Insurance/Reinsurance - Sweden

Proposed Reform of Solvency Rules for Insurance Companies

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Following the Financial Supervisory Authority's launch of a new supervisory system - the traffic-light model - at the beginning of 2006 and the recent publication of the proposed amended version of the model (which should be introduced in December 2006), the Ministry of Finance has recently presented a proposal for the reform of solvency rules for insurance companies.

While the regulations currently in force are based on what can best be described as a quantitative approach characterized by its explicit rules (eg, limitations on investment guidelines), the proposed regulations are based on a more qualitative approach, which is intended to be more flexible.

'Prudent Person' Principle

The ministry suggested that the qualitative approach be built on the 'prudent person' principle (which is already applicable to risks in most life assurance companies), which will affect the measurement of insurance risks in a number of ways. One significant change is that investment decisions will no longer need to be analyzed separately; on the contrary, the impact on the entire business of each insurance company will be considered.

The ministry also suggested that the measurement of technical reserves should be based on reasonable, 'prudent' assumptions of the insurance commitments, as opposed to today's safeguard assumptions. In practice, this means that technical provisions should be based on a realistic valuation of the insurance agreements entered into by the insurance company. Moreover, the assets matching the technical provisions will be calculated on the basis of real value.

The current regulations on investment guidelines will continue to apply only to matching assets. Furthermore, it is proposed that the restrictions on permissible investments and the limitations on investment in certain types of asset should be lifted to the extent possible given the EU regulations in force.

Security Margin

A realistic valuation of insurance undertakings may lead to a temporary reduction in technical reserves, resulting in a corresponding reduction in matching assets and the value of policyholders' priority rights. In order not to impair policyholders' rights, it was thus suggested that a security margin should be introduced as a buffer capital requirement in addition to the existing EU solvency margin requirements.

Whereas the solvency margin can be seen as a static tool (not taking into account the diversification level of the matching assets or the extent to which these assets match the technical provisions), the security margin is intended to form a risk-sensitive capital buffer defining when supervisory action will be triggered. The following risks will be taken into account when determining the security margin:

- insurance risks;
- financial risks (eg, market risks and credit risks); and
- operational risks.

Assets corresponding to the security margin will be registered and subjected to policyholders' priority rights.

The security margin will initially be calculated according to a standardized model developed by the authority. Insurance companies will subsequently be allowed to develop individual models of calculation.

Solvency II Project

According to the ministry, the proposed regulations are - as far as can be foreseen at this stage - in line with the key aspects of the ongoing Solvency II Project. The regulations are thus expected to bring about a smooth implementation of the future EU Solvency II Directive.

The new regulations should take effect on January 1 2008. It was suggested that the development of individual models for calculating the security margin should be allowed as of January 1 2010.

Comment

In light of the expansion of the traffic-light model to all insurance companies announced earlier this year, the proposed reform of the solvency system for insurance companies makes it clear that Sweden will not await the completion of the Solvency II Project. However, following Sweden's implementation of the EU Directive on the Activities of Institutions for Occupational Retirement Provision (2003/41/EC), all major life assurance companies have already adapted their asset-liability management to the 'prudent person' approach. The proposal is thus expected to have more impact on non-life insurance companies and life assurance companies that do not offer products governed by the Directive on the Activities of Institutions for Occupational Retirement Provision.

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