Working Group State Supervision

Vth AIDA Europe Conference 2015

Copenhagen, 11 June 2015

Agenda

15.15 p.m. **Introduction** (Dr Gunne W. Bähr, Germany; Yannis Samothrakis, France)

Topic: New Solvency II Regulation

Speakers:

1) **Jan Parner,** Danish FSA – Reselection of pension scheme
2) **Oleksandr Khomenko**, Helsinki - Solvency II and its impact on discontinued business in non-life insurance
3) **Lars Gerspacher**, Zurich – The Swiss perspective on Run-Off Business
4) **Yannis Samothrakis**, Paris – International programmes, admitted and non-admitted issues, financial interest clause

16.35 p.m. Discussion

16.40 p.m. Questionnaire, next meeting, topics for the next meetings etc.

16.45 p.m. End of session

Reselection of pension scheme

- A Catch between Legal Rights and Fairness

AIDA Europe Conference, Copenhagen, 11. June, 2015

Jan Parner

Savings have to deliver an income cash flow when retired

Short term solutions may cause long term problems

Will speak on…

Topics to be covered

- What type of policyholder protection is covered within Solvency II
- Fairness
- Reselection of pension scheme

Protection of policyholder

Main themes

- Solvency regulation (protection of promises) e.g. Solvency II or IORP II
- Market conduct (fair and loyal)
- Fairness (economically)

No canonical distinction between market conduct and fairness

FAIRNESS

FINANSTILSYNET

Think about the lottery…

and the possibility of a big win

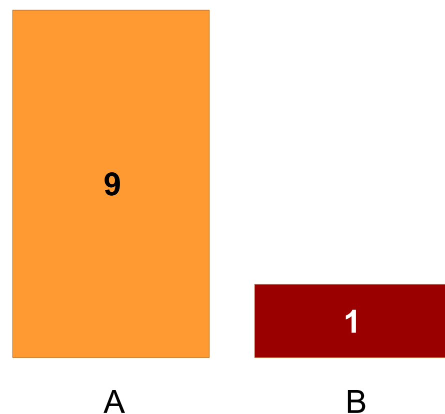
What do you consider being fair?

- You have shared a coupon with another friend.
- You are paying 10 € and your friend is paying 90 €
- Saturday comes and you have got a winning coupon. Together you win 10000 €
- How to you split the win?
    - Half and half?
    - 1:9 i.e. he gets 9000 € and you get 1000 € (the principle of contribution)
    - Is it important that one of you is old and the other is young?

What is considered "fair" is typically a cultural norm

Fair treatment of the policyholder

- DK regulation stemming from 1929 (or perhaps earlier), “The technical basis for calculation has to provide a fair treatment of the policyholder”
- For with-profit contracts, unless agreed by occupational pension fund parties (if applicable), they have to obey to the principle of contribution both between own funds and policyholders and between the individual policyholders
- Example. A holds 9 units, B holds 1 unit. Any surplus or deficit is then distributed as 90% to “A”, 10% to “B”.



Fairness is not like a bank account with a 1:1 unit metric

FINANSTILSYNET

Which principle is the strongest?

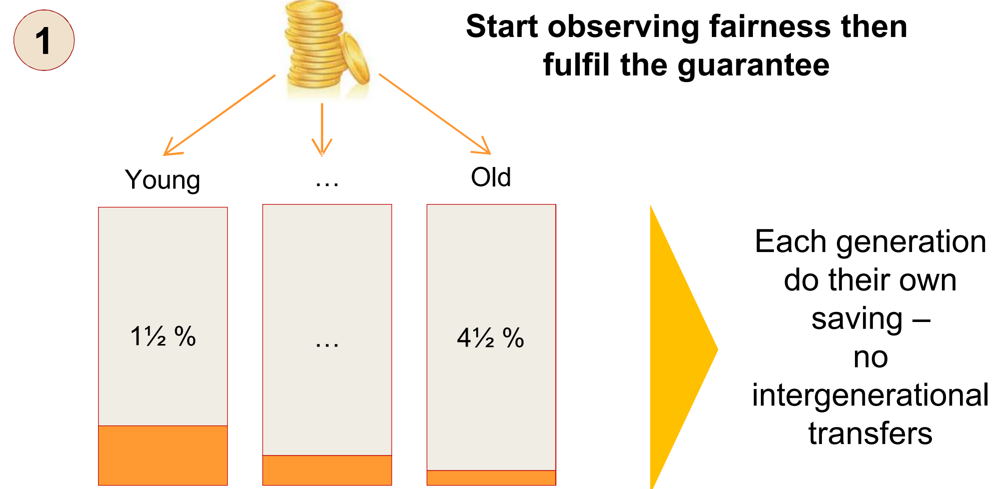
- Divide the contract into two elements: insurance cover and savings
- General questions:
  - Social norm
  - Intergenerational transfers
  - Who is paying for the increase in longevity or for legal guarantees?
- The Danish constraint (FBA §21)

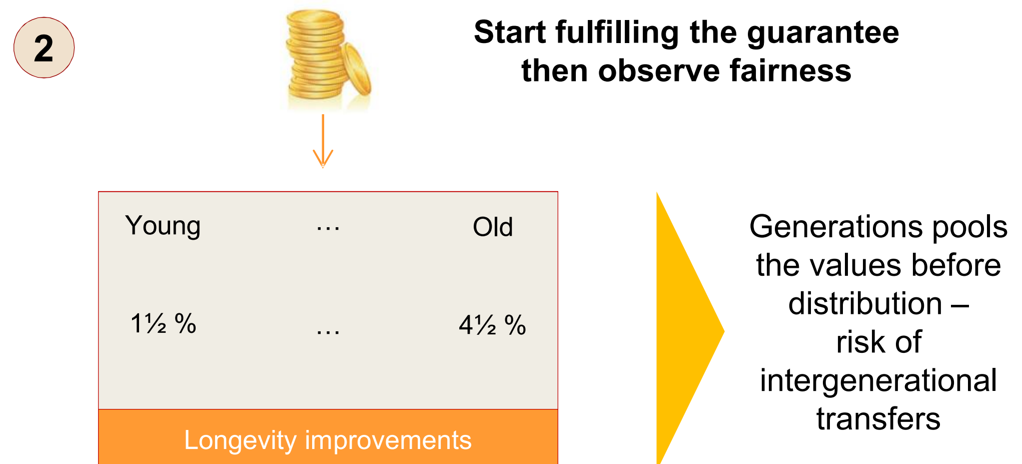
§ 21. De efter § 20, stk. 1, nr. 1-5, anmeldte forhold skal være betryggende og rimelige over for den enkelte forsikringstager og andre berettigede efter forsikringsaftalerne.

Stk. 2. De anmeldte regler for beregning og fordeling af realiseret resultat, jf. § 20, stk. 1, nr. 3, skal være præcise og klare og skal føre til en rimelig fordeling.

Stk. 3. Præmierne for nytegnede forsikringer skal være tilstrækkelige til, at forsikringsselskabet kan opfylde alle sine forpligtelser, således at der ikke vil være behov for systema-

… it has to lead to a fair distribution





Different solutions in EU, in DK fairness is the strongest

Reselection of Pension Scheme

- Why and How

Why reselecting the pension scheme?

Selected arguments from the sector

- "The pension fund cannot continue to support products with high guaranteed rates with the required capital due to low interest rate environment"
- "It is the right time to cash in the interest rate insurance (i.e. interest rate derivatives)"
- "Due to low interest rate environment investment returns are locked in by low risk investment strategies for products with high guaranteed rates. A move to lower guaranteed rates will increase the likelihood of higher future pension savings"
- "Market based products will deliver higher pensions due to more active investment strategies"
- "Market based products are more modern and flexible compared to the classical average interest rate product"

The value of the guarantee is depending on the capital backing it up

Process for reselection – have to respect general good

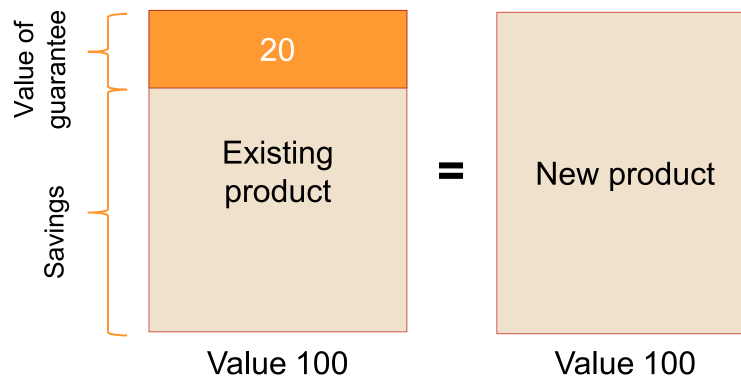
Different steps for reselection on an individual basis

- Optional: prior assessment of advertisement material by the FSA
- Advertisement. Information has to be objective, fair and balanced with regards to pros and cons
- Counselling by townhall meetings, publications, letters, etc.
- Call centre service
- Reselection by individual policyholder accept
- Complaints handling
- Execution

Quality information material still shows to be a challenge

Reselecting pension product – how to calculate the transfer value

- New regulation (law) voted on 26 March 2014 (FiL §60a), executive order issued on 26 June 2014, in force from 1 July 2014
- Specific regulation of market conduct (conduct rule) – fair and loyal treatment of the policyholder
- If offering reselection the policyholder has to be offered a transfer value equalling the current market value of the existing product
- The FSA has defined how to calculate this market value



Lovtidende A

2014 Udgivet den 28. juni 2014

26. juni 2014. Nr. 796.

Bekendtgørelse om opgørelse af den økonomiske værdi af en forsikringstagers produkt ved omvalg

I medfør af § 60 a, stk. 2, og § 373, stk. 4, i lov om finansiel virksomhed, jf. lovbekendtgørelse nr. 948 af 2. juli 2013, som ændret ved lov nr. 268 af 25. marts 2014 og lov nr. 403 af 28. april 2014, fastsættes:

Anvendelsesområde

§ 1. Denne bekendtgørelse finder anvendelse på forsikringsselskaber, som tilbyder omvalg, der er omfattet af § 60 a i lov om finansiel virksomhed.

§ 2. Denne bekendtgørelse regulerer forsikringsselskabets opgørelse af den økonomiske værdi af en forsikringstagers produkt.

Stk. 2. Opgørelsen sker med udgangspunkt i forsikringstagerens produkt, herunder den gruppe forsikringen tilhører på opgørelsestidspunktet.

Definitioner

§ 3. I denne bekendtgørelse forstås

1) "økonomisk værdi" som værdien af forsikringstagerens nuværende produkt, der skal overføres til et nyt produkt i forbindelse med omvalg, der er omfattet af § 60 a i lov om finansiel virksomhed,
2) "livsforsikringshensættelsen for en forsikring", "bonuspotentiale på fripoliceydelser for en forsikring" og "retrospektiv hensættelse for en forsikring" i overensstemmelse med bekendtgørelse om finansielle rapporter for forsikringsselskaber og tværgående pensionskasser,
3) "akkumuleret værdiregulering for en forsikring" som forskellen imellem livsforsikringshensættelsen for en forsikring og den retrospektive hensættelse for en forsikring, dog mindst nul,
4) "risikoforrentning" som den andel af de realiserede resultater i forsikringens gruppe, der afspejler omfanget af den risiko, der påhviler egenkapitalen, og som løbende betales til egenkapitalen i henhold til de til Finanstilsynet anmeldte kontributionsregler,
5) "gruppe" som den kontributionsmæssige gruppe, som en forsikring tilhører,
6) "skyggekonto hørende til en gruppe" som en konto med et registreret beløb, der forventes at kunne tilføres egenkapitalen ved en fordeling af fremtidige positive realiserede resultater hørende til gruppen, jf. § 111 i bekendtgørelse om finansielle rapporter for forsikringsselskaber og tværgående pensionskasser,
7) "overførselstillæg" i forbindelse med opgørelse efter den individuelle opgørelsesmetode som den akkumulerede værdiregulering for forsikringen justeret med et eventuelt omvalgskursværn, fratrukket et eventuelt sikkerhedsfradrag og tillagt en kontributionsmæssig andel af det kollektive bonuspotentiale, og "overførselstillæg" i forbindelse med opgørelse efter den gennemsnitlige opgørelsesmetode som den værdi udover den retrospektive hensættelse, eventuelt justeret med et omvalgskursværn, som en forsikring tildeles ved et omvalg,
8) "omvalgskursværn" i overensstemmelse med § 6,
9) "sikkerhedsfradrag" i overensstemmelse med § 7,
10) "en kontributionsmæssig andel af det kollektive bonuspotentiale" i overensstemmelse med § 8,
11) "ufordelte midler i en gruppe" som summen af det til gruppen hørende kollektive bonuspotentiale og de til gruppen hørende forsikringers akkumulerede værdireguleringer,
12) "skyldig bonus" som negativ bonus, der ikke er tilskrevet en forsikrings retrospektive hensættelse, men i stedet er registreret på en særlig konto for skyldig bonus, der hører til forsikringen,
13) "gennemsnitsrenteforsikring" som et forsikringsprodukt, hvor forsikringstageren og andre berettigede efter forsikringsaftalen er berettiget til bonus, og
14) "markedsrenteforsikring" som en unit-linked forsikrings- og investeringskontrakt.

Individuel opgørelsesmetode for gennemsnitsrenteforsikring

§ 4. Forsikringsselskabet skal opgøre den økonomiske værdi for en gennemsnitsrenteforsikring som den retrospektive hensættelse tillagt en eventuel regnskabsmæssigt opgjort akkumuleret værdiregulering for forsikringen, begge dele justeret med et eventuelt omvalgskursværn, jf. § 6, fratrukket et eventuelt sikkerhedsfradrag, jf. § 7, og tillagt en kontributionsmæssig andel af det kollektive bonuspotentiale, jf. § 8.

Erhvervs- og Vækstmin.,
Finanstilsynet, j.nr. 162-0020

BP000925

The policyholder has to be offered a new product with equal market value

Summary

In brief

- Fairness not included in the Solvency II framework
- Selection of pension scheme can be in the benefit of the policyholder
- Active process of reselection has taken place in DK since 2007

Thank You

Agenda

15.15 p.m. **Introduction** (Dr Gunne W. Bähr, Germany; Yannis Samothrakis, France)

<u>Topic:</u> New Solvency II Regulation

Speakers:

1) **Jan Parner,** Danish FSA – Reselection of pension scheme
2) **Oleksandr Khomenko***,* Helsinki - Solvency II and its impact on discontinued business in non-life insurance
3) **Lars Gerspacher**, Zurich – The Swiss perspective on Run-Off Business
4) **Yannis Samothrakis**, Paris – International programmes, admitted and non-admitted issues, financial interest clause

16.35 p.m. Discussion

16.40 p.m. Questionnaire, next meeting, topics for the next meetings etc.

16.45 p.m. End of session

Young Lawyer/Student Prize Sponsor

British
Insurance
Law
Association

Charitable Trust

© *Hanken Svenska handelshögskolan / Hanken School of Economics, www.hanken.fi*

Oleksandr Khomenko,

Doctoral student at the Department of Accounting and

Commercial Law, Hanken School of Economics, Helsinki, Finland

EFMD EQUIS ACCREDITED

ASSOCIATION OF MBAS ACCREDITED

© Hanken Svenska handelshögskolan / Hanken School of Economics, www.hanken.fi

#

Solvency II timeline

- 2001-2003 - beginning of the reform project
- 2007 - proposal for the Solvency II Directive
- 2009 - adoption of the Directive
- January 1st 2016 – entering of the Directive into force

© Hanken

Structure of Solvency II

HANKEN

Solvency II

Pillar I (Capital requirements)	Pillar II (Regulatory supervision)	Pillar III (Reporting)
- Solvency capital requirements - Rules on valuation of assets - Types of own funds -Rules on calculation of technical provisions	- Principles of supervision - Internal control - Own risk solvency assessment (ORSA) - Supervisory review process	- Supervisory reporting - Public disclosure

© Hanken

» Discontinued insurance business (run-off):

- business underwritten in the past;
- active underwriting no longer being done;
- has existing contractual obligations;
- generates little to no premium income;
- also referred to as "legacy" or inactive insurance business.

© Hanken

Reasons for discontinuing lines of insurance business

» Exit from low profitable or unprofitable lines of insurance;

» Shift of the core activity to other business segments;

» Complete exit from the insurance market.

© Hanken

Implications of Pillar I (capital requirements)

- Solvency II – new risk-based model, market-consistent valuation of assets and liabilities;
- Higher capital requirements:
  - Gurenko & Itigin (2013) – 40% increase in capital requirements;
  - Eling & Pankoke (2014) – Solvency II SCR up to 5 times higher than Solvency I SCR;
  - No definitive answer, need for more empirical research.

© Hanken

Implications of Pillar I (capital requirements)

- Costs of run-off portfolios are also likely to increase:
- Endres & De Galhau (2010), Labes (2011) – capital for a run-off portfolio 10 times higher than under Solvency I;
- Eling & Pankoke (2014) – non-life run-off business comprises 23.3% of Solvency II SCR;
- PWC - An increase in the cost of capital as one of the practical implications of Solvency II for Continental European (re)insurers with regard to their run-off business (57% of respondents).

© Hanken

Implications of Pillar I (capital requirements)

» Increased focus on the capital efficiency;

» Discontinued business ties up capital which could otherwise be spent on developing new lines of business;

» The need to release additional capital -> increase in the number of run-off portfolios;

» Passive management is no longer a viable option -> increasing demand for efficient exit mechanisms;

» PWC – Solvency II will influence the restructuring activities of Continental European (re)insurance groups over the next five years (72% of respondents).

© Hanken

» Hard to obtain data for supervisory monitoring purposes for run-off business;

» The data can be less reliable and the staff responsible for it might no longer be working at the firm;

» Increases financial and human resources necessary to conduct internal control, ORSA, etc.

» If poorly managed and not taken properly into account may result in a capital add-on.

© Hanken

» (Re)Insurers are required to report publicly information relating to their financial situation and solvency;

» Discontinued business has to be reported as well;

» Analysts, rating agencies and investors judge companies' business based on disclosures;

» Too large a part of run-off portfolios:
  - negative message to policyholders;
  - loss of prospective clients;
  - additional challenge to maintaining a company's reputation;
  - negative impact on the firm's rating.

© Hanken

» Pure run-off companies – undertakings that have decided to completely exit from the insurance market and discontinue all of their insurance books of business.

» Particular issues regarding compliance with Solvency II:

- Minimum amounts of premium while still required to hold enough solvency capital;
- Limited sources of generating capital to cover the requirements;
- Limited staff resources;
- Decreasingly attractive for investors, etc.

© Hanken

Exceptions for run-off firms

- Solvency II art 308b - insurance and reinsurance companies that have stopped entering into new insurance or reinsurance contracts before 1 January 2016 and are concentrating on running-off their existing obligations are not subject to the Solvency II requirements provided they manage to terminate all their activity before 1 January 2019 (1 January 2021 in case the undertaking is subject to reorganisation and an administrator has been appointed).

© Hanken

» Not all companies will be able to use the exemptions in practice:

- No exhaustive list of evidence of activity termination to be provided to supervisors is defined;
- UK: application before January 2016 with a defined run-off strategy;
- Additional costs for preparation of the run-off strategy;
- The period stipulated by the Directive is often not enough to complete run-off;
- Companies qualifying for the exemption might be still required to prepare for Solvency II.

© Hanken

- Run-off portfolios (especially passively managed) become even less attractive under Solvency II and have to be seriously considered;
- Increased focus on the active management tools;
- Capital restructurings of insurers;
- More attention to the capital management.

© Hanken

References

» Darag, 'Where does Run-off occur?' (2014) <www.darag.de>

» Directive 2009/138/EC of The European Parliament and of The Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) [2009] OJ L 335/1

» Eling M and Pankoke D, ‘Discontinued business in non-life insurance: an empirical test of the market development in the German-speaking countries’ (2014) 4(1) European Actuarial Journal 31

» K. Endres and V. de Galhau, Solvency II and the capital charge for run-offs (2010)

» Labes H, ‘A Trigger for Consolidation’ (2011)(36) Run Off & Restructuring 16

» PWC, *Unlocking Value in Run-Off: A Survey of Discontinued Insurance Business in Europe (8th edition)* (PWC 2014-09, Survey, 2014)

© Hanken

Young Lawyer/Student Prize Sponsor

British
Insurance
Law
Association

Charitable Trust

Agenda

15.15 p.m. **Introduction** (Dr Gunne W. Bähr, Germany; Yannis Samothrakis, France)

Topic: New Solvency II Regulation

Speakers:

1) **Jan Parner,** Danish FSA – Reselection of pension scheme
2) **Oleksandr Khomenko**, Helsinki - Solvency II and its impact on discontinued business in non-life insurance
3) **Lars Gerspacher**, Zurich – The Swiss perspective on Run-Off Business
4) **Yannis Samothrakis**, Paris – International programmes, admitted and non-admitted issues, financial interest clause

16.35 p.m. Discussion

16.40 p.m. Questionnaire, next meeting, topics for the next meetings etc.

16.45 p.m. End of session

International programmes

A brief overview of admitted / non-admitted issues and financial interest clauses

AIDA Working Party on State Supervision

Copenhagen, 11 June 2015

Yannis Samothrakis

General structure of international insurance programmes

- International group takes insurance cover for subsidiaries located in different jurisdictions
- **Group level:** master policy
- **Local level:**
  - Local policy by a locally authorised insurer *or*
  - Full cover by master policy on an admitted or non-admitted basis *or*
  - DIC / DIL cover by master policy

Admitted or non-admitted cover

- Two scenarios:
  - Master policy insurer is authorised to cover local risk (admitted basis)
  - Master policy insurer is not authorised to cover local risk (non-admitted basis)
- Determination of location of risk: typically the country in which the insured undertaking is established
- Trigger is typically cover of risk, not claims payment – criteria may differ as well as conditions

Risks

- **Regulatory**: fines, sanctions and/or ban for insurer, intermediary and possibly insured
- **Contractual**: all or part of policy terms may be void or unenforceable
- **Financial**: reinsurers may refuse to cover
- **Fiscal**
- **Reputational**

Risks

The Rio Times
News in English for Rio de Janeiro and Brazil

10 Jun | HOME | POLITICS | BUSINESS | REAL ESTATE | ENTERTAINMENT | SPORTS | NIGHTLIFE GUIDE
ADVERTISING | PREMIUM ACCESS | STORE | PRINT EDITION | CLASSIFIEDS
Help Wanted: Newsroom Intern

Brazil Targets Unregistered Financial Services

By Contributing Reporter on November 15, 2011

By Ben Tavener, Senior Contributing Reporter

RIO DE JANEIRO, BRAZIL – A U.S. based insurance company is being prosecuted for selling life insurance policies in Brazil without being legally registered in the country. National Western Life, which is headquartered in Texas, will receive the biggest fine ever imposed by Brazil's financial regulator: R$11 billion (US$6.2 billion).

National Western Life building in Austin, Texas, photo by city-data.com

Luciano Portal, Superintendent at Brazil's private insurance industry regulator Susep, says the company hired several "irregular brokers" who sold life insurance throughout Brazil.

"We believe in most cases policyholders [...] are unaware the company is operating illegally in Brazil. As the company is from the U.S., it is seen as credible in Brazil but obviously that doesn't correspond to reality," Portal was reported by O Globo as saying.

The case came to light after a client filed a lawsuit against the company in Brazil; when the case reached the U.S. justice system, it was shown to involve a company representative which was illegal in Brazil and the case was thrown out.

Susep has warned it is now stepping up checks and, if necessary, legal action against unregistered foreign businesses to fight "illegal insurance" and other financial services.

Experts interviewed by The Rio Times say the case should be seen more as a deterrent, and will unlikely be paid, but that it should act as a wake-up call for those operating illegally – with insurance companies in the first line of attack as they have the "deepest" pockets. But they warn other financial service providers could be next.

REUTERS
HOME | BUSINESS | MARKETS | WORLD | POLITICS | TECH | OPINION | BREAKINGVIEWS | MONEY | LIFE | PICTURES

Solvency II Risk Service
Regulatory Data Services Powered By Thomson Reuters

Business News | Mon Mar 31, 2014 3:14pm EDT

N.Y. regulators say MetLife to pay $60 million for violations

The financial interest clause

- Financial Interest coverage indemnifies the parent in its home country for its covered losses triggered by events that affect a local entity in its own country. The insurable interest of the Parent derives from its economic interest in its Local entity.
- The parent / policyholder of the master policy is insured, not the local entity
- Premium is paid by parent
- If properly structured, mitigates risk of non-admitted cover as no local risk is insured
- Must be drafted carefully to mitigate risks for the insurer, broker and intermediary
- Some specific risks relating to the financial interest clause, in particular: relationship between parent and affiliate (percentage of ownership, direct/indirect holdings etc.), no subrogation rights,

CLYDE&CO

Yannis Samothrakis
Partner, Clyde & Co LLP
134, boulevard Haussmann
75 008 Paris
Yannis.samothrakis@clydeco.com
+33 1 44 43 88 96

1,500
Lawyers and fee earners worldwide

1st
Law Firm of the Year Legal Business Awards 2011

300
Partners worldwide

40
Offices across Europe, Americas, Middle East, Africa and Asia.

Clyde & Co LLP accepts no responsibility for loss occasioned to any person acting or refraining from acting as a result of material contained in this summary. No part of this summary may be used, reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, reading or otherwise without the prior permission of Clyde & Co LLP. © Clyde & Co LLP 2015

Agenda

15.15 p.m. **Introduction** (Dr Gunne W. Bähr, Germany; Yannis Samothrakis, France)

<u>Topic:</u> New Solvency II Regulation

Speakers:

1) **Jan Parner,** Danish FSA – Reselection of pension scheme
2) **Oleksandr Khomenko***,* Helsinki - Solvency II and its impact on discontinued business in non-life insurance
3) **Lars Gerspacher**, Zurich – The Swiss perspective on Run-Off Business
4) **Yannis Samothrakis**, Paris – International programmes, admitted and non-admitted issues, financial interest clause

16.35 p.m. Discussion

16.40 p.m. Questionnaire, next meeting, topics for the next meetings etc.

16.45 p.m. End of session

Working Group State Supervision

Vth AIDA Europe Conference 2015

Copenhagen, 11 June 2015