

Finansinspektionen's Regulatory Code

Publisher: Hans Schedin, Finansinspektionen, Box 7831, SE-103 98 Stockholm, Sweden.
Ordering address: Fakta Info Direkt, Box 6430, SE-113 82 Stockholm, Sweden. Tel. +46 8-587 671 00, Fax +46 8-587 671 71.
ISSN 1102-7460

This translation is furnished for informational purposes only and is not itself a legal document.

FFFS 2000:5

Finansinspektionen's general guidelines regarding underwriting risks and reinsurance risks in insurance undertakings;

decided on 30 May 2000.

Finansinspektionen provides the following general guidelines.

Introduction

These general guidelines refer to the management of underwriting risks and reinsurance risks in insurance undertakings and include direct insurance as well as accepted reinsurance and reinsurance cessions. They primarily address non-life insurance, but apply where applicable to all types of insurance.

Underwriting risks and reinsurance risks refer to both pure insurance risks and risks that may arise during administrative handling. These general guidelines address both of these types of risks, which are not foreseen when setting premiums.

Systems for identification, control and follow-up of risks can be designed differently in different institutions. These general guidelines are therefore general in nature and can accommodate different solutions. For example, for insurance based on collective bargaining agreements, only parts of sections 4, 7 and 8 are applicable.

The requirement set out in Chapter 2, section 3, Chapter 3, section 2 and Chapter 19, section 1 of the Insurance Business Act (1982:713) that the business of an insurance undertaking shall be conducted in accordance with the Insurance Business Act and other regulations governing the business of insurance undertakings serves as the basis for these general guidelines.

Definitions

Section 1 In these general guidelines:

- *ceding undertaking*: direct insurance undertaking that reinsures large or small portions of its direct insurance activities with another insurance undertaking,
- *retro-ceding undertaking*: insurance undertaking that reinsures large or small portions of its accepted reinsurance business with another insurance undertaking,
- *Estimated Maximum Loss (EML)*: the maximum loss from a single event that could affect an insurance object (or multiple objects in the event of *accumulation*),
- *EML breakthrough*: losses larger than expected based on the EML calculation,

- *accumulation risk*: risk for losses caused by risk concentration, e.g. via multiple insurance objects so closely correlated that the insurance provider risks as the result of a single event incurring a loss on all or more than one of these objects, and

- *adverse selection risk*: the effect of setting premiums in such a manner that poor risks benefit at the expense of better risks, which e.g. means that the risk group's aggregate loss outcome gradually worsens.

Governance

Section 2 The board of directors should establish guidelines (policy) that are in agreement with the articles of association and operational targets. Both direct insurance and accepted reinsurance should be covered by the guidelines and, within the framework of the undertaking's operations, the guidelines should aim for a satisfactory risk spread and otherwise appropriate composition of the insurance portfolio given the undertaking's solvency.

With regard to reinsurance cessions, the board of directors should adopt a reinsurance program that is suited to the undertaking's unique risk coverage resources and in general in agreement with the undertaking's business and underwriting guidelines.

To the greatest extent possible, the guidelines and system of rules established by the insurance undertakings for their insurance management should minimise unforeseen risks.

The guidelines should be reviewed regularly and adjusted for changes to the undertaking's business.

Underwriting risks

Section 3 Unforeseen risks may arise as a result of deficiencies in the underwriting process. These deficiencies may lead to a poor risk spread or too much risk concentration in certain markets. They can also result in the incorrect classification of risks and, thusly, premiums that are calculated to cover risks for a different type of insurance portfolio. Furthermore, an incorrect classification can lead to incorrect reinsurance and subsequently higher retention than was intended.

Unforeseen risks can also arise if, at the time of underwriting, efforts are not made to confirm that uncovered reinsurance exists to the extent assumed in the reinsurance program.

Underwriting instructions

Section 4 The board of directors should ensure that every insurance class or risk group has underwriting instructions that comply with the guidelines. The underwriting instructions should include:

Underwriting limits and rules of procedure

The underwriting instructions should include general underwriting limits for all areas covered by the instructions. The instructions should also include:

- maximum gross commitment per risk, estimated maximum loss (EML) that takes into account the undertaking's solvency, liquidity and the reinsurance capacity judged to be available,
- retention limit per insurance class, risk group or individual risk that is in line with the undertaking's reinsurance program,
- rules of procedure for underwriting, and
- individual underwriting limits taking into account the position of responsibility and competence held by each decision-maker.

Insurance registration

Section 5 The undertaking should draw up a system and procedures for registering all insurances. Registration should take place without undue delay. The underwriting instructions should state the routines the undertaking has adopted for reinsurance registration.

The undertaking's underwriting instructions should be designed to ensure the registration of insurances.

The registration should state the type of insurance, its scope, the EML amount, retention and reinsurance. The system should be designed in such a manner as to facilitate the effective monitoring of accumulation risk. Furthermore, the system should be designed in such a manner to ensure that the information required to calculate the risk profile for the insurance policy is available.

Handling insurance documents

Section 6 The underwriting instructions should specify the information the insurance documents should provide regarding the relevant conditions for the assessment of the insurance policy. The instructions should also state how insurance documents shall be stored.

When storing insurance documents, account should be given to the insurance contract's duration and period for final claim settlement following incurred damages.

Insurance documents should be stored safely and satisfactorily.

Risk assessment

Section 7 For each insurance class or risk group the underwriting instructions related to risk assessment should include

- instructions and guidelines for risk assessment,
- instructions for follow-up and renewal of insurance,
- definition of the areas within the undertaking's business regarded as having accumulation risk,
- instructions and guidelines for managing accumulation risk, and

- instructions and guidelines for managing adverse selection risks.

For non-life insurance (insurance class 1-18) the underwriting instructions should include the following related to risk assessment:

- management of individual risks of such scope that the actual retention in the event of an EML breakthrough or accumulated loss risks exceed the undertaking's maximum retention or the maximum retention set out in the technical guidelines and technical documentation, and
- the level of any uncovered risk via facultative reinsurance.

Furthermore, with regard to non-life insurance, it should be taken into account that insurance for which facultative reinsurance is required should not definitively be accepted before the uncovered insurance is considered secured.

Where underwriting contracts have long settlement periods, the underwriting instructions should take into account the specific risks that may arise due to these types of insurances.

For credit or suretyship insurance (classes 14 - 15) the following should be taken into account:

Obtained liens in credit or suretyship insurances should not be able to replace uncovered reinsurance if the actual retention risks exceed the maximum retention set out in the technical guidelines and the basis for the technical calculation.

When assessing the risk of loan guarantees within credit insurance, the difficulty in settling such insurances without a claim arising, which extends the arrangement, should be taken into account.

For accepted reinsurance within each insurance class or risk group, the provisions set out above in respect of direct insurance apply. Furthermore, the underwriting instructions for accepted reinsurance shall include the following:

- how reinsurance agreements should be designed,
- the assessment of counterparties' (ceding undertakings or retro-ceding undertakings) solvency and capacity to pay,
- consideration for the accepted insurance risk's share of total risk and the actual risk exposure that this share entails, and
- systems for feedback to the reinsurance cession to avoid increased risks associated with retrocession spirals.

Setting premiums

Section 8 With regard to setting premiums in standardised premium calculation systems, the undertaking should establish routines to ensure the quality of the process thereof.

With regard to individual, non-standardised premium calculations for individual insurance involvements, the underwriting instructions for non-life insurance (insurance classes 1-18) should include the following:

- premium arguments based on technical assessments and their impact on the premium calculation, and
- premium arguments influenced by commercial considerations, e.g. discounts due to competition, etc.

Insurances brokered by insurance brokers

Section 9 The undertaking should establish guidelines that establish the conditions for the undertaking's acceptance of insurances brokered by insurance brokers. These guidelines should include a verification that the broker is registered with Finansinspektionen for the insurance class being brokered and that the broker has the required liability insurance.

With regard to insurance brokered by an insurance broker, the undertaking should furthermore conduct its own assessment of the underlying risk profile. The undertaking should always verify the EML calculations provided by insurance brokers.

Where insurance brokered by insurance brokers includes conditions that differ from the conditions normally applicable to the undertaking's insurances, a special assessment of the risks that could arise from these conditions should be conducted.

Reinsurance risks

Section 10 Unforeseen reinsurance risks can arise due to insufficient, incorrect or deficient reinsurance protection. Such risks can arise if the insurance undertaking's reinsurance program is not in line with the business conducted by the undertaking.

Deficient communication between insurance undertakings and reinsurers can also cause unforeseen reinsurance risks, for example via incongruencies between the insurance's original conditions and the conditions of the reinsurance agreement.

Reinsurance program

Section 11 The reinsurance program should include

- a list of the undertaking's active reinsurance agreements including, where applicable, group reinsurance agreements that specify retention and limits,
- principles for uncovered reinsurance in each insurance class or risk group, taking into account what within the undertaking has been defined as "a single risk" and "accumulation risk",
- retention limit in each insurance class and risk group. In non-life insurance undertakings, when establishing the retention limit, the undertaking should take into account the maximum retention set out in the technical guidelines and basis for the technical calculation,
- general guidelines for choosing a reinsurer, and
- guidelines for reinsurance cessions in groups to which the undertaking belongs.

Reinsurance cessions

Section 12 The undertaking should issue instructions for the management of reinsurance cessions that are in line with the undertaking's reinsurance program and instructions for underwriting. These instructions should include

- an assessment of the reinsurer's solvency and capacity to pay (security),
- the design of reinsurance contracts and reinsurance agreements, and
- a reporting and set-off procedure (system to ensure reporting to reinsurers).

With regard to reinsurance cessions, in order to avoid an excessively high retention, instructions should be issued for management of any EML breakthroughs.

Reporting

Section 13 The board of directors should ensure that an information system is in place that in a structured and appropriate manner provides information about underwriting and the associated risks.

Furthermore, the board of directors should also ensure that it, and other persons or bodies responsible within the organisation, regularly receives relevant information from the information systems.

These general guidelines shall enter into force on 1 July 2000, whereupon Finansinspektionen's general guidelines (FFFS 1995:48) regarding the management of underwriting risks and reinsurance risks in insurance undertakings shall be repealed.

CLAES NORGRÉN

Ingrid Gavrell Ullman
(Insurance Market Unit)