SUPERVISION ON THE SINGLE EUROPEAN INSURANCE MARKET – INTERACTION BETWEEN REGULATION AND COMPETITION

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Even though the financial markets have developed in the last decade, new requirements became strictly needed in order to create a common ground for the national markets and in the same time to enhance the development of the global market. If the authorities in fields began their activities as simple regulators, their role included also a new scope – the one of monitoring the relationship between the suppliers of products and services and the customers. Such a development can be noticed in insurance industry, all over the world, especially in the European territory, starting with the Solvency II project that intends to offer sounder financial stability for the insurance companies and higher transparency towards the clients and the supervisors.

Key words: prudential, solvency, supervision

Competition and supervision share one of their ultimate objectives: the interest of the consumer and client. Historically there had been a quite different legislative approaches to secure consumer protection in the financial sector, more over on insurance industry.

Before the European deregulation come into force in the early 90s, the main idea in many countries had been to highly regulate companies, products and pricing of the sake of policyholders. This approach had been working for many decades without producing major insolvencies and losses for consumers. Form a today's perspective this can be considered the centralized system of state regulated industry, with subordinated options for competitors.

In those days, supervisory authorities were assigned the job as competition authorities within the financial services as well ass the job of financial regulation and supervision. However and under tension or even a conflict of interest between the objective of competition and supervision the two functions have been separetated.

Supervision and competition on the insurance markets

For more than 10 years now insurance regulation and supervision developed quite new objectives and innovative instruments. It had always been an developing process including some transitional steps with term "supervision" not any longer described to cover the design or pricing of products but in a wider sense as the permanent process of monitoring that financial institution comply with the regulation, and the process of taking remedial action to secure the objectives of regulation. Parallel to the supervisory process these 10 years have seen increasing competition processes between insures in national markets as well as in cross-border business.

Two aspects of supervision might be noticed: prudential supervision and conduct of business supervision. Prudential supervision is monitoring the soundness of individual financial institutions, as whether they have the ability under all reasonably foreseeable circumstance, to fulfill their obligations as they fall due. To put it simply, supervisors assess individual financial institutions – the specific risk circumstances of each bank or insurer. The supervisor needs to tailor supervision and any action taken to the risk profile and specificities of each financial institution. When it comes to insurance industry, this risk profile refers to the solvency, the sufficiency of the technical reserves, reinsurance coverage and the security of reinsurers, asset portfolio and corporate governance. In other words, the prudential supervision does not primarily takes into account the actual process of designing or pricing the insurance products offered on the market, but on the financial resources needed by the insurance company in order to honor its obligations.

There are some tensions between the prudential supervision and the competition. Consider the case in which there is applied a risk-based and capital approach of the supervision process and the horizontal cooperation between insurers. Even if not obvious, the sharing of certain risks or certain functions might be significantly responsible and prudent risk mitigation for the insurance companies.

The risk pooling is in fact the essence of insurance and in a healthy market, the sharing is the only way of covering risks, that otherwise would be uninsurable. The sharing of databases is also an important factor for the success of the conduct of the business. The data must be representative for the population they apply to – reliable and extensive -. The lack of information would be disastrous for pricing, financial control, profit and other decisions of the insurance company.

Besides the data to be used by an insurance company, the supervisors are much interested also on the reinsurance companies, as their undercapitalization would be harmful for the world financial system (the year 2005 – the hurricanes season brought about losses of more than 25.76% at the level of international reinsurances, after which in 2001 and 2002, the Word Trade Center brought about bankruptcies and the promise that a renewal of those events would bring the entire industry to its knees).

New risks are producing effects on the insurance industry lately – such as long term liabilities, changes in legislations or risks of new technology. The effects are visible both on the insurers and reinsurers but also on the supervision and competition processes.

The competition process has developed also – the insurers will evaluate their loss potential on different levels and thus create a very differently risk profile of the products. The competition is no longer a common, normal competition but a risk-prone competition, which can bring about even pure speculation on the market.

High risk products will generate high volatile losses which at a certain point can lead to a non-insurable risk or highly-priced product. An example might be the terrorist attacks risk that became non-insurable after September 11 2001, the main insurance and reinsurance policies excluding this clause from the standard form.

What might be the counteracting measures in this case – exclusions on the policies, pricing, limits, right of termination and covering named perils only, transfer on other markets (securization) or even closing down of the operations. As the economic value will be damaged, the competition process can come in and based on prudent risk-sharing and agreed risk-transfer, as a cooperation way, can limit the effects of the highly volatile products. Moreover, a partnership between the insurance industry and the governments might be useful – as the state will be considered the last resort reinsurer. The states can act in the situations where the market finds itself unable to offer coverage or it can work as a mediator in designing the best solutions, for example the natural disasters' risks for the households or the aviation industry.

Competition and supervision on the Romanian insurance market

In 2007 alone, the insurance market recorded a volume of gross written premiums of 7.165 billion lei[137], showing a nominal increase of 25.07% compared with the provisions year. 79.9% of the total gross premiums was generated by non-life insurance, while the personal insurance had recorded again a lower level than the European average of 25.65%[138]. The insurance penetration ratio was 1.84% in 2007, as compared to 1.68% in 2006.[139]

As the confidence of the insured increased during the last 10 years, also the insureds' expectations regarding the quality of the insurance products became higher. The Romanian insurance market must prove that it is capable to comply with these expectations, otherwise it puts to danger the existing portfolio and also the potential one, as the customers can mitigate to European competitors.

The rush of the insurance companies after the market share, at any risk, in the detriment of the quality of service and financial stability, will definitely generate severe errors and discontent of the customers. The legal norms implemented last year concerning the establishment of technical reserves and also the ones concerning the risk management committee were destined to reduce the number and the severity of the deviations from the expected levels, as the arbitration is growing stricter.

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[137] Figures based on Insurance Supervisory Commission estimations

[138] CEIOPS Market Release – March 2008

[139] Insurance Supervisory Commission Annual bulletin no.1, March 2008

New acquisitions took place on the Romanian market, such that one of Viena Insurance Group of ASIROM after acquiring the majority of shares from Omniasig, Omniasig Life and ASIRAG, putting to danger the competitiveness of the market. The Austrian company asked for the agreement of the Competition Committee in order to be allowed to buy also the majority package, without endangering the oligopoly market. The first 10 companies on the market (out of 44 in 2007) concentrate over 92.3% of the market – a concentrated market brings about better pricing, better quality in the products offered for the customers.

Since its occurrence, the Insurance Supervisory Commission has developed its goal of regulator of the Romanian insurance market to the status of supervisor of the market. That is, the transfer from imposing the legal requirements on financial institutions to the one concerning the monitoring of compliance of the insurance companies with the legal provisions and also the process of taking remedial actions to secure the objectives of the regulation. The ISC became a consultant for the players and the consumers of insurance, especially concerning the new wave of capital requirements for the industry – the Solvency II directive. In this regard, the ISC organized several meetings in Romania together with CEIOPS for enhancing the cooperation and the supervision for the Romanian customers.

Solvency II – method of enhancing the competition and supervision

In order to develop the competition on the European market by 2010, the financial services action plan has been introduced (part of Lisbon goals) and part of it represent the Solvency II project. This structure is also known from Basle II in the banking sector.

Solvency II is based on a three pillar structure:

- Pillar I covering Minimum capital requirements;
- Pillar II covering qualitative requirements, i.e. risk management and supervisory processes and
- Pillar III covering disclosure requirements.

The first pillar establishes certain limits concerning the investments (covering the technical provisions, the minimum capital requirements and the solvency capital requirements) and concentration. Moreover, the model for computing the MCR and the SCR can be either a standard one, a partial internal one or a full internal one. In addition to the pillar I investment diversification rules, a further capital requirement could be included to address diversification – level of diversification in the portfolios of undertakings and the feasibility of portfolio.

Pillar 2 complements pillar 1 requirements. As part of the supervisory process, the authorities must evaluate the adequacy of the diversification process. The insurers are expected to do more than just satisfy the limits imposed by pillar 1. The authorities must also consider the need of additional capital. The SCR addresses those types of risks where material correlation effects can be expected between the asset and liability sides of the balance sheet, such as an asset-liability management policy (plans or procedures) to deal separately with the short-term and long-term risks.

This new system will assess the overall solvency and build on a more risk-sensitive approach, with incentives for proper risk management. Furthermore the system will support the harmonization of quantitative and qualitative supervisory methods and ensure consistency between financial sectors. Solvency II as the new prudential regime for insurance which CEIOPS[140] is helping the European Commission to develop has as one basic objective the improvement of the European internal market and the enhancement of the efficiency and competitiveness of the European insurance industry. It is aimed to include more efficient and cheaper capital for the industry and its allocation, which will definitely influence the pricing of the insurance products.

There is naturally some interaction when it comes to conduct of business and the competition. The purpose of conduct of business supervision is to evaluate the relationship between financial institutions and their customers. It is here that we might find concerns over market issues, pricing, timely and relevant information to policyholders, distribution and conflicts of interest. Requirements of the conduct of insurance business help to protect consumers, and eventually build consumer confidence in the insurance industry.

[140] CEIOPS – Committee of European Insurance and Occupational Pensions Supervisors

Solvency II gives an important contribution by enhancing public disclosure and better consumer information. The benefits may encourage customers to become policyholders, and to say so it will certainly be up to the market to decide if Solvency II should also provide standardized consumer information on the risk profile of the product, a guarantee fund in place or the supervisory authority in charge with the handling the complaints just to mention some important issues. Reliable and understandable information is a key parameter for future European wide competition process. Information to policyholders has to improve, as to the amount, the relevance, the clarity and its timing.

Although solvency II is promoting competitiveness of the insurance industry it cannot deny the need for some closer cooperation between insurers. Let us take as an example the field of data sharing. Imagine that we are introducing brand new, European wide harmonized market values approaches for technical provisions, the future obligations toward customers. Those technical provisions had never been harmonized throughout Europe before. Future values have to be based on entity specific collected data over a period of 10 to 20 years. Not all insurers have these data available – such as the Eastern European countries that known a development of the industry after 1989 and a clear collection of data only a decade later. The question of excluding these companies from Solvency II, just because they do not meet the requirements of this regulation or because they have poor databases is out. Moreover an encouragement is more proper, by offering them the possibility of relying on data and models of several insurers with comparable businesses from specialized countries that have reliable databases.

Conclusions

Supervision and competition are two sides of the same medal. However they are two different sides. The more that major insurers and reinsurers are seen to perform a social role in society, the higher the expectation that they will be able to provide coverage. This includes usual and unusual circumstances. They are expected to be able to manage their exposure and their capital strength. They have to be well understood. A good dialogue between the supervisors and competition authorities might help. Both have to be strong over their interests and enlightened to each other.

Solvency II will imply a major shift towards a risk sensitive framework, providing incentives to move towards more sophisticated methods for measuring and controlling risks. It will imply massive resources but it will generate better understanding of the balance between regulatory need and business efficiency.

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