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**Risk Management in  
the Slovenian Insurance Market**

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## History of the regulatory requirements concerning risk management

### Laws before Slovenia became independent in 1991

- Laws that were in force before Slovenia became independent did not have a specific chapter on risks and by today's standards prescribed low capital requirements.
- The Law on the foundations of the system of property and personal insurance of 1990 required for an initial guarantee fund:
  - at least 10 millions dinar for non-life insurance, which at the end of 1990 and at "Marković's" rate of 7 din/DEM meant 1,429 million of DEM or 0,695 million of ECU,
  - at least 5 million dinar for life insurance.

### Insurance Companies Act 1994

- The Insurance Companies Act was the first adopted law in independent Slovenia regulating insurance, but even that one did not have a specific chapter on risks, which does not mean that no attention was paid to risks.
- The Act laid down the calculation of the solvency margin, determined the level of the guarantee fund and what was considered to be sources of available capital.
- The amounts to be taken into account in the calculation of the minimum guarantee fund were dependent on the classes of insurance the insurance company transacted. They were expressed in tolar, but usually in the amount that was equivalent to the one in force in the EU.
- Provisions on compulsory reinsurance and technical provisions, as well as the principles and provisions governing the investment of assets covering technical provisions and securities could also be considered risk management, as well as provisions about the supervision of the insurance company.

## History of the regulatory requirements concerning risk management

### The Insurance Act 2000 with subsequent amendments

- The Insurance Act also contained a chapter on risk management, which was consistent with the EU requirements valid at the time. It prescribed in detail:
  - what is considered as available capital,
  - how to calculate the solvency margin,
  - how much the guarantee fund should be.

Also outlined were:

- technical provisions,
- types and restrictions on investment of assets covering technical provisions,
- other risk management measures, including:
  - duty of reinsurance
  - liquidity management.
- The chapter on risk management was comprehensive – the last officially consolidated version (2010) that included all subsequent amendments contained 42 articles.
- The law delegated comprehensive regulation of risk management to the Insurance Supervision Agency (ISA), which issued a number of implementing acts.

### Other external factors

In addition to the legal requirements, the introduction and development of risk management in some Slovenian (re)insurance companies was significantly affected by the requirements of rating agencies, such as Standard & Poor's, which assessed risk based capital requirements prior to Solvency 2.

## Preparations for Solvency 2

### Basis of preparation for Solvency 2

Slovenian insurance companies were aware of the changes to be introduced by Solvency 2 and spent several years intensively preparing for the new regime on the basis of:

- a draft and the adopted version of the Solvency 2 Directive,
- technical specifications,
- consultation papers,
- quantitative studies QIS1 - QIS5,
- a study on “long-term guarantees assessment” and others.

### The main activities during the preparations for Solvency 2

- raising awareness and informing the management and staff of the Solvency 2 requirements,
- identifying gaps between the future and existing state,
- planning, implementation and monitoring of the various gaps elimination projects,
- adapting the organisation structure to the new requirements,
- selection, procurement and implementation of new IT support,
- adaptation of existing IT support,
- engagement of external consultants and specialists,
- additional recruitment of highly qualified staff.

## Preparations for Solvency 2

### Gap analysis

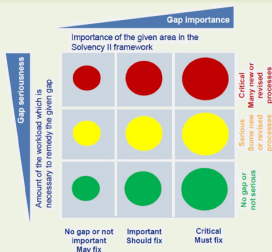
One of the gap analyses examined 690 issues in the following areas:

- █ governance,
- █ risk management,
- █ policies and standards,
- █ outsourcing,
- █ reinsurance,
- █ valuation of assets and liabilities,
- █ own funds,
- █ technical provisions,
- █ capital requirements,
- █ own risk and solvency assessment,
- █ disclosures,
- █ requirements for the group.

### An example of the results of the gap analysis

Results are sorted by:

- █ the severity of the gaps, which means that more severe gaps require more effort to be fixed,
- █ the importance of the gaps in the Solvency 2 environment.



		Importance		
		No gap or not serious	Serious	Critical
Seriousness	No gap or not serious	270	50	3
	Serious	0	41	245
	Critical	0	0	81

## Currently applicable legal requirements concerning risk management

### The Slovenian Insurance Act 2015

- The new law, which is consistent with Solvency 2, was announced in December 2015 and came into effect on January 1, 2016.
- The law contains an extensive chapter on risk management with 109 articles, which are listed in 14 subsections:
  - ① Terms related to risk management (10 Articles);
  - ② Basic rules on risk management (4 Articles);
  - ③ General risk management standards (3 Articles);
  - ④ Internal audit function (6 Articles);
  - ⑤ Actuarial function (4 Articles);
  - ⑥ Outsourced service (3 Articles);
  - ⑦ Valuation of assets and liabilities of an insurance company for the purposes of capital requirements calculation (3 Articles);
  - ⑧ Technical provisions for the purposes of capital requirements calculations (14 Articles);
  - ⑨ Own funds of insurance company (11 Articles);
  - ⑩ Solvency capital requirement (30 Articles);
  - ⑪ Minimum capital requirement (4 Articles);
  - ⑫ Investments (5 Articles);
  - ⑬ Ring-fenced funds (1 Article);
  - ⑭ Additional rules on risk management (11 Articles).
- The Act authorises the ISA for prescribing specific rules.

## Currently applicable legal requirements concerning risk management

### Regulations with detailed rules on risk management issued by the ISA

ISA issued the majority of implementing acts mentioned in the chapter on risk management by the end of March 2016, including:

- Decision on insurance companies' own funds;
- Decision on items that are not on the list of insurance companies' own funds;
- Decision on ancillary own funds;
- Decision on ring-fenced funds;
- Decision on the own risk and solvency assessment;
- Decision on detailed instructions for the valuation of technical provisions;
- Decision on conditions and manner of covering losses by reducing the technical provisions and deferred taxes;
- Decision on use of the modules of market risk and counterparty default risk;
- Decision on the application of life underwriting risk module;
- Decision on the application of property catastrophe risk sub-module;
- Decision on the application of health catastrophe risk sub-module;
- Decision on the use of specific parameters for the individual insurance company;
- Decision on the necessary knowledge for the actuarial function holder and certified actuary;

## Organisation of risk management in insurance companies

### Key functions of Solvency 2

Slovenian insurance companies have adapted their organisation structure in time. Two of the four key functions have long been established, but in the field of actuarial duties things have changed and some dilemmas have emerged.

#### Existing functions

- actuarial function,
- internal audit function.

#### New functions

- risk management function,
- compliance function.

### Responsibilities of the management and supervisory bodies

Management and supervisory bodies of an insurance company:

- determine precise, transparent and consistent internal relationships regarding responsibility:
  - provide a clear segregation of responsibilities,
  - put in place an effective system for ensuring the transmission of information,
  - prevent conflicts of interest;
- approve and regularly review strategies and written rules on risk management, the internal control system, internal audit and actuarial function, and ensure their implementation.



## Organisation of risk management in insurance companies

### Segregation of tasks and responsibilities – three lines of defence system

Effective risk management is organized in three lines of defence, which include a clear division of tasks and responsibilities.

#### The first line of defence

The management board and business functions, such as underwriting, claims handling, finance, accounting and controlling, whose business decisions actively manage specific risks and are primarily responsible for identifying and taking risks.

#### The second line of defence

The risk management function, the actuarial function, the compliance function and authorities such as the risk management committee, assets and liabilities committee, etc., who set up the risk management system with included procedures for identifying, measuring and monitoring exposures, determination of exposure limits, etc.

#### The third line of defence

Internal audit, which among other things implements (and is also responsible for) the processes and activities related to the inspection of the effectiveness of internal controls in individual business areas.

## Organisation of risk management in insurance companies

### Some development activities

- development of a methodology for own risk and solvency assessment,
- using specific parameters for individual insurance companies,
- modeling, using programs such as Igloo, Risk Explorer, etc. (preparation for a partial internal model).

### Dilemmas of the necessity of all key functions in companies outside the EU

In insurance companies outside the EU owned by Slovenian insurance groups the actuarial function and the internal audit function have long been taken for granted, although there are substantive differences. With new risk management and compliance functions, dilemmas have appeared whether it makes sense to introduce them where local legislation does not require them yet.

#### Pros of the introduction

- safer operation,
- unification within the group,
- future preparedness.

#### Cons of the introduction

- increased costs and reduced competitiveness,
- lack of qualified staff,
- unnoticed added value in environment.

### The key question – formalism or content?

Do we need risk management and compliance functions because of regulations or due to our own knowledge and the need for a safer and more coherent business?

## Some dilemmas

### International Financial Reporting Standards (IFRS)

- The Insurance Act instructs that unless stated otherwise, the general rules in the Companies Act must be applied for the accounting books and the annual report.
- The Companies Act provides that financial reports must be prepared in accordance with IFRS, which are not even mentioned in the Insurance Act.
- Effectively, this means that insurance companies will have to calculate technical provisions under Solvency 2 rules and IFRS rules.

### The opinion of the certified actuary on the annual report as required by IFRS

- According to the Insurance Act, a certified actuary is required only for pension companies, which are not subject to Solvency 2. Insurance companies are only required to establish an actuarial function, while duties are specified solely for the Solvency 2 regime.
- Does this mean that there is no requirement for an actuarial opinion to the annual report on technical provisions and other relevant matters concerning the operation of an insurance company?

### Assessment of Solvency 2 compliance

- Different studies and test calculations of SCR indicate that Slovenian insurance companies will not have problems with capital adequacy.
- Only time will tell if all the new reports will be prepared thoroughly and in time!