THE EVOLUTION AND PERSPECTIVES OF IMPLEMENTING SOLVENCY II REQUIREMENTS ON THE ROMANIAN INSURANCE MARKET

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Abstract:
Solvency II represents a great challenge for the European Insurance Market, in the laborious approach of creating a unitary framework, based on uniform supervising standards, adjusted to the complex risks which the financial system meets. Domestic models of determining the capital demands offer a source of competitive advantage to the pro-active players who have started implementing coherent systems of risk management. The final objective of Solvency II is offering to its insured persons a high level of protection. In subsidiary, the new regulations /settlements will sustain the increase of the integrating degree and of the insurance market competition Within the European Union in order to improve the competition between the European insured persons at an international level.

Key words: *Solvency, Insurance, Risk Management, FSA*

JEL Classification: G22

1. Features of the present development in the insurance services

1.1. The crisis impact on the field

Due to the financial liberalization, deregulation and innovation, insurance markets have become even more connected to the capital market and to the financial system in general. Insurance ways have appeared on the capital markets like other products such as derived instruments. Moreover, the insured persons offer even more products to save and to invest, similar with the banking products and the investments funds. The interaction and convergence of the financial market, in general and the insurance market, in special have determined issues related to the field settlement, specific elements related to the risk, being determined, in their turn, by the national regulation systems.

However, the insurance industry entered a crisis period on a stronger position and was not so much affected than the banking sector due to the nature of the specific business model. This means that the insurers, illegally undertake responsibilities on a long term, coordinating them with the investments on the same period in ”sure” instruments, while the banks do not have the same sequence between assets and liabilities, thus being more under the risk of ratio and over-liability. The stress tests the analysis of different scenarios required by the supervising authorities from many countries (Great Britain, Germany, Holland) **have proved the field steadiness.** The main activities of the insurers do not generate systematic risk, the ”classical” insurance products do not generate that type of risk which could determine a financial crisis: this aspect should also be understood under the context in which the activity of the multinational banks is mainly global, while the insurance services take place in national spaces.

The financial crisis has proved the necessity to adjust to measures of economic and legal policy in order to make the difference between the banking and insurance sector, even if some of them are common, thus available for both sectors. (Ciurel, V. 2011).

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Considering the interaction, more and more important, between different types of companies on the financial and insurance markets that can determine complex problems, including the systematic instability, context in which the authorities of regulations and supervision have a very important role to make sure that, in cooperation with similar authorities in each country, cooperates and settles a proper supervising and controlling system for the complicate insurance markets and for the participants on these markets. This adds to the main role of the supervising insurance authorities, that of keeping financial steadiness and of the insured persons protection.

The lower impact of the crisis on insurance can be explained by the improvements in the risk management, organizing and managing companies in the last years, even if these can be still improved substantially in order to anticipate future losses of the customers and shareholders. OECD and IAIS have cooperated beginning with the spring of 2008 to settle a new governing model of the insurance companies. Among the recommended changes because of the crisis can be mentioned http://unsar.ro/politici-şi-reglementari-post-criza):

- **improving risk management usages** – the integrated approach of the risk, efficient communication and implementing reporting systems proper to identify, evaluate and control the risks; redefining the function of risk management which will have to be independent within a company;
- **the boarding members of the insurance company** to have enough knowledge and experience to manage the company, an essential condition because of the complexity of the insurance products and the financial markets;
- **the remuneration system to consider the nature of the insurance,** to be motivating for a proper behavior related to the assumed risks – on a short and long term, both at the company level and the suppliers of insurance services;
- **risk assessment made by the rating agencies to be filled with own assessments of the company.**

1.2. Requirements adjustment concerning the insurance solvency

The evolution of these products had another feature: since the autumn of 2004, the European Commission proposed to the European Committee for those settling the regulations and supervisors in the field of insurance and occupational pensions (EIOPC), the text of the adjustment project, improving 13 directions (which became 14 after adjusting the direction concerning the reinsurance), known as Solvency II Direction.

Actually, reviewing the calculation way of the solvency and the risk management standards for the insurance within the European Union lead to the new direction concerning solvency, known as Solvency II, the exact name being DIRECTIVE 2009/138/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) since November 25th 2009.

Later, on January 19th 2011, the Commission adopted a proposal (”Omnibus Proposal II”), to adjust the Direction 2009/138/CE to consider the new architecture of supervising in the insurance field, meaning the creation of the European Supervising Authority (The European Authority for Insurance and Occupational Pensions). The Omnibus II Proposal also includes provisions to prolong the terms of transposition and to postpone the application date of the Direction 2009/138/CE and to postpone the abrogation of the Solvency I date.

The Direction will be applied for all the insurance and reinsurance companies with a yearly volume of premiums of more than 5 millions of Euro or with technical reserves of more than 25 millions of Euro. Though, **Solvency II** regime was approved in November 2009, according to the Lamfalussy process (which has as an objective simplifying and accelerating the legal process of the EU in the field of financial services, in which, both insurance and occupational pensions within a four level plan), this direction will have to be used in the national legislation of each member state. The initial implementation plan dates October 2012,

but the term was extended for all the European countries (including Romania). According to the figures of the Insurance European Federation - CEA, from the about 5.000 insurance companies from Europe, about 3.600 will go under the incidence of Solvency II, but only 65% from these have participated at the impact quantitative studies QIS5.

Solvency II Direction will lead to **a new approach of the supervision process** at a common European level based on economic principles to measure assets and liabilities, considering the great variety of risks of the company and using common principles to set the capital level, updating the calculation methods of the insurance companies in case of unusual situations.

The central elements of the Solvency II regime are quantitative and qualitative, on a three level approach.

Level I refers to setting some quantitative requirements concerning capitalization, this being observed with the aim to increase flexibility, a two dimensional system to determine it (the existence of a minimal social capital, and the possibility to settle it basing on solvency).

Thus, one aims to guarantee a proper protection of the insurer, in order to keep the market competition.

Level II will create the frame by which to allow the supervising authorities to make a global assessment of risk management within insurance companies: the general strategy to subscribe, damages, protection by giving up in reinsurance.

Level III will introduce a ”discipline effect” of the company management the field, providing an increase of the organizational transparence.

Implementing **Solvency II Direction** will have a great influence on the risk approach, capital, products, business mix, prices, distribution, in operational process of the insurance industry as a whole and for this reason, the general fundamental frame and the modalities of supervising the insurance. The direction aims to approach solvency in a complex way determined by the realities of the present financial world and by the complexity of the risks undertaken by the insurers in their activity. Moreover, these requirements do not aim only the capital optimization, but they will also affect the present risk management procedures, the architecture of the data basis, audit function, being even necessary to create new responsibilities in order to integrate the requirements into organization.

Graphic no. 1 The structure of Solvency II requirements

Within the process of developing the implementation measures at level 2 related to the Direction 2009/138/EC, in March 2010, the European Commission asked the Supervising European Committee from Insurance and Occupational Pensions (CEIOPS) organizing the fifth study of quantitative impact QIS5.

2. Romania and Solvency II requirements

The initial program of implementation for Romania was also advanced with one year. The principles of Solvency II Direction will have to be implemented by all member states in the European Union beginning with January 1st, 2014 and represent a set of deep transformations, both for Financial Supervisory Authority institution and the supervision bodies.

FSA - the Financial Supervisory Authority in Romania has been established in May 2013 under the Law for adopting the Government Emergency Ordinance no.93/2012 as an autonomous, independent, self-financed administrative authority with legal personality. The new structure will operate by taking over the attributions and functions of CNVM - the Romanian National Securities Commission, CSA - the Insurance Supervisory Commission and CSSPP - The Private Pension System Supervisory Commission, authorities that were dissolved.

Application of Solvency II in Romania meant a very good cooperation between CSA - the Insurance Supervisory Commission and the insurance companies, a process which meant setting the own calendar for correct understanding and assimilation of all the necessary adjustments – legal, organizational and professional ones.

Since QIS5 exercise is considered by the European Commission as being the real test to validate the implementation measures and to calibrate Solvency II, the European Commission for Insurance Supervision made efforts to sustain the insurers from Romania to attend this exercise.

Thus, CSA made interviews with important within the 28 insurance companies on the topic of Solvency II and QIS5. CSA also received, verified and centralized all reports sent by insurers according to the technical specifications of QIS5, in order to draw the country Report QIS5, asked by EIOPA in order to integrate the report at a European level.

2.1. Objectives and results of QIS5 exercise

Requirements for the Romanian insurers

- providing detailed information to all interested parties related to the quantitative impact on the balance drawn by the insurers/ reinsurers in accordance with the implementing measures at level II, comparing to the existing situation according to the present regime of Solvency – Solvency II;
- verifying the fact that the technical specifications of the exercise are in accordance with the cooperation principles and aims set up by the frame Direction, of level I, concerning Solvency II;
- encouraging insurers/reinsurers and supervisors to prepare themselves to introduce Solvency II and to identify the fields where the domestic process, procedures and infrastructure need to be improved, particularly encouraging insurers/reinsurers to improve the process of collecting data.

Conclusions of QIS5 Report for Romania

1. Financial impact

Considering the transition from the present supervising regime to Solvency II, which, globally can be characterized by an increase of the capital requirements, a decrease of the technical reserves values and an increase of the eligible funds values, financial position of the insurance sector in Romania remains a stable one: the resulted surplus (SCR) resulted according to the QIS5 technical specification is only 17,47% smaller than the surplus of the current regime, for the insurance sector in Romania.

2. Assessment methodology and design

According to the results and comments of the qualitative questionnaires in case of QIS5 exercise, one can conclude that Solvency II design was highly supported. However, in order to provide a consequence and compatibility, the assessment methodologies of the technical reserves (definition of the limits in case of insurance contracts, calculation of risk margin) and of the postponed taxes need further analysis.

3. Calibration of standard formula

QIS5 tested if the system is correctly calibrated (sized), if for SCR the trust level of 99.5% is provided for a period of one year. Generally, even if the results proved this, however, some areas have been identified, where further calibrations are needed: catastrophe risk, cancellation risk for the general insurance, premium and reserves risk for general insurance. One can mention that EIOPA works for these recalibrations.

4. Feasibility and complexity (SII System aims both small companies and middle and big ones)

After analyzing the information sent by insurers by attending QIS5, some fields within Solvency II Regime have been identified which could take advantage of more simplicity (either by a less complicated design of the standard formula, or by means of simplifications), on condition to be captured properly all the quantifiable risks. These are: failure risk calculation of the counterparty, adjusting calculation for the capacity of the postponed taxes and the technical reserves to cover the losses, catastrophe risk design, assessment of the possibilities and guarantees stipulated under the insurance contracts, risk margin calculation.

5. Preparing to implement Solvency II

The large rate of participation at QIS5 provides a positive message concerning the fact that the insurance sector prepares to implement the new supervising regime. Though the OIS5 reports of the insurers show that some fields should be improved: data quality, IT systems, human resources training, however, there were positive signals, all the participants mentioning that they will be ready when coming into force the new supervising regime.

2.2. The situation of the Romanian insurance market, according to Solvency I, between 2007-2011

The degree of solvency and the insurance funds that an insurance company should permanently have, registered increase, between 2007-2010, while 2011 was the first year which brought a decrease, both for general insurance and life insurance, is shown in the report of 2011 concluded by the Insurance Supervising Commission (ISC) and published on the institution site.

Analyzing the value evolution of the available **solvency margin**, one can observe that for the general insurance: in 2011, it was a nominal decrease of 87.193.098 lei, which means **4,10%**. Eliminating the inflation influence showed a stronger decrease, that is **198.934.582 lei (-9,36%).**

For life insurance, the available solvency margin registered a nominal decrease of 190.516.421 lei, that means in real terms a cut of 246.921.972 lei. The whole amount of assets free of any task, excepting non-corporal assets correspond with Solvency Margin.

Table no. 1. The evolution of the available Solvency margin between 2007-2011

The available solvency margin	**31/12/07**	**31/12/08**	**31/12/09**	**31/12/10**	**31/12/11**
General insurances	1.615.625.237	1.856.450.935	2.012.033.024	2.125.511.889	2.038.318.791
Life insurances	666.682.358	944.393.619	1.199.193.246	1.219.431.465	1.028.915.044

In the field of general insurance, according to the aggregate calculation, the middle Solvency degree was, at the end of 2011, at 2,13, a mainly similar level with that of 2010, that is 2,21. This result has been registered in the context of lower level for the subscribed premiums, as well as the net loss resulted from the activity done, is shown in the ISC report.

Table no. 2. The evolution of the Solvency average degree between 2007- 2011

Level of middle solvency	31/12/07	31/12/08	31/12/09	31/12/10	31/12/11
General insurances	2,38	2,14	2,15	2,21	2,13
Life insurances	3,85	3,64	4,46	4,29	3,93

For life insurance, the average Solvency degree registered at the end of 2011 was of 3,93, in a slow decrease comparing to the level of 4,29 for 2010. This negative evolution was determined by the net loss registered in the field of life insurance.

In the same report of ISC of 2011, there is also mentioned the fact that Solvency II directions are considered, which introduces two capital levels minimal capital requirements (MCR) and solvency capital requirements (SCR), so that if the own funds of the company are lower than the minimal capital, SCR will start a last resort action (of withdrawing the license), and if the own funds are lower than the solvency capital requirements, the supervising authority will make supervising measures according to the situation of the company.

According to these, in March, 2011, ISC sent a questionnaire regarding the level of all actions taken for implementation of the requirements included in the Solvency II Direction to the Romanian insurance companies.

The replies received by ISC for this questionnaire shows that five insurers analysis the possibility of using a domestic patterns for the Solvency capital requirements calculation. Considering all these aspects, within ISC, a document was elaborated regarding the documentation requirements for the process of pre-applying for domestic patterns, which will be applied at a local level, is mentioned in the quoted document.

There is also important for ISC activity the fact that, the Council for the Insurance Supervising Commission (ISC) agreed in 2012 with the strategy for the period between 2012-2016 and the action plan for achieving the aimed targets.

The two main general objectives of the ISC strategy approved for the period between 2012-2016 are:

- consolidation of the supervising authority at a national and international level;
- elaborating a regulation frame to support the insurance market development.

The evolution analysis of the Romanian insurance market and the domestic and European context were the main aspects considered to set up the ***strategic objectives***, which aim two large fields and involve action policies clearly defined by the strategy:

- Improving the institutional capacity of the Financial Supervisory Authority.
- Changing the supervising philosophy, by replacing the 'accordance' supervising with the one based on risk assessment, this representing the preliminary stage necessary and essential for implementing the requirements of the European Directions Solvency II and Omnibus II.

On a short term basis, the principles of Financial Supervisory Authority are concentrated on four three areas: reforming the regulation frame, with a stronger accent on the activity of managing the financial stability of the company and with the insurance brokers and developing the initiatives aiming the improvement of the consumer protection.

3. Conclusions

At the level of the insurance industry, the evident effects of the crisis – besides the financial aspects – consist of the increase of the liquidity risk and the insolvability risk. These aspects are approached by the statutory principles at the three levels on which the regulations of Solvency II are built.

Considering the fact that Solvency II project was developed and analyzed from the quantitative impact point of view before the crisis at the level of global economy, it is obvious to appear a set of questions about the availability of some provisions and the necessity of adjustments to consider this real test of stress of the financial system, broadly and the insurance industry, especially.

Even if practice will prove or not the Solvency II provisions, the present crisis confirmed the importance of many principles promoted by these.

Certainly, a capital level correlated with the risk profile, a closer supervision of the insurance industry operations and the increase of the responsibility degree are necessary measures that can only make the insurance industry even stronger. No matter the efforts of updating the normative frame, experience proves that the provision and supervising system tends to react rather late and it develops an inertial mechanism comparing with the market evolution.

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