FINANSINSPEKTIONEN

Supervision of insurance undertakings

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Summary

The objective of Finansinspektionen's (FI's) supervision of insurance undertakings is to monitor their ability to fulfil their commitments to customers, and to monitor that customers receive comprehensible and accurate information. This report focuses on the first of the above-mentioned primary objectives.

In order for insurance undertakings to fulfil their commitments, they must have sufficient capital and manage their risks and conflicts of interest. FI's review shows that the insurance undertakings are generally well-capitalised and non-life insurance undertakings have demonstrated solid profitability for a number of years. Regulatory amendments and product adaptation have enabled the life insurance undertakings to maintain good solvency despite declining market interest rates.

How the life insurance undertakings in particular manage the risks posed by low interest rates has, in the past few years, been the single most important matter in FI's insurance supervision. The low-rate environment remains in focus in 2015 too. FI sees risks in both the short and long term. The rules regarding the discount rate curve may lead to business models that are unsustainable in the long term potentially being concealed for a long time. This can also lead the undertakings to invest more in risky assets in the hope of boosting return.

A key question in FI's supervision is the insurance undertakings' internal governance and control, and how owners and management deal with conflicts of interest. FI sees that outsourcing operations may present conflicts of interest between the willingness of the management of the undertakings to enhance the efficiency of the operations, and the interests of policyholders. FI's point of departure is that an undertaking shall meet the internal governance and control requirements, irrespective of whether the operations are conducted internally or by a service provider. A relevant question pertains to whether the operations of selection centres should be considered outsourced operations, and what control an insurance undertaking should have of the selection centre's operations.

The implementation of the Solvency 2 regulations is time-consuming work that gives rise to a number of issues on which the undertakings need to take a position, and which they need to manage. In addition, there are questions as yet unanswered, which leads to uncertainty. The Government has proposed that an insurance undertaking that conducts both life insurance and occupational pension insurance operations shall, during a transitional period for the occupational pension operations follow the current rules. In FI's opinion, a complete separation of the operations during the transitional period is preferable and occupational pension operations should be regarded as a separate fund. Furthermore, FI finds that the question of a new separate regulatory framework for occupational pension undertakings is closely interlinked with the question of how occupational pension operations in life insurance companies should be managed. FI finds that the protection value for occupational pension is no different from the protection value of other pension insurance, and it is difficult to see why the regulation of these operations should differ. If the Government is of the opinion that occupational pension and life insurance operations should be regulated differently, FI is of the opinion that it is inappropriate to allow such operations to be conducted within one and the same undertaking.

FI and the insurance market

The insurance market is an important part of the national economy, and is fundamental to the ability of individuals and corporations to manage their risks and secure their future financial welfare. Ensuring that insurance undertakings are able to fulfil their commitments is therefore a primary objective of FI's supervision. It requires the ability of insurance undertakings to manage their risks and conflicts of interest, and to have sufficient capital.

The possibility of insuring oneself against the consequences of damage or an incident is a key element of the risk management of both individuals and corporations. Different types of life insurance enable people to secure their future financial situation for themselves or their survivors. The ability of insurance undertakings to fulfil their commitments, both present and future, is therefore of great importance to both individual policyholders and society at large.

The possibility of insurance undertakings to pool risks

The basic concept of insurance operations is that a number of policyholders share the risk of a certain incident transpiring, but that only a few of them are actually affected. Sharing the risk means that the group jointly holds capital that equals the cost of the risk transpiring, and that each individual policyholder therefore does not need to do so.

An insurance undertaking creates risk pools with a great number of policyholders who share the risk associated with a certain incident. By grouping together a large number of individuals and uncertain outcomes, the insurance undertaking can calculate a relatively accurate measure of the number of claims that will transpire within the group over the course of, for example, a year. It can also pool its risks by purchasing reinsurance, hence further diversifying its risks. The possibility of pooling risks enables the insurance undertaking to manage risks more efficiently than an individual policyholder can. For the individual, an insurance policy means that a large and unknown cost can be converted into a cost that is both manageable and known. In a broader economic sense, this is an important reason for the existence of insurance undertakings.

Information asymmetry creates the need for supervision

An insurance contract involves obligations for both the insurance undertaking and the policyholder. The policyholder undertakes to pay a premium for the insurance undertaking to assume the risk associated with certain incidents, which are specified in the contract. In turn, the insurance undertaking undertakes to compensate the policyholder in the event of the incident transpiring. If the policy contains elements of saving, the insurance undertaking also undertakes to manage the capital throughout the term of saving and then, at a certain specified point in time, pay it out on the agreed terms.

In order for the insurance market to function efficiently, both parties must have sufficient information. In practice, in certain respects the customer is at an advantage in terms of information in relation to the insurance undertaking, while in other respects the insurance underta-

king has more information. The fact that the parties have different access to information, known as information asymmetry, affects the functioning of the market.

Insurance risks

Insurance premiums are to cover expected claims compensation, but also administration and any profit requirements from owners. In order to know which premium to charge, the undertaking needs to be aware of the probability of the policyholder being affected by the incident, and the cost of the claim. Important factors in setting premiums are past experience in terms of risks and expenses, as well as actuarial assumptions about the average lifespan of the population or maximum claims expenses in the event of storms. However, history and models do not create forecasts that are certain, and the actual outcome can deviate from expectations, meaning that the insurance undertaking is exposed to insurance risks. This requires the insurance undertaking to have financial buffers. If the undertaking does not manage these risks – for example by adapting premium levels or changing contractual terms of future contracts – and the risks are greater than can be borne by the undertaking's capital, this could lead to the inability of the undertaking to fulfil its commitments. For consumer protection, it is thus crucial that the undertakings measure and manage their risks and regularly review their assumptions in order to ensure that the assessments of the risks to which the undertaking is exposed are not inaccurate.

The information disadvantage of the insurance undertaking

The insurance undertaking is at a disadvantage in terms of information regarding the individual policyholder, which makes setting premiums and devising contract terms more difficult. For example, the undertaking rarely knows the individual policyholder's risk of suffering damage. It thus sets a premium that equals the average risk in a group of policyholders, which risks giving rise to adverse selection because high-risk people will be more inclined to take out insurance than low-risk people. Hence, there is the risk of the insurance collective primarily consisting of people from high-risk groups and that claims expenses will be higher than premium income. The undertaking may therefore experience difficulties in fulfilling its obligations.

Because insurance protection reduces the financial consequences of damage, the protection can affect how people behave, and hence also the probability of suffering damage. The insurance undertaking does not know the extent to which the policyholder's behaviour can change. This moral hazard also poses difficulties for the undertaking to set a premium that reflects the probability of damage transpiring.

How can an insurance undertaking manage its information disadvantage?

For certain types of insurance, the information disadvantage can be relatively easy to manage in theory. For example, the insurance undertaking can, through inspections, assess the risk of fire in various buildings. It can also require people to complete a declaration of health or undergo a medical examination in order to assess the probability of the person falling ill. However, in many cases such methods are not available or are too costly, and the undertaking must find other ways to manage the risks. Policyholders can be

divided into different risk categories. For example, young people can be made to pay a higher premium for car insurance than other age groups because experience shows that they are more prone to damages. The undertaking can also, through the contractual terms, reduce the risks in its information disadvantage by only providing compensation up to a certain level, through insurance excess and by withdrawing any bonus from a policyholder who caused damage.

The information disadvantage of the policyholder

It is often difficult for the policyholder to understand an insurance product and what it encompasses, and claims settlement in the event of damage. It is also difficult to evaluate the insurance undertaking's financial situation and its possibility of fulfilling the obligation, not least if it is a matter of obligations extending over a long period of time, such as pension insurance. In these respects, the policyholder is thus at a disadvantage in terms of information. In order for people to make well-founded decisions, they must have accurate and relevant information, and understand the terms of the product.

Conflicts of interest

There are inherent conflicts of interest within insurance undertakings – between different policyholder collectives, between policyholders and the management of the undertaking, and between policyholders and owners. How the conflicts of interest come to expression depends in many instances on the company form in which the operations are conducted.

A clear conflict of interest is that between the owners of an insurance undertaking, who want return, and the policyholders, who want protection. A distinctive feature of the Swedish insurance market, particularly in the life insurance area, is the existence of mutual insurance undertakings, in which the policyholders also own the undertaking. Because the customers are also the owners of the undertaking, there are no conflicts of interest between them and the purpose of the undertaking is solely to promote customers' best interests. However, the absence of a strong owner could mean that the management of the undertaking has relatively broad freedom of action, and there is thus a risk of the management, both in the insurance operations and in asset management, being driven by interests other than those of policyholders. In a mutual undertaking, the policyholders are entitled to any surplus. The surplus is also the undertaking's equity. Because the claims of policyholders on equity are not contractual, there may be an incentive for management to use the capital in a way that is not in the interests of customers. There is also a risk of management choosing to use the surplus of a collective to benefit another collective, or to subsidise new products or customer groups. This constitutes conflicts of interest, which do not exist in the same way in profit-distributing undertakings. In insurance companies that may not distribute profit (hybrid companies), the owner may have an incentive to circumvent the profit distribution ban, for example by means of intra-group agreements or transactions that discriminate against the hybrid company, and hence ultimately policyholders.

On the whole, it can be ascertained that conflicts of interest are in many cases due to the management and owners of an undertaking having substantial discretionary scope to act in a way that does not necessarily benefit customers, and them also having financial incentives to act in

that way. In order for operations to be conducted in the interests of policyholders, owners and management alike must be capable of identifying and managing conflicts of interest in order to ensure that policyholders are not affected by them.

FI'S ROLE ON THE INSURANCE MARKET

The problems described above are fundamentally the same for all types of insurance, despite different products potentially having different purposes and characteristics. The primary objectives of supervision are also fundamentally the same for all types of insurance operation; that is, monitoring to ensure that the undertakings can fulfil their obligations towards customers, and monitoring to ensure that customers receive comprehensible and accurate information. FI's work on the insurance market thus primarily has a consumer protection focus. FI shall take preventive measures and the aim is to identify and manage risks before they cause harm to consumers. This report focuses on the first of the above-mentioned primary objectives. Matters pertaining to information for customers are addressed in FI's consumer report.

There are also certain stability aspects that FI must take into consideration. The insurance undertakings, mainly the life insurance undertakings, are major investors on the securities markets. If several insurance undertakings simultaneously make major changes to their asset portfolios, the market prices of assets can be affected, which affects other market participants. FI must therefore analyse whether the measures taken can have undesirable effects in other parts of the financial system. The fact that the insurance undertakings take out reinsurance from other insurance undertakings can also imply problems in the form of contagion effects between undertakings, which FI must also take into consideration.

Supervision requires prioritising

Supervision of the insurance area covers both very small and large undertakings. Around 400 insurance undertakings are under supervision. Out of these, just shy of 300 are insurance companies, around 65 mutual benefit societies and around 75 pension funds.[1]

It is neither possible nor desirable to review all undertakings in the same way; rather, FI must prioritise based on where the risks, and the consequences thereof, are greatest. FI uses different methods to identify risks at undertakings and in products.Such methods include the periodic reporting of the undertakings to FI, and stress tests to see whether the undertakings have the capital they need in light of their risks.. An important part of the work is also to continually analyse and assess the risks posed by external factors, and how they can affect the insurance undertakings.[2]

FI's ongoing supervision is based on a risk classification system in which the undertakings are divided into four groups. FI regularly reviews the breakdown, which is based on a qualitative assessment of the risks asso-

1 This includes a number of small local entities that do not have a reporting obligation. Primary supervisory responsibility for the pension funds rests with the county administrative boards, and for foreign-owned branches, with the home country in question.

2 For a description of FI's supervision strategy, see the memorandum Supervision strategy, Ref. 13-12064.

ciated with each undertaking. Around 20 insurance undertakings, including all the major ones, are in risk category 1.[3]

They are under the ongoing supervision of an appointed supervisory contact person, and are subject to annual risk assessments. Many of the undertakings have cross-border operations and are thus also subject to the work of the supervisory colleges at EU level. The ongoing supervision of the undertakings in other risk categories primarily consists of the analysis of reported data and risk-based thematic studies. If the analyses provide grounds for taking measures, FI follows up on this in different ways, for example through in-depth investigations or on-site visits. There is thus flexibility in the measures taken.

The non-life insurance market and supervision

The insurance area displays great differences, both in terms of products and company forms. Different supervisory matters are therefore more or less relevant depending on the type of undertaking and product. In the non-life insurance area, in which contracts have a short commitment period as a rule, an insurance undertaking can adapt premiums and terms relatively easily if it turns out that previous assumptions and calculations do not reflect reality. For certain types of insurance, not least on the private market, the high number of claims settlements means that the undertaking can quickly evaluate how to devise terms and premium levels, and adapt them if needed.[4]

An undertaking that acts on heightened risks in the operations and makes the requisite adaptations will thus relatively quickly see the effects in its earnings and financial position. Consumers, for their part, have the possibility of regularly evaluating the undertakings and their products, and can relatively easily choose to switch a product or undertaking if the latter does not deliver as expected, or if it is financially weakened. The possibility of customers to "vote with their feet" incentivises undertakings to act based on the best interests of customers. The pressure that customers can themselves exert thus enables them to improve their position on the market. However, this requires the customer to have the requisite information, and the ability to interpret its content.

FI continually analyses the results of the non-life insurance undertakings in different lines of business and the progression of premium revenue to see that they adapt their assumptions and premium-setting to actual conditions for example for claims expenses and risks of claims. FI also follows up on the undertakings' provisioning to ensure that they can cope with fulfilling their commitments. An important part of the supervision is to detect at an early stage undertakings that have set aside too little capital to cover their costs. FI also monitors the undertakings' reinsurance protection to see that it provides sufficient security if it were needed. For example, FI studies annually the credit ratings of the reinsurance counterparties. Another important element of supervision is to ensure that the interests of policyholders are safeguarded in connection with claims settlement.

The life insurance market and supervision

The distinctive feature of life insurance is that the relationship between the policyholder and insurance undertaking usually extends over a long

3 In FI's opinion, no individual Swedish insurance undertaking can currently be considered systemically important.

4 This is not possible for insurance that covers major risks with a low probability of them transpiring.

period of time. Although pure risk insurance exists, most products contain an important savings element, and often both the term of the contract during which the undertaking manages the savings, and the payout period, are long. This marks an important difference to the non-life insurance undertakings, which generally have a short investment horizon and which manage premiums mainly with the purpose of meeting future claims payments.

The risks in life insurance are strongly linked to the type of insurance in question. In *traditional life insurance*, the insurance undertaking guarantees that a certain amount shall be paid out at a certain time to the policyholder, for a determined period (temporary payment) or throughout the remainder of the policyholder's life (life-long insurance). Because the policyholders provide the venture capital, that too entitles to any surplus arising, known as bonus. Traditional insurance can be *defined-contribution* or *defined-benefit*. In defined-contribution insurance, future disbursements are determined by the size of contributions and the return on them. In defined-benefit pension insurance, the insurance undertaking often promises that the disbursement shall be a certain percentage of the pensionable salary that the person has, for example, upon retirement. When an undertaking issues financial guarantees, it is exposed to considerable financial risks. An undertaking that offers life-long insurance is also exposed to major insurance risks because life span in the insurance collective can prove longer than expected.

In traditional insurance, the policyholder fully transfers responsibility for managing the capital to the undertaking, while at the same time it is difficult to judge how its asset management is conducted and which costs are charged. Neither is it possible for the individual to assess the undertaking's future ability to fulfil the commitment. In certain cases customers are locked in, meaning that they cannot "vote with their feet" if it emerges that the undertaking does not meet expectations or is financially weakened.[5] The customer's information disadvantage, combined with a limited right of transfer, increases the risk of the undertaking acting in a way that is not in the interests of the individual customer.

In *unit-linked insurance*, the policyholder decides on the funds in which premiums shall be invested, and the value of the policy is linked to the value of the fund units selected by the policyholder. For unit-linked insurance, the insurance undertaking does not usually provide any guarantee regarding how large disbursements will be and it is thus the policyholder who bears the financial risk. Similar to that which applies to traditional insurance, the customer might find it difficult, however, to evaluate factors such as charges and the level of risk actually entailed in a choice of fund. In *deposit insurance* too it is the policyholder who selects the assets in which premiums are to be invested, and who bears the financial risk. Unlike unit-linked insurance, in deposit insurance investments may be made in cash and cash equivalents and securities other than funds.

Just like the non-life insurance undertakings, a life insurance undertaking can adapt terms and premiums of new contracts to altered conditions. However, the undertaking does not have the same possibility to

5 The statutory right of transfer applies to individual life insurance policies with certain characteristics entered on or after 1 July 2007. The right of transfer does not apply to collectively bargained occupational pensions. However, in many cases these are covered by a right to transfer, agreed by the parties to the collective bargaining agreement, between a number of selected insurance undertakings.

adapt the terms and guarantees of existing contracts and hence, for a long time ahead, it must honour the promises it made previously. If assumptions and terms subsequently turn out to be unreasonable, this may therefore have an impact on the undertaking's financial position, which it may have difficulty in redressing. An undertaking may certainly offer customers the opportunity to transfer to another product, but the customer must approve the change.

Compared with non-life insurance, the risks in the life insurance area are thus more numerous in many respects, and in many cases of a very different nature. This also influences the supervisory actions prioritised by FI. FI reviews the asset management of the life insurance undertakings, and performs ongoing stress tests to ensure that they are sufficiently resilient to manage sharp changes on securities markets. An important part of the supervision also pertains to the undertakings' technical provisions and the assumptions at the basis of the provisions made by the undertakings. The outcome of these assumptions is reported each year to and reviewed by FI. The objective is to detect at an early stage undertakings that employ inappropriate assumptions in their calculations to avoid the accumulation of such errors over a long period of time.

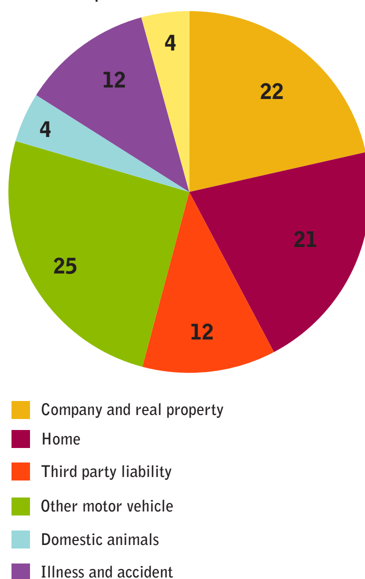
Supervision of insurance undertakings

FI's review shows that both non-life and life insurance undertakings in Sweden are well-capitalised on the whole. In the life insurance area, the low interest rate environment remains a focal point of supervision. The amended regulations regarding the discount rate mean that undertakings can take a more long-term approach in their investments, but FI sees the rules potentially posing other, more long-term risks. In its supervision of the undertakings' internal governance and control, FI sees that the outsourcing of certain parts of operations can give rise to conflicts of interest between the willingness of management to enhance the efficiency of operations, and the interests of policyholders. It can also lead to a sharp deterioration in the operational governance and control possibilities of the insurance undertaking, which poses risks to policyholders.

DEVELOPMENTS AMONG INSURANCE UNDERTAKINGS

Non-life insurance encompasses a great number of different product types. The common denominator is that they cover financial loss attributable to property or liability. In many cases, illness and accident also counts as non-life insurance.[6]

1. PREMIUMS CONTRIBUTED FOR NON-LIFE INSURANCE
(share in per cent)



The Swedish non-life insurance market is dominated by a handful of participants. Expressed as a percentage of total premium contributions, the market share of the five largest non-life insurance undertakings exceeds 80 per cent. Premium income for direct Swedish insurance has, in the past five years, increased from SEK 58 billion to SEK 65 billion, marking an increase from around SEK 11,500 to SEK 13,000 per household. The increase is explained by inflation, population growth and the related increase in the stock, and that the standard of insured objects has risen. Small parts of the business have disappeared abroad because undertakings that used to be Swedish have become the branches of foreign undertakings, or Swedish undertakings have transferred parts of their operations to foreign undertakings. Premium income for direct insurance abroad of the Swedish undertakings has been stable at around SEK 23 billion during the period.

The technical outcome of the past five years has been around SEK 8–9 billion, equalling around 10 per cent of the premium. Profit for the year, including asset management at undertakings, has varied however, between SEK 4 billion and SEK 17 billion during the same period, with an average of just over SEK 10 billion. Overall, the industry has been fairly profitable without triggering any considerable price pressure. The market shares of individual undertakings were also relatively unchanged in 2014 compared to 2009.

Life insurance compensates a policyholder who is injured, on sick leave or deceases, or when he or she retires. The life insurance area also features many different types of product. The breakdown is based on who subscribes to the insurance, and type of saving and insurance risk.

6 Illness and accident insurance that counts as life insurance applies for longer than five years, for an indefinite period or until the policyholder has reached a certain age and may usually only be terminated by the insurance provider if specified in the agreement.

In the past five years, premium contributions in life insurance have been stable at just shy of SEK 200 billion annually. However, capital transferred has increased in recent years, leading to premium income amounting to approximately SEK 240 billion in 2014. The share of premiums not exposed to competition, which largely refers to defined-benefit occupational pension, is at around 6 per cent. In light of the fact that major collective bargaining agreements are gradually making the transition to defined-contribution occupational pension in new policy subscriptions, the share of defined-benefit occupational pension will shrink ahead. Around 35 per cent of premium income refers to unit-linked insurance, which marks somewhat of a decline compared with traditional insurance and deposit insurance from previous years. However, greater amounts are transferred to unit-linked insurance than to traditional insurance.

The aggregate insurance capital for life insurance products with saving was SEK 2,919 billion at the end of 2014, marking an increase of just over 50 per cent since 2009. This equals almost 40 per cent of total household savings. Just over 50 per cent of insurance capital is managed by the five largest life insurance undertakings. The majority of the stock[7] consists of traditional insurance, and as much as 75 per cent of the total stock is linked to occupational pension operations. Only around 13 per cent consists of private pension insurance. Because the tax benefit will probably be entirely abolished in 2016, both contributions to existing private insurance policies, and subscriptions to new policies, will practically cease, and the share will hence shrink in the future. Also products such as group life and illness insurance only make up a small part of the stock.

For savings products, asset management is an important element in creating value growth and bonuses. Annual total return for the undertakings with traditional insurance was on average 8.0 per cent during the period 2010–2014. However, there are considerable differences between undertakings, with several of them applying a more cautious investment strategy. Otherwise, the ever-decreasing market rates have affected the undertakings' finances and meant that commitments for new premiums and contracts are based on shrinking assumptions about future return.

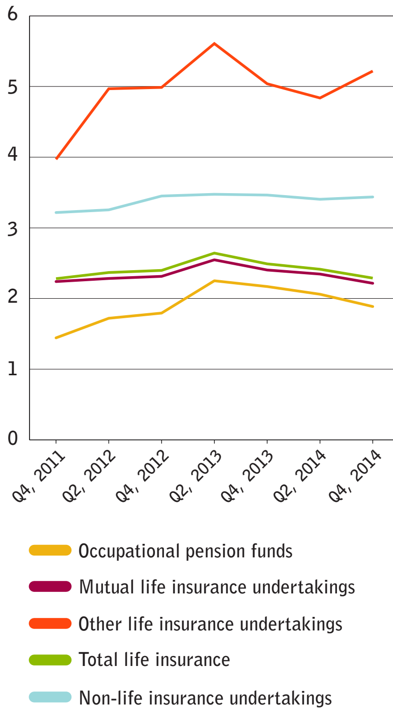
The insurance undertakings' assets

At the end of 2014, the investment assets of the insurance undertakings amounted to almost SEK 3,900 billion, which almost equals Sweden's GDP. The vast majority of the capital is managed by the life insurance undertakings. Just over half of the assets are invested in equities. The equity holdings consist more or less equally of Swedish and foreign equities. A third of the capital is invested in bonds. The insurance undertakings also invest in, for instance, real estate and derivatives.

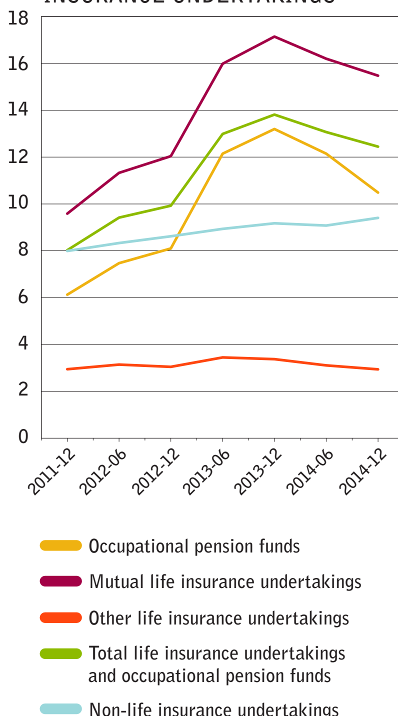
The undertakings' considerable assets mean that financial risks, mainly equity price risk and interest rate risk, are substantial. The largest single risk for most insurance undertakings is the equity price risk, i.e. the risk of the value of equity holdings or equity-related holdings being negatively affected by a change in the market value of equities. The interest rate risk is an important factor for the life insurance undertakings that have lengthy commitments with financial guarantees. Changed market interest rates affect the liabilities side, because the value of commitments is calculated using a discount rate curve which is based to a certain extent

7 "Stock" refers to the total asset value broken down by policyholder or insurance contract.

2. TRAFFIC LIGHT RATIO FOR INSURANCE UNDERTAKINGS



3. SOLVENCY RATIO FOR INSURANCE UNDERTAKINGS



on market rates. The net effect for an undertaking depends on e.g. the average maturity (duration) of its liabilities and its assets, and how well the asset side matches the liabilities side.

The traffic light test

The traffic light test gauges how an insurance undertaking copes with exposure to financial risks and insurance risks, and forms an important part of FI's supervision methodology. The purpose of the traffic light test is for FI, at an early stage, to identify undertakings that have taken such large risks that their possibility of fulfilling their commitments towards customers is under threat.

The traffic light ratio

In the traffic light model, a capital buffer is calculated based on the fair value of both assets and liabilities. The undertaking is then subjected to a number of fictitious stress scenarios. Their outcome shows an overall capital need, a hypothetical "capital requirement" with account taken of the risks to which the undertaking is exposed. The capital buffer divided by this capital requirement gives the traffic light ratio. Depending on the outcome of the traffic light test, the undertaking may become subjected to more intense supervision. It could be a case of FI requesting that the undertaking report information more frequently and of FI, together with the undertaking, discussing the latter's financial situation.

As shown in the diagram, the progression of the traffic light ratio has generally been stable in the past two years. The life insurance undertakings currently offer to a greater extent pension insurance with a temporary disbursement period, which has entailed a reduction in the insurance risk. Because interest rates have declined during the period, the value of the commitments has increased. This primarily affects mutually operated life insurance companies and occupational pension funds, which generally have lengthy commitments. While a reduction in the interest rate indeed brings about an increase to the value of assets, because the asset side has a shorter duration than the liabilities side, this increase is relatively smaller. This is confirmed by the results of the traffic light test, which show that the capital buffer of the undertakings increased by 2 per cent while at the same time the total capital requirement increased by 7 per cent. On the whole, the traffic light ratio declined 5 per cent at the end of 2014 compared with the end of June 2014. For other life insurance undertakings, the average traffic light ratio increased in the second half of 2014.

The traffic light ratio of the non-life insurance undertakings was largely unchanged at the end of 2014 compared with the end of June. On the whole, these undertakings have shown a stable level with a ratio of over 3 in the last three years.

The insurance undertakings' solvency situation

Compared with 2013, solvency ratios declined in 2014 for life insurance undertakings and occupational pension funds. This is primarily due to sharply declining market interest rates during the year. The fact that solvency ratios did not decline more than they did in 2014 is explained by the model for establishing the discount rate curve introduced by FI on 31 December 2013.

Solvency – a measure of an insurance undertaking's financial strength.

The solvency of an insurance undertaking measures its ability to fulfil its obligations to policyholders. According to applicable rules, an insurance undertaking shall calculate own funds based on the nature and scope of the operations. The undertaking shall have a solvency margin such that the value of all assets comfortably exceeds the value of the guaranteed and conditional commitments in the insurance contracts. Also, own funds may never be lower than a guarantee amount determined by law. If an undertaking's solvency ratio – i.e. own funds divided by the solvency margin – falls below 1, FI shall intervene.

Another reason for why the solvency ratios of the life insurance undertakings have not dropped further is the product adaptation done by the undertakings in the past few years. The undertakings offer today traditional insurance with lower guarantees, but also unit-linked insurance and deposit insurance to a greater extent than before. This applies to both new and existing customers, which in many cases have been offered the possibility of transferring from traditional insurance with a high guarantee to another product. In so doing, the undertakings have been able to reduce their guaranteed commitments, and hence the capital they must hold.

For the non-life insurance undertakings, which are not affected by low interest rates in the same way as many life insurance undertakings, solvency ratios increased during the year.

RISKS IN A PROTRACTED LOW-RATE ENVIRONMENT

The trend towards low market rates has been occurring over a long period of time. Interest rates are currently at historically low levels and there is a lot that indicates that they will remain at low levels. Hence, the undertakings must manage the current state of the market, and plan for it persisting. How the life insurance undertakings in particular manage the risks linked to low rates has, in the past few years, been the single most important matter in FI's insurance supervision. FI sees risks in both the short and long term.

Solvency risk in a low-rate environment

The state of fixed income markets puts particular pressure on the life insurance undertakings which have long commitments with financial guarantees. When the value of liabilities increases while at the same time return on fixed-income securities decreases, the financial position of an undertaking is affected. When solvency declines, the undertaking may be forced into reallocation in the asset portfolio in order to reduce financial risks. In that case, the undertaking sells equities and purchases interest-bearing assets, with low return. This can mean that the undertaking's future ability to generate return deteriorates, which affects policyholders in the form of lower pensions. In a longer perspective, the action of the undertakings can in itself pose a further risk of shrinking solvency. Because the life insurance undertakings are major investors, such reallocation can also amplify downturns in market rates and equity prices, known as procyclicality, which risks leading to a further drop in solvency.

For a long time, Swedish insurance undertakings have been valuing their

assets and liabilities using market rates. This gives the undertakings an incentive to manage their interest rate risk, but may at the same time, as described by FI above, pose other risks. In 2013 FI amended the then applicable rules regarding the discount rate curve that an insurance undertaking shall use to calculate technical provisions. One of the reasons was that the rules entailed excessive sensitivity to the longest market rates.[8] According to the new rules, the discount rate curve is based partly on market rates, and partly on a long-term assumption about an equilibrium rate.[9] Such a model reduces the undertakings' need for short-term reallocation, and hence also the risks in such behaviour.

EIOPA's stress tests

In 2014 EIPOA[10] conducted stress tests of European insurance undertakings with the purpose, based on forthcoming solvency rules, of testing the resilience of the undertakings to stressed situations in terms of e.g. market and insurance risks. On the whole, the participating Swedish undertakings appear to be relatively well equipped for the requirements of the Solvency 2 regulations to start with. However, because of their relatively large equity portfolios, they are exposed to sharp drops in equity prices, and when the equity risks are sharply stressed, more undertakings experience difficulty in meeting the requirements. However, the stress tests show that the majority of the Swedish undertakings can cope with protracted low interest rates. Compared with European undertakings, Swedish life insurance undertakings nevertheless appear to be relatively sensitive to such a situation, although the risks are long-term. Sensitivity is a natural consequence of the great difference in duration between the undertakings' assets and liabilities, and is partially due to limited supply on the Swedish fixed-income market and low liquidity for long interest-bearing securities.

Risks associated with the discount rate curve rules

In recent years, FI has observed how life insurance undertakings manage business models and products that are unsustainable in the long term. The currently applicable discount rate curve reduces the undertakings' incentive to manage the risk of the guarantees they provide exceeding the return they can attain. The model also enables an undertaking to conceal such problems for a lengthy period, because changes in long market rates do not affect the value of liabilities in the same way as before. An undertaking which, when devising products and business models, does not take into account the difference between the state of interest rates and the interest rate levels used in the model, and the market's expectations about how interest rates will progress, thus risks making erroneous decisions and e.g. offering products with guarantees that are too high. Once the problems are detected, they can be difficult for the undertaking to remedy, which entails a risk of inability to fulfil its commitments.

In 2014 FI investigated the management strategies of the insurance undertakings, and whether they have changed following the amended discount rate curve rules. FI concludes that no major, immediate changes have occurred in the undertakings' management strategies and asset

8 For the same reason, FI introduced an interest rate floor in 2012 when interest rates dropped sharply

9 FFFS 2013:23

10 The European Insurance and Occupational Pensions Authority

allocation. However, the undertakings see better possibilities of acting with a more long-term approach in their management thanks to the model. FI sees no reason at present to perform follow-up of the investigation. However, FI will continue to review how the undertakings work in the long term to fulfil the guarantees they have provided.

Heightened investment in risky assets

A potential risk in a low-rate environment is that undertakings increase investments in riskier assets in order to improve return. The undertakings may thus seek markets about which they lack both knowledge and experience, and in which both transparency and liquidity may be limited. FI has noted that the undertakings' investments in alternative assets and hedge funds – in which return possibilities might indeed be higher, but which also carry a considerable risk of major fluctuations in asset values – have increased somewhat. A potential drop on these market would lead the capital return of the undertakings to decrease, affecting the possibilities of the undertakings to fulfil commitments towards policyholders. FI also sees that the insurance undertakings invest in covered mortgage bonds to a greater extent than previously. The credit risk in such bonds is indeed relatively low, yet nevertheless higher than for government bonds, and the value of the bonds could be negatively affected in the event of a drop in prices on the housing market.

Because the insurance undertakings' investments in riskier assets has been limited thus far, FI has not conducted any more substantial specific investigations in the area. In 2014, however, EIOPA conducted an investigation of the investments and specific exposures of European undertakings. The results of the investigation will be published in the summer of 2015. Because of the limited participation of Swedish undertakings, it will not be possible to draw any general conclusions for the Swedish market specifically. However, FI expects that the results ought to be largely in line with what FI has determined in its ongoing supervision of Swedish insurance undertakings.

Effects of implemented and future measures

FI is of the opinion that the risk of a deterioration in solvency remains high but that the situation – following amended rules and the product adaptation carried out by the undertakings – is not as critical as it was a few years ago. However, The Riksbank's decision to cut the repo rate to below zero puts the insurance undertakings under further strain, making it even more crucial to follow up on how they manage the market situation.

An important task of FI is to follow up EIOPA's stress tests, for instance by analysing in more detail how protracted low interest rates affect the Swedish insurance undertakings, and performing simulations of how the reinvestment risk affects their solvency situation. FI will also participate in the stress tests for the occupational pension institutions that EIOPA will conduct during the year.

There is reason to believe that, going forward, the undertakings will wish to seek out new markets to find high-returning assets. Hence, FI expects the undertakings' investments in risky assets to grow, increasing the aggregate risk level in the undertakings. Although FI cannot yet see any such tendencies, FI intends, in the latter part of 2015, to review in more detail the undertakings' investments through the preparatory reporting that is taking place ahead of the entry into force of Solvency 2. The reporting is

limited in scope and the review will thus be an initial step towards a more comprehensive analysis when the regulations come into force.

What is Solvency 2?

Solvency 2[11] is a new solvency regulatory framework in the insurance area coming into effect on 1 January 2016. Solvency 2 contains risk-based rules in all key parts of the regulations for insurance business and rests on three pillars:

– quantitative requirements for calculating capital

– qualitative requirements for risk management and internal control

– requirements for the information disclosed to the market

According to Solvency 2 an insurance undertaking shall prepare a specific solvency balance sheet that is separate from the financial accounts and in which assets and liabilities are marked-to-market. Measurement of technical provisions shall consist of a best estimate and a risk margin. With Solvency 2, a prudent person principle is also introduced, which is to imbue the undertakings' investment activities and which entails the current quantitative investment rules being replaced by qualitative rules for asset management.

Through Solvency 2, two capital requirements are introduced – a minimum capital requirement and a solvency capital requirement. The capital requirements shall be calculated such that the size of the capital buffer that an undertaking must have shall be more clearly linked to the risks to which it is exposed. This means that an undertaking needs to identify, manage and measure the risks to which it is exposed. It shall also incentivise an undertaking to develop its risk management, because insufficient risk management may entail a higher capital requirement.

The Solvency 2 regulations also contain transparent accounting requirements. An important part of that is the public solvency and business report that an undertaking must present each year. The rules are to increase transparency and provide policyholders, shareholders and other stakeholders with a better picture of the financial position of undertakings. In turn, this will provide undertakings with further incentive to manage their risks appropriately.

Unlike previous insurance directives, the Solvency 2 directive is in many parts a maximum harmonisation directive. This means that, in certain areas, it will no longer be permitted for Member States to introduce national rules that deviate from the directive.

It should in this context be highlighted that, in the Solvency 2 regulations, requirements are imposed on an undertaking regularly reviewing the appropriateness of its methods and assumptions and – as needed – adapting them to changed conditions and experience. The undertakings will thus need to evaluate their sensitivity to the assumptions at the basis of setting the discount rate curve. Solvency 2 thus emphasises the importance of undertakings not only steering their actions based on

11 The Solvency 2 regulations are usually described as comprising four different levels. "Level 1 regulation" includes the Solvency 2 directive, which contains the fundamental. In addition there are more detailed rules in the form of regulations and in EU standards, as well as guidelines and recommendations issued by EIOPA.

regulations, but also taking actual prevailing conditions into account. FI will, in its ongoing supervision, follow up on the actions of the undertakings. Solvency 2 also marks an improvement in FI's possibilities of following up on and analysing the investments of the undertakings, and going forward this will provide better conditions for monitoring, in the ongoing supervision, how the undertakings manage the market climate.

RISKS ASSOCIATED WITH EXTREME WEATHER

A non-life insurance undertaking that is exposed to natural disasters must measure, manage and estimate damage that occurs relatively seldom, but which can entail major claims expenses. The assumptions underlying premium-setting are therefore based on models to a great extent rather than historical outcomes. In order to limit risks and expenses, the undertakings often purchase reinsurance. An undertaking that does not regularly review both the assumptions at the basis of premium-setting and the reinsurance protection it has in place risks becoming exposed to greater risks than it can bear, which in turn could lead to its inability to fulfil its commitments towards customers.

An increased probability of extreme weather conditions could hit the claims expenses of non-life insurance undertakings hard. In recent years, climate change and greater weather variations have led to the frequency and cost of claims rising in certain exposed regions. Storms have caused major damage to forest areas, and rapid, heavy melting of snow has led to many buildings being flooded. The damage caused by the storms Gudrun in 2005 and Dagmar in 2011 are examples of the consequences of extreme weather.

Climate change gives rise to heightened uncertainty in the assessment of the risks of the non-life insurance undertakings associated with extreme weather, and in FI's opinion the risk will probably rise. FI has therefore initiated an investigation of the actions of the insurance undertakings by reason of climate change. By requesting information about the undertakings' assessed exposure to weather-related damage ensuing from natural disasters such as extreme storms and flooding, and how the modelled values affect their reinsurance levels, FI wishes to gain better insight into how the undertakings view and manage the risk of disaster ensuing from extreme weather. The investigation, which is being conducted in 2015, will form the basis for an assessment of whether the measures of the non-life insurance undertakings suffice.

INSUFFICIENT INTERNAL GOVERNANCE AND CONTROL IN OUTSOURCED OPERATIONS

In FI's supervision of the undertakings' internal governance and control, the question of how owners and management deal with conflicts of interest is constantly present. How the insurance undertaking ensures internal governance and control, and how it manages any conflicts of interest that may arise are also factors that FI regularly raises in its contacts with the boards and management of the undertakings.

In a number of investigations, FI has seen that the outsourcing of business-critical functions, such as compliance or actuarial, can lead to a considerable deterioration in the ability of the insurance undertaking to control such operations, which poses risks to policyholders. In many cases, this has also affected FI's possibility to exercise supervision of the outsourced operations because the undertaking has lacked the informa-

tion necessary for FI's controls. Furthermore, FI has seen cases of outsourcing leading to an inability to develop the in-house expertise of the undertaking in the area, which further complicates the undertaking's control of the operations. In certain cases in which undertakings have opted to outsource operations with which policyholders are in contact, such as claims settlement, FI has found that the undertakings have lacked procedures for registering and managing customer complaints regarding the outsourced operations. On the whole, FI ascertains that outsourcing parts of operations may present conflicts of interest between the willingness of management to enhance the efficiency of the operations, and the interests of policyholders.

The board's responsibility when an undertaking outsources operations

The board of directors and the managing director of an insurance undertaking that chooses to outsource parts of its operations to an external service provider also bear full responsibility for the outsourced operations, and for the service provider conducting the operations as required by regulations. The board of directors and the managing director are also responsible for the undertaking having the order placement expertise needed to impose appropriate requirements on both the expertise of the service provider, and how it executes its duties. It must also be possible to ensure that the internal control and quality of the service provider are satisfactory. Furthermore, the board of directors shall ensure that it receives information enabling efficient control of the outsourced operations. This also includes ensuring that FI can conduct efficient supervision of those operations too.

An insurance undertaking that chooses to outsource a considerable part of its operations to a service provider shall report this to FI. In various supervisory actions, FI follows up on how the undertaking manages its outsourcing agreements, because this forms a natural part of the review of whether it meets the internal governance and control requirements imposed on the operations, irrespective of whether such operations are conducted internally or by a service provider.

The operations of selection centres – outsourced operations?

On the collectively bargained occupational pension market there are selection centres that take care of occupational pension administration. The selection centres manage the premium contributed by the employer to the employee's pension, and provide information to the insured person. They register the insured person's choice of insurance undertaking, and forward contributed premiums to the insurance undertakings. A selection centre thus plays an important role in the occupational pension area and deficiencies in its operations could have considerable implications for a great number of individuals. The selection centres are not under FI's supervision.

It is presently unclear whether the operations conducted by the selection centres shall be considered outsourced operations. It is the parties to the collective bargaining agreements that decide on the role and duties of the selection centres within the bounds of each pension scheme, and the insurance undertakings have no possibility of choosing to execute the duties in-house. Neither can they influence the choice of selection centre. At the same time, many of the duties of the selection centres are such that the insurance undertakings would otherwise have conducted, and for

which internal governance and control requirements shall be fulfilled irrespective of who conducts the operations.

In previous contexts, FI has pointed out the importance of the selection centres satisfactorily fulfilling their duties. Because of the prevailing uncertainties, and a number of complaints received, FI has commenced an investigation at two insurance undertakings regarding the operations conducted by the selection centres instead of the undertaking. The purpose is to identify which parts of the insurance undertaking's operations have been outsourced to selection centres, and how the undertakings concerned control and follow up on the operations. The investigation will result in an assessment of whether the operations of the selection centres shall be considered outsourced operations, and of which control the insurance undertakings are expected to have of the selection centres' operations.

INCREASED PRESENCE OF FOREIGN INSURANCE UNDERTAKINGS

When a Swedish policyholder subscribes to an insurance policy with a foreign insurance undertaking, it is primarily the laws and regulations of the home country of the undertaking that apply. The rules in place to protect policyholders if an undertaking encounters problems may vary from country to country, and it is not always clear whether the rules entail the same protection for an undertaking's foreign customers as for its domestic ones. Also, it is the supervisory authority of the home country that largely conducts supervision of the undertaking. Because of the limited supervisory possibilities, FI has a restricted ability to safeguard the Swedish customers of the foreign undertaking.

Foreign insurance undertakings that insure Swedish private customers and corporations are an increasingly common phenomenon. The regulations for such undertakings are complex, and the operations of foreign insurance undertakings in Sweden can come in many forms. Undertakings can have cross-border operations into Sweden, meaning that they have no representation in Sweden. They can also offer insurance through secondary establishments. The most common form is through a branch. FI determines that in many cases it is difficult for a consumer to understand that he or she has purchased insurance from a foreign undertaking, and the implications of this in terms of consumer protection.

Since 2001 there have been minimum rules in place in the EU, whereby policyholders with claims on an insurance undertaking that goes bankrupt shall have right of priority in the bankruptcy. In other words, the bankruptcy estate shall compensate policyholders ahead of other creditors. This can take time, however.

There are currently no EU rules regarding guarantee systems, in the same way as a deposit guarantee for banking customers. The EU Commission has announced that it would like to see such rules being devised to achieve consistent consumer protection in the EU, but there has been no such regulation to date.

In FI's opinion, Solvency 2 will lead to a greater presence of foreign insurance undertakings in Sweden. Solvency 2 may also lead to undertakings choosing to conduct operations in the form of branches rather than subsidiaries, because the latter requires double the administration in some cases. This tendency towards more branches places great demands on

the cooperation between the national supervisory authorities. It also means that the individual will need to take greater responsibility for procuring the requisite information to make a carefully considered choice.

FI works on an ongoing basis with developing cooperation within the supervisory colleges for the large insurance undertakings with cross-border operations. Through EIOPA, collaboration is also in progress between the Member States to develop the supervision of such undertakings that lack a supervisory college. FI also regularly publishes information on its website about the foreign undertakings authorised to conduct insurance operations.

Important information about foreign insurance undertakings operating in Sweden

In the case of a foreign undertaking, it is important that consumers themselves find out about which rules apply in the country in question. The consumer should also find out how the undertaking has organised it claims settlement and complaints management, in order to know what applies in the event of a claim or dissatisfaction with an insurance policy. If an undertaking is not in FI's company register, this might mean that it entirely lacks authorisation. If this is the case, consumers should be vigilant and seek more information about the undertaking in question.

Current regulatory matters

FI's review shows that the preparations of the smaller undertakings ahead of Solvency 2 are insufficient in many cases. These deficiencies will be subject to specific initiatives by FI. An important question related to Solvency 2 is how occupational pension operations shall be managed. In FI's opinion, undertakings that conduct occupational pension operations ought to come under the same rules as undertakings that conduct life insurance operations. If Solvency 2 is not to apply to occupational pension operations, FI finds it preferable for life insurance undertakings with mixed operations to completely separate the operations.

The Solvency 2 regulations involve considerable changes to Swedish insurance business regulations, and hence completely new conditions for the undertakings. They also present changes in the conditions for the issuance of national regulations, and it will therefore be more difficult to gain an overview of the regulations. This places heightened demands on the insurance undertakings.

The work with Solvency 2 has been in progress for many years and FI has been active in both the European work and in the preparation and implementation of the regulations at the national level. FI has also worked to reduce uncertainty regarding the regulations and to facilitate the adaptation of undertakings to the new rules. The implementation of the regulations is time-consuming work which in itself gives rise to a number of issues on which the undertakings need to take a position, and which they need to manage. Besides, a number of questions remain as yet unanswered, leading to further uncertainty.

In January 2015 FI submitted for consultation its proposals for new and amended regulations ensuing from the implementation of Solvency 2 in Sweden. Because the Government's regulatory work is in progress in parallel, amendments to laws and ordinances may involve amendments to the rules that FI will ultimately issue. When FI makes decisions about the new rules also depends on the Government's work. A bill is expected in June, and Parliament will probably adopt the amended laws in the autumn.

PREPARATIONS OF THE UNDERTAKINGS AHEAD OF SOLVENCY 2

The results of a survey sent out by FI in April 2014 show that the majority of insurance undertakings and groups of undertakings covered by Solvency 2 have current, or completed, projects ahead of the regulations coming into force. As expected, there are relatively large differences in how far the undertakings have come in the preparations, and also in the assessments of how much remains to be done. FI also determines that larger undertakings are generally more prepared than smaller ones, and that there are those that have not yet commenced their preparatory work. This conclusion is also confirmed by the survey carried out by FI in the autumn of 2014 regarding the preparedness of the insurance undertakings to calculate the technical provisions based on the Solvency 2 regulations. FI also sees that there are undertakings that do not have any perception of the expenses entailed by the introduction of the Solvency 2 regulations. This indicates that certain undertakings do not have a clear perception of the scope of the regulations, which FI finds concerning.

Own risk and solvency assessment

A key part of the Solvency 2 regulations pertains to the risk control and governance of the insurance undertaking. According to the regulations, an undertaking shall analyse each part of the operations, measure its risks and calculate the capital requirements generated by the risks. As part of the risk management work, the undertaking shall regularly conduct an own risk and solvency assessment (ORSA) and, based on that, assess its solvency needs. As part of the preparations, undertakings and groups for 2014 and 2015 are expected to conduct a forward looking assessment of own risks (FLAOR) in accordance with the principles that apply for an ORSA. The purpose of the work with FLAOR is to ensure that the undertaking meets the solvency requirements as of the day of the rules coming into effect.

FI's review of the undertakings' FLAOR for 2014 shows that the majority of the undertakings' and groups' assessments of the total solvency need are based on the capital requirements in the Solvency 2 regulations instead of being based on the risks to which the undertaking or group is or could become exposed. Because there may be risks within and outside of the undertaking or group that the statutory capital requirements do not take into consideration, this could lead to the solvency need being misleading. FI also determines that several undertakings or groups have only prepared one alternative scenario to stress their solvency needs, which limits the possibility of analysing the stress levels at which the undertaking or group no longer copes with the solvency requirements. FI has called the attention of the undertakings to these areas of improvement and expects improvements to be made in the FLAOR that the undertakings will conduct for 2015.

In FI's opinion, the work conducted by the authority in the past few years has helped many undertakings, mainly the large ones, to have come relatively far in their preparatory work. At the same time, FI ascertains that a maintained dialogue is important in the continued preparations. The deficiencies highlighted by FI will lead to specific initiatives. Furthermore, FI has the ambition to conduct activities during the year to increase knowledge in the industry about different parts of the regulations. Following the undertakings' demand for further information about the technical aspects of reporting, FI organised an FI Forum[12] on that topic in February.

APPLICATIONS FOR AUTHORISATION

At the same time as the Solvency 2 regulations entail heightened requirements, the undertakings are also given new opportunities in many areas. For example, an undertaking, after obtaining authorisation, may use an internal model to calculate the solvency capital requirement, and undertaking-specific parameters when calculating the capital requirement for certain insurance risks. In order for the undertakings to have the possibility of applying the regulations in their entirety from 1 January 2016, there are phasing-in provisions that enable FI to review cases before the rules come into effect.

Since the end of April 2015, FI has been giving the insurance undertakings the possibility of applying for a review of certain cases in accor-

12 FI Forum is FI's external knowledge seminars for the financial industry.

dance with the phasing-in provisions, despite the regulations not yet having been implemented in Swedish law. The purpose is for the undertakings to be able to apply the regulations in their entirety as of when they come into effect. In this way, FI contributes to a practical solution for Swedish insurance undertakings and insurance groups, and a predictability that can reduce their costs of contingency for various alternatives.

MANAGING OCCUPATIONAL PENSION OPERATIONS IN LIFE INSURANCE COMPANIES

In the proposal to the Council on Legislation regarding the implementation of the Solvency 2 directive, the Government proposes that an insurance undertaking conducting both life insurance and occupational pension operations shall, for a transitional period of four years, for the occupational pension operations follow parts of the currently applicable regulations.[13] For the insurance operations, the Solvency 2 regulations shall apply. In light of the major differences of principle between the regulatory frameworks, the Government ascertains that difficult application problems may arise during the transitional period. For the calculation of the capital requirements for the various parts of the operations, the Government advocates a standard separation of the undertaking's balance sheet, including surplus, into the different operations. This shall then constitute the basis for the capital requirement calculation. In FI's opinion, complete separation is preferable and the occupational pension operations should be considered as a separate fund.

REGULATION OF OCCUPATIONAL PENSION OPERATIONS

In the commission of inquiry New regulation for occupational pension undertakings[14], a completely new occupational pension business act is proposed. The proposal is linked to the applicable occupational pension directive, but some adaptations have also been made to the forthcoming directive in the area. As a way of strengthening consumer protection, the inquiry also proposes rules on solvency, corporate governance and risk management that go beyond the requirements of the directive. In conformity with what applies in the Solvency 2 directive, this inquiry proposes a risk-sensitive capital requirement, but emphasises at the same time the importance of adapting the regulations to the specific conditions that apply to Swedish occupational pension institutions.

In its consultation response, FI has opposed the inquiry's proposal and finds several reasons against the introduction of an occupational pension business act. FI's point of departure is that both the risks in occupational pension and the grounds for regulating occupational pension operations largely coincide with that which applies for insurance operations. Furthermore, FI finds that defined-contribution occupational pension insurance and private pension insurance are basically the same product. FI is thus of the opinion that the protection value for occupational pension is no different from the protection value for other pension insurance. On the whole, it is difficult to see why the regulation of these operations should differ. FI also determines that some of the proposals set forth by

13 The Government proposes that applicable current rules on business, supervision and intervention shall be applied to the occupational pension operations. For such operations, the new rules regarding corporate governance and legal form shall apply where relevant, however.

14 SOU 2014:57

the inquiry entail that consumer protection in occupational pensions would be weaker than that which applies to the insurance area.

It is not currently known how the Government will proceed with the proposal. In FI's opinion, the matter is closely linked to how the question of occupational pension operations in life insurance companies should be managed. If the Government is of the opinion that occupational pension and life insurance operations should be regulated differently, FI is of the opinion that it is inappropriate to allow such operations to be conducted within one and the same undertaking.

Glossary

Adverse selection A distorted selection of policyholders for the insurance undertaking that leads to claims expenses being higher than calculated, and which might lead to the undertaking finding it difficult to fulfil its obligations.

Asymmetric information A situation in which different parties to an agreement or on a market have different access to information.

Branch Operations in the form of a branch office with independent administration but which is not a separate company. The branch can conduct operations in a country other than the undertaking's home country.

Defined-benefit insurance Traditional pension insurance in which the insurance undertaking promises that pension shall be a certain percentage of the pensionable salary which the person has upon retirement.

Defined-contribution insurance Traditional pension insurance in which the policyholder is guaranteed a certain minimum return. The ultimate pension is determined by e.g. the size of the premiums contributed and return on them.

Deposit insurance Life insurance of the saving kind in which the policyholder selects how premiums and return are invested. The capital can be invested in, for example, securities or investment funds.

Discount rate The rate used to calculate the present value of a future payment.

EIOPA European Insurance and Occupational Pensions Authority. A union body in the EU since 2011. EIOPA is a part of the European system for financial supervision and is also an independent advisory body to the European Parliament and the Council.

FLAOR Forward looking assessment of own risks. Part of the preparations ahead of Solvency 2 with the purpose of ensuring that the insurance undertakings can cope with the solvency requirements from the date on which the rules come into effect. FLAOR shall be conducted in accordance with the principles that apply for an ORSA.

Group Two or more undertakings that are bound together by connected ownership structures, such as a parent undertaking and a subsidiary undertaking. Sometimes associated undertakings are also counted as being part of a group (such undertakings in which the owning undertaking directly or indirectly has fewer than half of the votes or otherwise cannot solely exercise control).

Hybrid company Life insurance limited company run in accordance with mutual principles and in which all surplus in the business shall accrue to policyholders instead of being shared with the owners.

Moral hazard Arises when two parties enter an agreement and the behaviour of one of the parties changes by reason of the agreement. Insurance protection reduces the financial consequences of damage and can therefore affect policyholders' behaviour, and hence also the probability of them suffering damages.

Mutual insurance undertaking An insurance undertaking that is owned by its policyholders and in which all surplus is returned to the policyholders. If the undertaking incurs losses, the policyholders' surplus is used to cover them.

Occupational pension fund A mutual benefit society that provides occupa-

tional pension insurance to a certain determined group of people, such as the employees of a certain undertaking or people who belong to a certain group of professionals, etc. An occupational pension fund may not conduct commercial insurance business.

Occupational pension insurance Insurance that pertains to pension benefits that are linked to professional activities and which are based on an agreement regarding pension benefits between an employer and an employee, or their respective representatives.

ORSA Own risk and solvency assessment. Part of the risk management system of an insurance undertaking in which the undertaking, based on its risk profile, risk tolerance and business strategy, shall calculate how much capital is needed to conduct operations in both the short and long term. The ORSA shall provide the management of the undertaking with an understanding of the risks in the operations, and shall therefore form an integral part of the business strategy and be taken into consideration in strategic decisions.

Pension fund A fund that secures the pension obligations of an employer.

Procyclicality When the actions of insurance undertakings lead to an amplification of market fluctuations.

Profit-distributing life insurance undertaking A life insurance undertaking that has had its terms regarding profit distribution in its articles of association or statutes approved by FI. It refers to profit distribution to guarantors in mutual life insurance companies or to the shareholders of a life insurance limited company.

Reinsurance Risk distribution method whereby an insurance undertaking, in return for a premium, insures its own commitments with one or several other insurance undertakings.

Solvency 2 The new solvency rules for insurance undertakings developed in the EU and which come into effect on 1 January 2016.

Solvency ratio An insurance undertaking's own funds divided by the undertaking's solvency margin.

Solvency The ability to honour obligations towards policyholders.

Stress test Analysis of various scenarios to test resilience to unforeseen and negative events.

Supervisory college A forum in which supervisory authorities from different countries, with supervisory responsibility for different parts of an international group, jointly plan and distribute supervision of the group.

Technical provisions The provisions that an insurance undertaking must have to cover future disbursements to policyholders and costs for insurance administration.

Traditional insurance Life insurance in which the insurance undertaking guarantees a certain minimum return on savings, usually through an agreement on a guaranteed insurance amount level.

Unit-linked insurance Life insurance in which the policyholder selects the funds in which the capital shall be invested.

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