investors, policyholders and depositors in the event of an authorised firm being unable to meet claims against it. This new scheme will replace the existing compensation arrangements, including the Policyholders Protection Scheme (it is not anticipated there will be any change in the funding arrangements in respect of insurance company failures), and come into operation with the main provisions of the FSMA. Eligibility for compensation will essentially be limited to private individuals and certain small businesses. For insurance company failures, the proposed limits on compensation are:

- for long term insurance, at least 90 per cent of the value attributed to the policy - including future benefits declared before the date of default;

- for compulsory general insurance (e.g. motor third party liability) 100 per cent of the valid claim or unexpired premium; and
- for non-compulsory general insurance, the first £2000 of a valid claim or unexpired premium, plus 90 per cent of the remainder of the claim.

G. Complaints handling

The FSA is also in the process of setting up a single ombudsman scheme, the Financial Services Ombudsman Scheme (FSOS), to replace the existing arrangements for resolving disputes. The new scheme will largely mirror the coverage of the existing schemes, and will be available to all private individuals and certain small businesses. The FSOS will provide a free, simple, informal and accessible alternative to the Courts, and will cover complaints such as mis-selling, unsuitable advice, unfair treatment, maladministration, misleading advertising, delay and poor service in relation to products or services provided by financial services firms. It will be independent of the industry, accessible for complainants, fair in its decision-making and publicly accountable. The FSOS will initially explore whether there is any realistic prospect of resolving a complaint by a conciliated settlement acceptable to both parties, and it is anticipated that a substantial proportion of complaints will be resolved speedily by conciliation. In the other cases, arbitration will be based on the information provided by the complainant and the firm. If a final decision by the ombudsman is accepted by the complainant, it will be binding on both the complainant and the firm. If it is not accepted by the complainant, then he will be free to pursue the matter by court proceedings against the firm. The FSOS will be able to make binding awards of up to £100,000 (and may recommend awards above that threshold).

H. Looking forward

The last three years have been a period of major change in the UK regulatory system, and the FSA is still in the process of developing and refining its approach to supervision. Many challenges lie ahead in the UK market, but the Authority – and financial supervisors generally - can no longer afford to be purely inward looking. Greatly enhanced co-operation and co-ordination with other supervisors - both nationally and internationally - is required to match market and institutional developments. The agreement of a Protocol relating to the collaboration of the supervisory authorities of the Member States of the European Union with regard to the application of the Insurance Groups Directive is a step along this road for the European insurance sector. The International Association of Insurance Supervisors (IAIS) is also working to improve co-operation and co-ordination amongst insurance supervisors worldwide and, through the Joint Forum comprising representatives of the IAIS, IOSCO and the Basel Committee on Banking Supervision, co-operation across financial services sectors. It is hoped that these initiatives, amongst others, will lead to further harmonisation of supervisory approaches.

UNITED STATES

I Introduction

The primary objectives of insurance regulation in the United States are to protect the interests of policyholders, assure insurance company solvency and assure that rates are not inadequate, excessive, or unfairly discriminatory. Of these objectives, the one that is perhaps most fundamental to protecting consumers is solvency regulation.

Individual states are responsible for regulating the insurance business within their own jurisdictions. To facilitate this state regulation of insurance, each state maintains its own insurance department. Each of these departments is organised under the supervision of a commissioner (or director or superintendent) who is either appointed or elected.

II Basic components of solvency regulation

A. Regulatory requirements

Capital and surplus provide a cushion against unexpected increases in liabilities and decreases in the value of assets, and is intended to fund the costs of a rehabilitation or liquidation of an insurer with minimal losses to policyholders and claimants. States require insurers to have a certain amount of capital and surplus to establish and continue operations. Regulators may seize a company if they can show that it will be unable to meet its obligations to policyholders.

Current fixed minimum capital and surplus standards typically range in the area of US$2 million for a multi-line insurer. However, regulators are increasingly critical of fixed-capital standards because they are: 1) unrelated to risk; 2) too low for many insurers; and 3) provide an insufficient basis for timely regulatory action against failing companies. Because of these limitations of fixed minimum capital standards, the NAIC has adopted Risk-Based Capital (RBC) formulas for life/health and for property/casualty companies, and a model law prescribing regulatory action based upon the results of those formulas. The stated objectives of the NAIC RBC requirements are to provide a standard of capital adequacy that: 1) is related to risk; 2) raises the safety net for insurers; 3) is uniform among states; and 4) provides authority for regulatory action when actual capital falls below the standard.

The NAIC's life/health RBC formula encompasses five major categories of risk: 1) asset risk - affiliates; 2) asset risk - other; 3) insurance or pricing risk; 4) interest rate risk and health credit risk; 5) business risk. The risks addressed by the NAIC's property/casualty formula include: 1) asset risk subsidiary insurance companies; 2) asset risk - fixed income; 3) asset risk - equity; 4) asset risk - credit; 5) underwriting risk-reserves; and 6) underwriting risk-net written premium.

Under the model act, certain company and regulatory actions are required if a company's total adjusted capital falls below its calculated RBC level. The act establishes four levels of company and regulatory action, with more severe action required at lower levels.

B. Asset valuation reserve/Interest maintenance reserve

Another important development in regulatory requirements for life/health insurance companies is the institution of the Asset Valuation Reserve (AVR) and the Interest Maintenance Reserve (IMR). The AVR establishes reserve requirements for all major asset classes including securities, real estate, and mortgage loans. The IMR requires insurers to amortise interest-related gains and losses over the remaining life of the disposed asset.

Other statutes and regulations pertain to insurers' investment practices and various aspects of their operations. Most states require insurers' investments to be diversified and many have placed limits on the amount of lower quality bonds that insurers can invest in. Holding company laws control transactions between affiliated companies, including the payment of dividends from a subsidiary to a parent. Insurers are prohibited from improper delegation of authority to managing general agents with respect to underwriting and paying claims.

States require insurers to maintain records and file financial statements with regulators in accordance with statutory accounting practices (SAP). Under SAP, assets are valued conservatively and certain non-liquid assets, e.g. furniture and fixtures, are not admitted in the calculation of an insurer's surplus.

C. Solvency monitoring/Surveillance

The fundamental objective of solvency monitoring is to ensure that insurance companies meet regulatory standards and to alert regulators if actions need to be taken to protect policyholders. To accomplish this task, states require insurers to file annual and quarterly financial statements and to submit themselves to financial examinations.

States have expanded financial reporting requirements to provide more detailed and accurate financial information. Schedules dealing with reinsurance, bonds, real estate and mortgage loan investments, and loss reserves have been enhanced. Statements of actuarial opinion, asset adequacy analysis and independent audit requirements are also required.

States generally will prioritise the review of their domiciliary companies and any companies that require expedited scrutiny. Most departments use some system of financial ratios or other tools to screen and prioritise insurers for analysis. Regulators also use NAIC financial information systems including the Insurance Regulatory Information System (IRIS), Financial Analysis and Surveillance Tracking (FAST) Scoring system, and other reports.

State insurance departments and the NAIC review the annual and quarterly financial statements through a variety of systems. Insurers that appear to be healthy based on their financial results receive no further scrutiny, with the exception of their regular examination, unless other information indicated a need for further investigation. Insurers with anomalous results or that have been the subject of previous attention receive further scrutiny and analysis. For such an insurer, regulators will perform a more detailed analysis and likely request additional information and explanations from the insurer.

The domiciliary state is relied upon as the primary solvency regulator. Other states in which a company is licensed will perform some monitoring and take action if necessary. The NAIC facilitates co-ordination and communication among state regulators concerning insurers' financial condition through its information network, financial analysis systems and committee structure.

D. Financial reporting

The annual statement has evolved considerably since its introduction by the NAIC in 1875. The current statement is an extensive document containing a balance sheet and income statement as well as a number of supporting exhibits and schedules. The most significant exhibits/schedules in the annual statement include: assets; liabilities and surplus; summary of operations (life/health only); statement of income (property/casualty only); cash flow; underwriting and investment exhibit (property/casualty only) and similar investment exhibits in the life/health statement; analysis of assets; real estate; mortgages; other long-term investments; collateral loans; bonds and stock; Asset Valuation/Interest Maintenance Reserves (life/health only); short-term investments; financial Options; Reinsurance; Transactions with Affiliates; General Interrogatories; notes to the financial statement; and information regarding management and directors. Most insurers also are required to file quarterly statements that contain key information on assets and liabilities, income, changes in investment holdings, premiums, written, losses and reserves. The quarterly statements are an important regulatory tool for detecting trends in a company's financial condition.

E. Solvency screening/Analysis systems

Insurance Regulatory Information System (IRIS)

The NAIC's IRIS has served as a baseline solvency screening system for the NAIC and state regulators since the mid-1970's, and is designed to help regulators prioritise insurers for detailed financial analysis. The first phase of IRIS involves calculating a series of financial ratios for each insurer based on its annual statement data. An experienced team of examiners and analysts then reviews these financial ratio results along with selected insurers' annual statements and categories insurers by regulatory priority.

Financial Analysis and Solvency Tracking (FAST) System

In 1993, the NAIC implemented a new solvency screening model and analytical process to facilitate peer review of domiciliary regulation of "nationally significant" insurers. The objective of the NAIC's peer review process, as exercised throughout its Financial Analysis Working Group (FAWG) is to ensure that domiciliary regulators are taking effective action with respect to "nationally significant" insurers that are in financial difficulty.

The NAIC's Financial Reporting and Analysis Division subjects these insurers' financial statements to a computerised analytical routine, FAST Scoring, and other analysis ratios which are used to prioritise companies for further analysis. FAWG reviews this analysis and identifies those insurers that it will subject to review. For those insurers, FAWG queries the domiciliary state on various aspects of the insurers' financial condition and regulatory actions with respect to those insurers. If FAWG determines that the domiciliary regulator has taken the appropriate actions then FAWG may close the file or continue to monitor the company. If FAWG determines that further measures are desirable, it will recommend the appropriate corrective action to the domiciliary state. If the domiciliary regulator fail to follow FAWG's recommendation, FAWG will alert other states accordingly and co-ordinate their actions against the troubled company.

The NAIC makes available the IRIS and FAST ratios to all state regulators over the NAIC's Internet-State Interface Technology Enhancement, I-SITE. I-SITE provides a common user interface for 50+ customised applications, queries, and reports by accessing multiple databases seamlessly. Users can search for timely information specific to company profile information or a variety of financial ratios. This provides a comprehensive tool kit for regulatory solvency analysis and the evidence suggests that state regulators are making extensive use of it.

Examinations

Examinations have been a mainstay of insurer solvency monitoring. The basic purposes of an examination system are: 1) to detect as early as possible those insurers in financial trouble and/or engaging in unlawful and improper activities; and 2) to develop the information needed for appropriate regulatory action.

The scope of a comprehensive examination encompasses a number or areas, including an insurer's: management and control; plan of operation; corporate records; accounts and records; financial statements; business in force; mortality and loss experience; reserves; quality of assets, and reinsurance. The NAIC encourages the use of "association" or "zone' examinations in which states from each region participate.

One important component of improved examination procedures is the use of automated examinations. The NAIC has helped to develop automated exam systems and provides consulting support to assist state examiners in the pre-examination and on-site phases. The Examination Jumpstart system generates a series of analytical reports from the NAIC's database that allow the supervising examiner to pinpoint problem areas and allocate resources accordingly before going on-site. The system also performs many routine, time-consuming tasks that the examiner would otherwise perform at the company. Special audit software is used at the company to retrieve, check and analyse information from its electronic files.

Numerous services are available for financial and market conduct examinations in the field as well as chief examiners and their staff members based at the insurance department offices. The NAIC offers consultation regarding specific accounting practices and interpretations, examination procedures, company-specific examination reports and recommendations and automated audit procedures. The Examination Tracking System (ETS) combines exam calling and exam tracking features for financial as well as market conduct exams. ETS automatically generates financial reports and market performance reports as background information for all regulators involved in an in an insurance company examination.

Others Sources of Information

Regulators are continually looking for other sources of information to supplement standard financial reporting in order to detect earlier problems that may jeopardise a company's long-term viability. These sources include SEC filings, corporate reports, CPA audits, actuarial opinions, market conduct reports, consumer complaints, rating agencies, contacts from agents and insurers, and business media.

F. Actions against troubled companies

The objective of a regulatory solvency monitoring system is to identify, in a timely manner, insurers in need of regulatory attention in order to prevent or minimise losses due to insolvencies and to provide protection for the insurance consumer. Actions to prevent a financially troubled insurer from becoming insolvent include hearings/conferences, corrective plans, restrictions on activities, notices of impairment, cease and desist orders, and supervision. If preventive regulatory actions are unsuccessful and an insurer becomes severely impaired or insolvent, then a state will institute more formal delinquency proceedings, such as conservation, seizure of assets, rehabilitation, liquidation and dissolution.

State guaranty associations have been established to protect, within statutory limits, policyholders, claimants, and beneficiaries against financial losses due to insurer insolvencies. Guaranty funds are financed by assessments on licensed insurers' premiums written in covered lines of business in that state, subject to an annual cap. Assessments generally are made after an insolvency occurs to cover the claims of the insolvent insurer.

III State insurance department resources

Each insurance department is under the supervision of an official who is either appointed or elected. In 1999, the size of departments' staffs varied from 16 to 1,243 with a total combined staff of 10,411 in addition to 1,436 contract staff. Similarly, for fiscal year 2000, state department budgets range from US$1,303,843 to US$142,043,000, with a total combined budget of approximately US$880 million.

Despite tight fiscal constraints overall, the states have significantly increased the resources devoted to insurance regulation in recent years. From 1992 to 2000, funding for state insurance departments increased by 69.8 per cent. The increase in financial staff and computers has allowed regulators to improve the effectiveness and timeliness of solvency monitoring activities.

IV The role of the National Association of Insurance Commissioners (NAIC)

The NAIC is an organisation of the chief insurance regulatory officials of the 50 states, the District of Columbia, and the four territories. It was established in 1871 to co-ordinate the supervision of interstate companies with a state regulatory framework. The NAIC co-ordinates and assists state solvency efforts in a number of ways, including: 1) maintaining and extensive insurance database and computer network linking all insurance departments; 2) analysing and informing regulators as to the financial condition of insurance companies; 3) co-ordinating examinations and regulatory actions with respect to troubled companies; 4) establishing and certifying states' compliance with minimum financial regulation standards; 5) providing financial reinsurance, actuarial, legal, computer and economic expertise to insurance departments; 6) valuing securities held by insurers; 7) analysing and listing non-admitted alien insurers; 8) developing uniform statutory financial statements and accounting rules for insurers; 9) conducting education and training programs for insurance department staff; 10) developing model laws and coordinating regulatory policy on significant insurance issues; and 11) conducting research and providing information on insurance and its regulation to regulators, state legislators, Congress, US government agencies, insurance regulators in other countries, and the general public. These activities facilitate state regulators' oversight of a complex industry extending across state and national boundaries.

A. Databases and information systems

The NAIC has amassed an extensive financial database on insurance companies accessible to state insurance departments and other NAIC users through I-SITE. The NAIC database contains 10 years of detailed annual and quarterly financial information on-line for approximately 5,200 insurance companies as well as data archived back to the mid-1970's.

The NAIC database serves as the core of the solvency surveillance and other analysis activities of state insurance regulators and the NAIC. State regulators and NAIC staff access the database through a variety of application systems that allow them to review data on specific companies, generate "canned" reports on a group of companies, or generate custom reports to suit their specific needs. More than 10,000 insurance department users have direct access to the NAIC system with currently 3,551 I-SITE ids issued. Regulators also have access to the NAIC database on CD-ROM and other media. In addition, the NAIC provides its insurance database to federal agencies, academics, rating organisations, and various other users.

The NAIC maintains a number of other databases which state regulators and NAIC staff use for financial analysis and other regulatory functions. The Alien Reporting Information System (ARIS) provides financial reports that show reinsurance ceded to domestic or alien reinsurers. The on-line Valuation of Securities (VOS) system provides a complete VOS manual, listing securities held by insurers, along with historical data beginning with 1989.

There are two special databases containing information on regulatory or disciplinary actions against insurers and agents – the Regulatory Information Retrieval System (RIRS) – and information on entities of regulatory concern – the Special Activities Database (SAD). RIRS and SAD enhance regulators' ability to share information on individuals or companies suspected of illegal or questionable activities and prevent their infiltration into new areas, State regulators and NAIC staff also use an electronic mail system on the NAIC's computer network to communicate and co-ordinate with respect to examinations, regulatory actions, troubled companies, entities of regulatory concern, and a variety of other matters.

B. Financial analysis and solvency monitoring

The NAIC serves an important co-ordinating function in the event that multi-state insurance companies experience financial difficulty, primarily through computerised monitoring systems (such as IRIS and FAST Scoring, discussed above) as well as in-house financial analysis of insurance companies, the results of which are disseminated to regulators.

C. Financial regulation standards and accreditation programme

In June 1989, the NAIC adopted the Financial Regulation Standards, which establish baseline requirements for state solvency regulation in three areas: 1) laws and regulations; 2) regulatory practices and procedures; and 3) organisational and personnel practices. To provide guidance to the states regarding the minimum standards and an incentive to put them in place, the NAIC adopted a formal certification programme in June 1990. Under this plan, an independent review team reviews each insurance department's compliance with the NAIC's Financial Regulation Standards. All states have enacted legislation designed to achieve compliance with the NAIC standards, and insurance department budgets and staffing have increased rapidly. As of 1 October, 2000, 47 states were accredited under the NAIC standards.

D. Other NAIC functions

The NAIC's Securities Valuation Office (SVO) determines uniform accounting values of insurers' securities investments that include government, municipal and corporate bonds, and common and preferred stocks. The SVO assigns quality designations to more than 120,000 municipal and 52,000 corporate debt and preferred securities that are filed with the office. The designations are used for a wide variety of reasons including risk-based capital and overall portfolio soundness. The SVO assesses the quality of more than $1.7 trillion in insurer assets annually. In addition, the SVO staff can assist regulators in understanding the technicalities behind new investment vehicles and in identifying banks that meet NAIC criteria for approved letter of credit issuers for reinsurance credit.

The NAIC's International Insurers Department (IID) gathers information for the NAIC regarding the surplus lines market and alien insurers including Lloyd's. One way this information is shared with regulators is through the *Quarterly Listing of Alien Insurers* and the *Quarterly Listing Supplement*. Many states may use this advisory list to determine their approved surplus lines carriers.

Market conduct support activities also have expanded significantly at the NAIC to assist the states in their responsibilities in this area. In addition to maintaining the RIRS and SAD systems, the NAIC has developed a nationwide complaint database, a database on insurance company officers and directors and an overall system for tracking basic profile data on entities involved in the insurance business. State insurance department regulators in the areas of market affairs, investigations, enforcement and complaints that deal with claims handling, advertising and marketing, producer and company licensing, company management and consumer information benefit from the on-line information exchange in the NAIC's Market Information Systems. Regulators can search the databases before granting licenses to help prevent violators from obtaining licenses in multiple jurisdictions. In market investigations, the databases flag entities and activities of regulatory concern. The amount of information in these databases is ever increasing as insurance departments continue to report such market information to the NAIC Market Affairs Department.

The NAIC also provides important education, training, and research services to state insurance departments and their staffs. The NAIC offers more than 40 insurance education programs and seminars per year. At least half are for insurance regulators and are usually held at the training facility at the NAIC Executive Headquarters. Separate programs are designed for commissioners, financial regulators and market conduct regulators with varying levels of expertise. The other programs and seminars are public, offered to regulators and others concerned about insurance regulatory topics. They provide education or training on specific insurance topics or current insurance regulatory issues.

Commissioner and state insurance department staff members may obtain assistance from the NAIC Research Library for ready reference and research needs. The library's extensive collection of books, studies, subject files and journals dates back to the first published NAIC Proceedings in 1871 to present, contains back issues of insurance journals and magazines, and provides the most current information available through on-line access to several electronic databases. Examples of research services available to state regulators include monitoring coverage of insurance trends; finding background information for special projects; preparing bibliographies on material related to a particular subject area; developing historical perspectives on insurance issues; locating articles from the local or national press; and tracking coverage of individuals, companies and issues.

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