FIN-FSA
FINANCIAL SUPERVISORY AUTHORITY

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Public

Life and non-life insurance companies

CEO

With this letter, the Financial Supervisory Authority (FIN-FSA) wishes to draw the attention of companies to certain findings highlighted in supervision during 2019 and at the same time to express the supervisor's expectations in respect of them in 2020.

In general, Finnish insurance companies are well managed, and solvency is on a good level. Increased uncertainty, however, requires companies to prepare even better for risks by improving their management and securing their solvency.

Under the Insurance Companies Act[1], the Board of Directors and the CEO are required to manage the company in a professional manner, in accordance with sound and prudent business principles and good corporate governance practices. In their activities, companies must also comply with the precautionary principle[2]. The purpose of the precautionary principle is to ensure that the insurance company's own funds, reinsurance and other factors affecting the company's solvency are arranged in a manner that protects the insured interests.

ORSA must be a key management tool

The general principles governing the management of an insurance company and the organisation of its activities are reflected in the actions and decision-making of the Board of Directors and in the practical implementation of decisions. A key element is the company's own risk and solvency assessment (ORSA), which takes a position on, among other things, the capital required, the company's risk profile in relation to the solvency requirement, and fulfilling capital requirements as well as requirements related to technical provisions.

Built and functioning according to its objectives, the ORSA is based on a deep understanding of the company's own business model and the identification of business risks and the factors underlying them. It acts as a link between the company's strategy and business operations and the determination of solvency needs. With the support of the ORSA, the

[1] Insurance Companies Act (521/2008), chapter 6 section 2 subsection 2.
[2] Insurance Companies Act (521/2008), chapter 1 section 16.

company will also be able in the future to fulfil the promises it has made to policyholders.

Board of Directors' role in the ORSA process is essential

The Board of Directors should participate actively in the ORSA process by, for example, questioning the assumptions of analyses, the choices made during the process and the results of the assessment. In the FIN-FSA's view, this requires more input from the Board. The process may begin, for example, with a Board referral discussion, providing guidelines for the preparation of the ORSA. The company should also specify the assessment principles used in the ORSA, describing the procedures to be used and the roles of the parties involved in the process.

Scenarios and stresses must be applicable to the company's own activities

When discussing the ORSA, the company's Board of Directors may challenge the effectiveness and viability of the selected business model by requiring the use of stresses that are relevant from the company's perspective. In addition to stresses concerning the external environment, the company should also extensively use internal stresses and scenarios that reflect the company's own risk profile. The ORSA should justify why the stresses and scenarios used in it have been selected as the basis for analysis.

In addition, the FIN-FSA requires that scenarios also take into account the combined effects of serious events as well as realistic management actions in such situations. The stresses and scenarios used must be so severe that the results can be used to assess the company's solvency also in the unlikely but possible event of risk situations being realised.

The FIN-FSA monitors the impact of low interest rates on the solvency of companies

At the European level, EIOPA will not carry out stress tests for the insurance sector in 2020[3]. Moreover, the FIN-FSA will not carry out a full stress test exercise in 2020. However, in the recommendations issued on the basis of the previous stress test carried out in 2018, EIOPA urged national supervisors to ensure that companies take sufficiently into account in their own risk management and ORSA the risks stemming from a possible decline in the interest rate curve, for example.

The FIN-FSA will specifically request for use in its supervisory work certain calculations made with predefined scenarios, particularly with regard to the effects of low and possibly falling interest rates. Companies may, if they wish, use these definitions as part of their own ORSA process and the calculations made therein.

Companies should exercise restraint in profit distribution

Unless otherwise provided for in its articles of association, the purpose of the activities of an insurance company is to produce a profit and, in a mutual company, also other economic benefit. The Insurance Companies Act requires, however, that in the pursuit of a profit or other benefit the

[3] In the future, the intention is to carry out stress tests every three years, and next in 2021.

company take into account the principles set out in insurance activities legislation to protect the interests of the insured.

A well-constructed ORSA process will be able to identify and assess the company's profit-distribution capacity, taking into account the ongoing adequacy of capital, even in highly unlikely situations. The FIN-FSA requires that this consideration also be taken into account in the longer term when assessing total capital needs.

In a survey of compliance with the principle of equity (to be published in December), the FIN-FSA recommended that companies, in the current challenging investment environment, should exercise restraint in their profit-distribution policies. This reminder should continue to be taken into account in order to protect the interests of the insured.

Changes in operating environment and impact of low interest rates should be taken into account

The business environment of the life insurance sector, in particular, has been challenging this year due, among other things, to uncertainties related to the development of investment markets. Various legislative changes, for example in the area of taxation and savings products, are likely to change the behaviour of insurance companies' customers and therefore the companies' competitive position.

The FIN-FSA expects companies to critically assess their accounting assumptions that are vulnerable to change, and to modify them quickly, if necessary, when the operating environment and, for example, customer behaviour change significantly.

Groups should pay particular attention to conflicts of interest

When conducting insurance business as part of a group, particular attention should be paid to the relationship between individual insurance companies and the group. Potential conflicts of interest should either be prevented or managed. Conflicts of interest may arise, for example, if the same person has both operational responsibility and a supervisory role in different companies of a group.

The FIN-FSA also draws entities' attention to the fact that regulatory requirements set for corporate governance and risk management, for example, must be fulfilled at the level of both the individual company and the group.

Statutory reports to be submitted to the FIN-FSA

In order to function, business operations and risk management need lots of data to support decision-making. The accuracy and timeliness of the data used are critical from a risk-management perspective. Moreover, it is a prerequisite for the effective functioning of the supervisor that companies submit statutory reports in a timely and correct manner.

In the reports submitted to it, the FIN-FSA has observed significant deficiencies that companies should have identified in their own quality control. Shortcomings have been evident, for example, in the information of individual investment instruments and as inconsistencies between different reports. The FIN-FSA requires companies to pay attention to the adequacy of their quality control processes, to reporting dates and to the accuracy of the data reported to the FIN-FSA. Shortcomings observed in the reporting of individual supervised entities will be reported separately to the entities concerned.

For further information, please contact the financial supervisor for your individual company and, more generally, Head of Division Teija Korpiaho, tel. +358 46 87 69 600 or teija.korpiaho(at)finanssivalvonta.fi