Guten Tag – Добар дан !

Supervisory aspects of life insurance

Introduction

Life insurance is a product that depends heavily on trust

Policyholders expect insurance companies to be able to honour contractually agreed payments at all times and often over a very long period of time

Thus, it is necessary to have a regulatory and supervisory regime in place that

a. **adequately safeguards** the interests of the insured and, in particular,

b. ensures that the insurance companies will be able **to meet their future liabilities** under the insurance contract at any time.

Introduction

In this respect, special attention must be given to **solvency supervision**: Focus must be drawn that

•adequate premiums are charged and sufficient provisions established to cover the expected insurance benefits,

•sufficient free assets are available also to cover unexpected losses and that unexpected losses are adequately reinsured

•the companies properly render account of their activities, i.e. that both balance sheets and profit and loss accounts are established on the basis of uniform principles correctly reflecting the financial standing of the company

BaFin

Introduction

In order to adequately **safeguard the interests** of the insured, it must be made sure that,

- the insurance policy conditions, which describe the product and both the rights and obligations of the contracting parties, have been established in a proper way.

  This applies in particular to private customers who always are in a weaker position and in need of particular protection in dealings with insurance companies
- before the customer enters into an insurance contract he is informed in detail about the object and conditions of the contract to enable him to judge the product offered

After these introductory remarks……

How should the supervisor be structured ?

How should regulation and supervision be designed ?

The supervisor ….

• Should be equipped with adequate powers, legal protection and financial resources to exercise its functions and powers

Should be operationally independent and accountable in the exercise of its functions and powers

And should hire, train and maintain sufficient staff with high professional standards

Regarding the organisational structure, several models are possible:

- Integrated (together with banking and capital market) supervisor

- Solo insurance supervisor

- twin peaks model (Solvency supervision separate from market supervision)

The main ingredients of a two staged supervisory regime

1. Checking at the gate: Authorization

+

2. On going supervision (analysation and intervention)

Checking at the gate: Authorization

a. <u>Authorization and authorization requirements</u>

insurance business may not be transacted until the company has received a licence

The carrying on of insurance business without such a licence should be subject to penalties

Checking at the gate: Authorization

An insurer wishing to be authorized to carry on business

should meet a number of requirements:

- It should be required to have a <u>certain legal form</u> (public limited company, mutual society, public corporation, SE)
- It should <u>only carry on insurance business</u> and business directly related to it (such as intermediation of insurance business). Carrying on business other than insurance business should not permitted.
- If it wishes to carry on life , it may not operate non-life insurance at the same time. The insurer should <u>specialize in life insurance</u>.

Checking at the gate: Authorization

Life insurance is part of social security. Therefore, the interests of the insured of these classes of insurance must be specially protected against the losses of non-life insurance

- It should also submit a business plan which describes the risks it intends to cover.

  The plan should comprise also other information, such as the articles of association and

  agreements with other companies or contracts spinning off certain functions *("outsourcing agreements")*

Checking at the gate: Authorization

- In life insurance the technical bases for the calculation of the premiums and provisions should be submitted

- The insurer should submit a describtion of the principles of its reinsurance policy

- It should also provide prove of having sufficient capital. The minimum amount of own funds (minimum guarantee fund) will depend on the class of insurance which is to be offered (life: € 3,2 million)

Checking at the gate: Authorization

- Furthermore, the company should provide prove of having sufficient resources to develop the business and the sales organisation (organisation fund)

- Proof should also be given of a reliable (fit and proper) management/supervisory board which disposes of the necessary professional qualification or practical experience
- companies offering life insurance should appoint a ***responsible actuary*** who is responsible for checking the calculation of the premiums and technical reserves in these insurance classes.
- The natural or legal persons with qualifying holdings (at least 10 % of the nominal capital or members funds) should be mentioned. The persons with qualifying holdings must stand for a reliable and cautious management of the company

Checking at the gate: Authorization

- If after examination of the submitted documents the supervisor comes to the conclusion that the legal requirements have been met, the autorization should be granted.

  The supervisor should **not** permitted to make granting of a licence dependent on considerations <u>in the light of the economic needs</u> of the market

On going supervision

2. On – going supervision

Once the insurance company has been granted an authorization to carry on business it is subject to on-going supervision. In this connection the duties of the supervisor are twofold:

- It has to collect and evaluate information, verify business documents and keep a close eye on all business operations to detect any irregularities (offences against the rules, unfair treatment of policyholders, financial problems) in time
- Should any such irregularities arise, the supervisor should intervene and restore orderly conditions

On going supervision

In this context, the supervisor should be equipped with a set of tools enabling him to

-evaluate and analyse the business operations (both off- and on-site) and

- intervene if necessary

On going supervision

The insurance companies should report permanently about their investments. These should be placed in accordance with the principles of profitability and security, mix and diversification.

The supervisor should also conduct ad hoc surveys into, for example, the effects of falling equity prices (so-called stress tests or scenario analyses)

On going supervision

- Special provisions should be in place requiring insurance companies not only to report to the public (external accounting) but in particular to report extensively to the supervisor (internal accounting) and provide it with the information necessary to assess the economic and financial situation of the companies. Certain essential financial data should be sub-mitted on a quarterly basis (investments; coverage of technical liabilities)
- Furthermore,insurance companies should be equipped with an adequate risk management. This requires i.a. the establishment of a suitable internal management and control system

On going supervision

- Insurance companies should be required to have an internal audit which examines the whole business organisation of the company

- The supervisor should be entitled to inspect the business operations of insurance companies on their premises, even without specific cause and to quickly gather information of the company

  The intensity of the inspections should be based on the principles of riskoriented supervision (market impact, riskas-sessment)

Intervention Powers

The supervisor should also be equipped with of a number of instruments for taking action:

1. There should be a general provision entitling the supervisor to *take all adequate measures necessary to avoid or do away with abuses which endanger the interests of the insured*
2. Apart from this general clause there should also be a number of *special provisions* which enable the supervisor to take preventive measures against certain typical risks which also comprises the power to withdraw authorization ("ultima ratio")

Intervention Powers

3. If the financial situation of an insurance company deteriorates, special provisions should be in place giving the right to demand

- a plan for the restoration of a sound financial position (solvency plan)
- a financial recovery plan as well as
- a plan for the short-term procurement of the necessary own funds (financial plan)

Intervention Powers

4. The powers of the supervisory authority should also cover personnel matters.
   There should be the possibility to appoint a specially authorized representative (Sonderbeauftragter) to the board of directors or to the supervisory board

However: it should also become practice to solve problems, wherever possible, by <u>informal administrative actions</u> (guidance notes in circulars, talks with the insurance companies and the associations, etc.).

Information provided to the policyholder

Treat the policyholder fairly through disclosure of information

Information provided to the policyholder

Such disclosure rules could distinguish between

- pre-contractual information obligations and

-information, that must be provided throughout the policy period

as well as informations relating

- to all classes of insurance and such for
- certain classes of insurance

Information provided to the policyholder

The insurer should inform the policyholder in writing of his terms of contract, including the general terms and conditions of insurance

This information should be provided in good time before the policyholder submits his contractual acceptance

Regarding life insurance, the information should also extend to

-the expected benefits, their determination and calculation and

-acquisition costs, insofar as these are set off against insurance premiums

- Regarding life insurance with surplus sharing, information about the development of the policyholder's entitlements should be provided throughout the policy period

Vielen Dank - Хвала!

Peter Baier
Head of Section
International Policy/Affairs
Federal Financial Supervisory Authority (BaFin)
Marie-Curie-Str.24-28, 60439 Frankfurt, Germany
Tel: 0049-228-4108-3967
Fax: 0049-228-4108-1550
Email: Peter.Baier@bafin.de