Bosnia and Herzegovina
Federation of Bosnia and Herzegovina
Federation of Bosnia and Herzegovina
Insurance Supervisory Agency

www.nados.ba

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Survey results on
the subject:

Qualitative impact study of "SOLVENCY II"

Contents

INTRODUCTION

According to the non-life and life insurance directives adopted in February 2002 (*Directive 2002/13/EC and Directive 2002/83/EC), within the framework of the* **Solvency I** project, the solvency margin is determined by applying fixed coefficients to the value of the total premium income or the average amount claim (in the case of non-life insurance) and to the amount of the mathematical reserve (in the case of life insurance). Amendments of the directives were made to the calculation of the solvency margin, and in the case of non-life insurance, the amount was increased for the premium basis (to EUR 50 million) and for the loss basis (to EUR 35 million). The amount of the minimum guarantee fund was also increased (to EUR 2-3 million, depending on the type of non-life insurance), with a transitional period of 5 years for the fulfillment of the aforementioned requirements. In the case of life insurance, the minimum amount of the guarantee fund has been increased to EUR 3 million.

The Solvency I regime, which is currently in use in Bosnia and Herzegovina and whose adapted version (with regard to the prescribed lower amounts of the guarantee fund and solvency margin) is applied in (re)insurance in BiH, stipulates that an insurance company is solvent if:

(1) optimally and cautiously forms reserves in an amount sufficient to cover its obligations,
(2) has the prescribed minimum guarantee fund and,
(3) provides and maintains a solvency margin as a prescribed amount of capital to cover unexpectedly high liabilities for damages.

In the Federation of Bosnia and Herzegovina, after the entry into force of the Law on Insurance (entered into force in 2017), within the five-year deadline, **insurance companies increased the minimum capital for non-life from 5.0 to 10.0 million KM, for life from 3.0 to 6.0 million KM, for reinsurance from 3.0 to 6.0 million KM, thus aligning with the minimum capital threshold defined by the Solvency II Directive for EU member states.** New Law on Insurance represents a sort of intermediate phase, the preparation for the gradual transition from Solvency I to Solvency II. The focus is on capital increase and risk management to which

the insurance company is exposed. Insurance

undertakings are obliged to adopt their own internal documents for the identification and management of risks. There is the need for the application of modern information technology for the purpose of documenting all procedures, business change, implementation of prescribed procedures, ensuring the security of the database, etc. The importance of internal control, monitoring and timely recognition of warning signals of possible problems in business that could lead to illiquidity and insolvency of the insurance undertaking was emphasized.

NEW SOLVENCY II REGIME IN THE EU AND APPLICATION DEADLINES

Solvency II in the insurance and reinsurance system in the European Union is prescribed by the Solvency II Directive 2009/138/EC on insurance and reinsurance activities, which was adopted and published by the EU in December 2009. In September 2012, the European Union adopted Directive 2012/23/EU, which extended the deadlines for application of the Solvency II regime in the EU insurance and reinsurance system. New deadline for implementation of new Solvency II regulation in the national legislation of the European Union member states is 31 January 2015 (the original deadline was 31 October 2012), and the deadline for applying Solvency II in the operations of insurance and reinsurance companies is 1 January 2016 (it was previously set as 1 January 2013).

New deadlines for the application of Solvency II derive from new *Omnibus II Directive*, which supplements the Solvency II Directive in regard to the competence of new supervisory institution (EIOPA) and other provisions of Solvency II.

With the Stabilization and Association Agreement (including the Interim Agreement) of 16 June 2008, which represents the international obligation of Bosnia and Herzegovina, our country committed to harmonize its legislation according to the criteria of the European

Union. Before signing the Stabilization Agreement, taking international law into consideration, BiH was, on the one hand, harmonizing its regulations with the EU regulations on a voluntary basis, considering the fact of not having a contractual relations with the European Community and its member states, and, on the other hand, taking domestic law in consideration, harmonizing was biding, because at the end of 2003, the Council of Ministers of Bosnia and Herzegovina adopted the Decision on Procedures in the process of harmonizing legislation with Acquis communautaire - community law ("Official Gazette of BiH", number 44/03).
On the way to full membership of Bosnia and Herzegovina in the EU, it, like the other candidate states, must necessarily harmonize its entire legislation with the legislation of the European Union, just as its predecessors did.

CONTENT OF THE SOLVENCY II REGIME IN INSURANCE AND REINSURANCE BUSINESS IN THE EU

Solvency II sets new rules and requirements for capital adequacy and new rules for risk management of (re)insurance companies with the aim of policyholders better protection and prevention of disruptions in the insurance market. The new regime is based **on the quantitative and qualitative definition and measurement of the main groups of risks and the proportional determination of the required amount of capital to cover the defined (measured) risks of (re)insurance companies**.

The Solvency II system is based on three pillars which define: quantitative requirements (1), qualitative requirements (2) and market rules (3)
.

The first pillar - Quantitative risks: the capital requirements that the insurance company must meet **to cover five basic risks** (insurance risk, credit risk, business or operational risk, market and liquidity risk) are quantified according to the prescribed methodology - standard, internal or mixed model, namely:

- the calculation of required solvency capital (SCR) which represents the level of capital with which 199 out of 200 or 99.5% of insurance companies will satisfactorily cover operations, existing and new obligations for claims in a period of 1 year,
- calculation of minimum required capital (MCR) - safety minimum,
- calculation of technical reserves - harmonization and transparency at EU level,
- calculation of the risk margin over the technical reserve level,
- valuation of assets and liabilities according to market methods,
- investment rules of insurers in order to better cover investment risks.

According to the new concept of solvency, the required solvency capital (SCR) should ensure a sufficient level of security for the insured and at the same time enable the insurance company to be profitable and the insurance industry to be competitive with other sectors of the economy. SCR represents the level of capital, which guarantees that the insurance company is able to survive and absorb significant unforeseeable or catastrophic damages in a period of one year and to pay the insured obligations arising on the basis of the assumed risk. The target level of SCR can be calculated using a prescribed standard formula or using an internal model related to the characteristic risks of a certain insurance company or using partially internal models. The latter ones are a combination of the standard formula and an internal model and are applied when the insurance company establishes that the exposure to risk in certain types of insurance or the participation of a risk is different than defined by the standard formula.

The minimum required capital (MCR) is replacement of the currently valid required solvency margin under the Solvency I project. It is the amount below which the insurance company's capital shall not fall, and if such occurs, the supervisory authority is obliged to, immediately, take the prescribed measures, including the revocation of the license. MCR cannot be calculated using internal models. The limit amount of MCR is between: 25% SCR ≤ MCR ≤ 45% SCR. MCR is calculated every three months and the supervisory authority is informed about it.

The second pillar includes **the rules in the insurance supervision process** or the so-called qualitative risks, and contains the requirements or rules of supervision of the insurance company with regard to internal solvency control. The role and responsibility of members of the insurance company's management and financial supervision by state authorities was emphasized. Efforts are being made to ensure strict procedures and high quality of the insurance business and human resource management processes, as well as development and improvement of the internal control system. Greater mutual cooperation is being established: database, supervision, transparency of work, prescribing procedures and rules for company security.

The third pillar contains measures of market discipline and data transparency. The goal is to increase responsibility, transparency and availability of information about the insurance company's business to all market participants. Companies should establish public relations services that will have access to information about the company (the same information that is available to its management). The introduction of new accounting standards based on fair value and supported by capital valuation market models is planned.

OBSTACLES TO THE APPLICATION OF NEW SOLVENCY II REGIME IN BOSNIA AND HERZEGOVINA

At the current economic development level, even if BiH were to become a full member of the EU (which is currently the basic limitation for the mandatory application of new Solvency II rules), the main obstacle would be current limited economic power of the overall economy, including the insurance and reinsurance sector in BiH.

As the organizational and financial fragmentation of insurance undertakings is a serious obstacle, further consolidation and merging of the internal business potential of insurance companies is expected.

Division of the total market in BiH, including division of the national insurance market by entities, is also a possible obstacle to the unified conception and application of the new regime in BiH. Also related to the market division is the legal and legislative division in BiH by entities, which will possibly make difficulties in adoption and application of new solvency regime in BiH.

Also, possible aggravating circumstances in defining, and especially in practical application of new solvency regime in our country, are insufficient measures for organization of mass education about the Solvency II project of personnel engaged in the national insurance sector.

Possible limitations also concern inadequate information (databases) and software support in the management of insurance and reinsurance business, and especially in the process of applying the model for quantifying the capital requirements that the insurance company must meet to cover basic risks under the new solvency regime.

SURVEY RESULTS

In order to determine the initial level of understanding of the Solvency II concept and the level of functions development from the Solvency II management system, the Federation of Bosnia and Herzegovina Insurance Supervisory Agency conducted a survey, in such a way that "Questionnaire - Qualitative impact study "SOLVENCY II" (hereinafter: Questionnaire) was submitted to insurance companies established in the Federation of Bosnia and Herzegovina (FBiH).

The research objective is for insurance companies to carry out a self-assessment of their position and level of development in relation to questions from the Questionnaire, but also to look at future regulatory requirements and directions for the establishment and/or improvement of key internal functions. The purpose of the research was to collect information on understanding of the significance and level of development of the functions of the management system according to Solvency II requirements.

The results of this research will be the starting point for identifying the needs for raising the level of knowledge in the insurance sector, but also for future regulatory activities.

The Questionnaire contained 57 questions and included, together with basic general knowledge questions on Solvency II, questions about the understanding and level of development of the management system functions. It was divided into:

1. AREA 1: MANAGEMENT EXPECTATIONS
2. AREA 2: CURRENT STATUS OF IMPLEMENTATION
3. AREA 3: IT OPTIONS AND DATABASE MANAGEMENT
4. AREA 4: COMPLIANCE WITH SOLVENCY II - PILLAR I
5. AREA 4: COMPLIANCE WITH SOLVENCY II - PILLAR II
6. AREA 4: COMPLIANCE WITH SOLVENCY II - PILLAR III
7. AREA 5: CONCLUDING QUESTIONS

12 insurance companies participated in the conducted survey, including a reinsurance company.

In the analysis of responses from the Questionnaire, it was assumed that the responsible persons of the insurance companies answered the questions honestly and objectively.

The results of the survey indicate a low level of knowledge of the quantitative and qualitative requirements of Solvency II, especially the ORSA process, while in some cases companies that are members of foreign groups (applying Solvency II and ORSA) overestimated their level of harmonization (a conclusion drawn from understanding of the process at certain companies due to supervisory activities).

The vast majority of participants reported that they were not fully prepared for the implementation of Solvency II, especially for ORSA (only two companies declared that their phase of harmonization was above 75%, the rest were below 50%).

According to data from submitted questionnaires, the majority of participants believe that they do not have all the resources available and that they do not have a Solvency II implementation plan.

Regarding the readiness for Solvency II (pillars 1, 2, 3) including ORSA, the majority of participants expressed the need for support from the regulator in methodologies, reporting guidelines in line with pillars 1/2/3, a clear implementation schedule and during development adequate reporting model.

Insurance companies that are members of foreign groups operating in the territory where the requirements of Solvency II have already been implemented (a total of five companies), pointed out that they all participated in the delivery of reporting packages or data necessary to support reporting in accordance with Solvency II, at the group level and that they received a high level of support, mostly in the form of templates and draft reports (four companies), practical training and education (three companies), and very little in the form of tools and methodological decisions.

Although all insurance companies have declared that they are ready to accept changes and understand the concept and importance of risk management in business, independent and concrete activities are still insufficiently developed and applied. A great number of insurance companies expect positive effects of Solvency II, and as an explanation they state the identification and quantification of risks (a better risk management system) and an overview of their own capital needs, increased transparency and regulatory reporting that better reflects business performance. For the functions established due to legal requirements (internal audit, internal control, actuarial function, risk management and compliance monitoring function), it was pointed out that the limiting factor in their harmonization with Solvency II requirements was the lack of methodologies, guidelines, available personnel resources and education. Accordingly, companies have adopted strategies for risk management, actuarial and internal control, and some have also applied compliance monitoring, as well as a reporting system.

From the qualitative answers to questions related to the development of risk management functions, internal acts and the process of risk identification, it can be concluded that insurance companies do not sufficiently recognize the concept of risk management from Solvency II requirements. Regarding the relationship between assets and capital, the value of liabilities and capital requirements from the regulatory results after alignment with the requirements of Solvency II, most companies stated that they have mostly the same expectations. An exception are companies that operate within groups whose main activity is insurance, and from their answers it can be recognized, to a certain extent, that they understand the requirements of risk management according to Solvency II. It also follows from the answer that the need to comply with regulatory requirements and the development of human resources will stimulate the development of functions from the risk management system.

Below is a short excerpt from the research results, which contains representative questions and answers, as well as cross-referenced answers to certain questions, having regard to number of companies that responded or in regard to the size of the insurance company.

Regarding the preparation for Solvency II, concerning the calculation of Solvency Capital Requirement (SCR) and Minimum Solvency Capital (MCR), the majority of participants consider that they are partially technically prepared for the calculations. When calculating technical reserves, five participants stated that they had a high level of technical preparation for calculations, five participants indicated that they were partially prepared, while two companies expressed that they had a low level of technical preparation.

Among the highlighted measures that the participants intend to take in order to prepare for Solvency II, are database extensions and additions, improvement of IT support and improvement of the data management. Also, almost all participants reported the need for additional human resources in order to meet the large administrative requirements of Solvency II, the need for training of existing personnel. Personnel reinforcements are especially needed in the area of risk management and actuarial business. Regarding gap analysis, five companies indicated that they had conducted a partial analysis, five companies stated that they had not conducted an analysis, while two companies indicated that they had conducted a full gap analysis.

All respondents declared that they have established a central risk register.

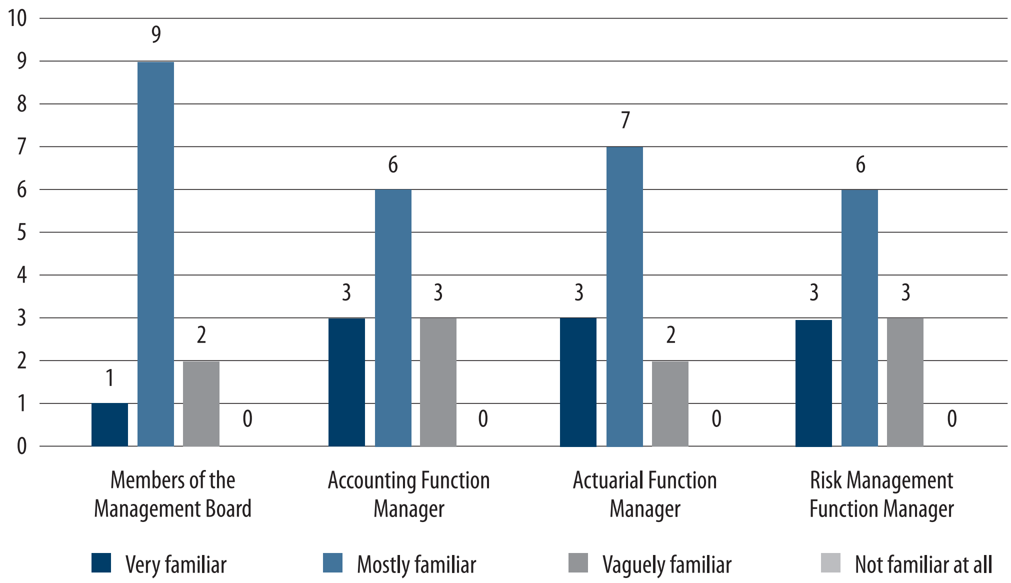
As for the area of technical preparedness for Solvency II in terms of calculations, the majority of participants expressed a moderate level of preparedness for the calculation of SCR, MCR and own funds, while for the calculation of technical reserves five companies expressed a high level of preparedness, and that they would mostly use standard calculation formulas, while only one company intends to use an internal model.

The majority of companies (nine companies) consider implementation of Solvency II, at the end of the reporting year, on 1 January 2026 likely possible, while seven companies believe that the deadline of 1 January 2024 is eventually possible. Most companies believe that they have enough time to implement the system technology required for Solvency II in the period of the next two financial years.

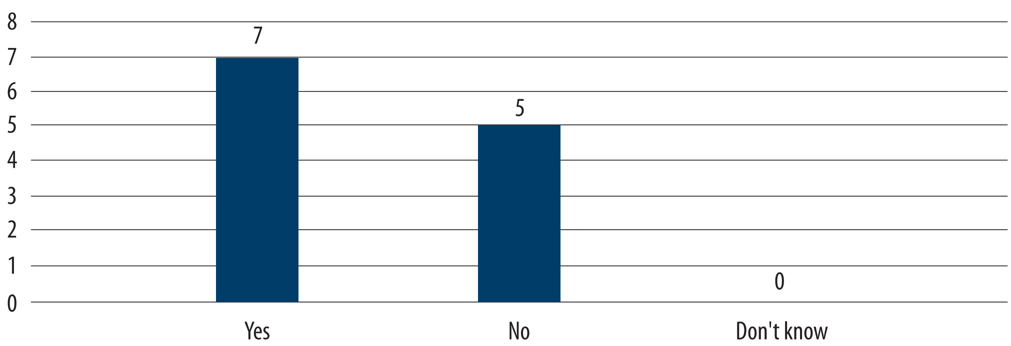
2021					
	Non life [1]	Life [2]	Non and life [3]	Reinsurance [4]	Total
Domestic [5]	3	-	1	1	5
Foreign [6]	1	-	6	–	7
Total	4	-	7	1	12

AREA 1: MANAGEMENT EXPECTATIONS

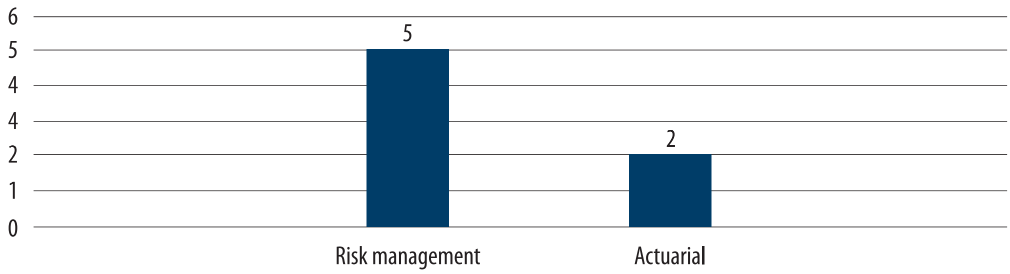
1. Are you familiar with the reporting requirements governed by the Solvency II regulations?



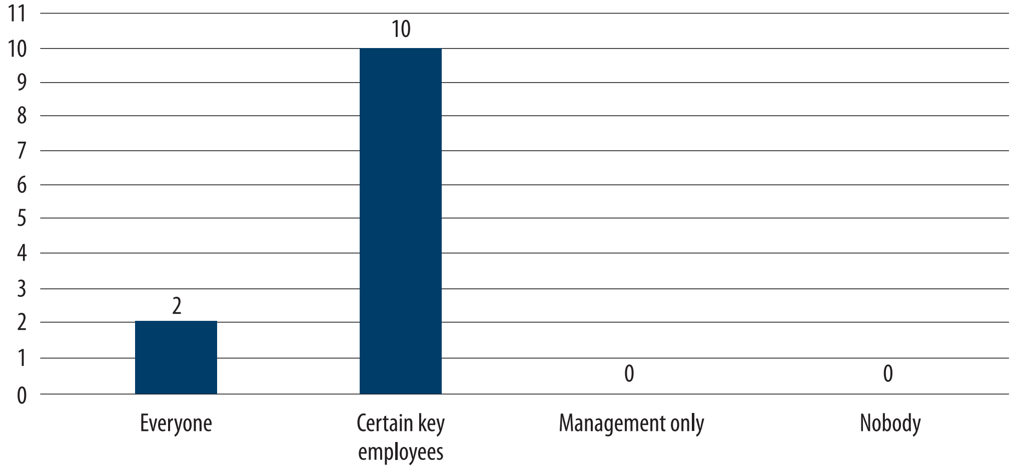
2. Have you defined who in your company would be responsible for compliance with Solvency II Criterion?



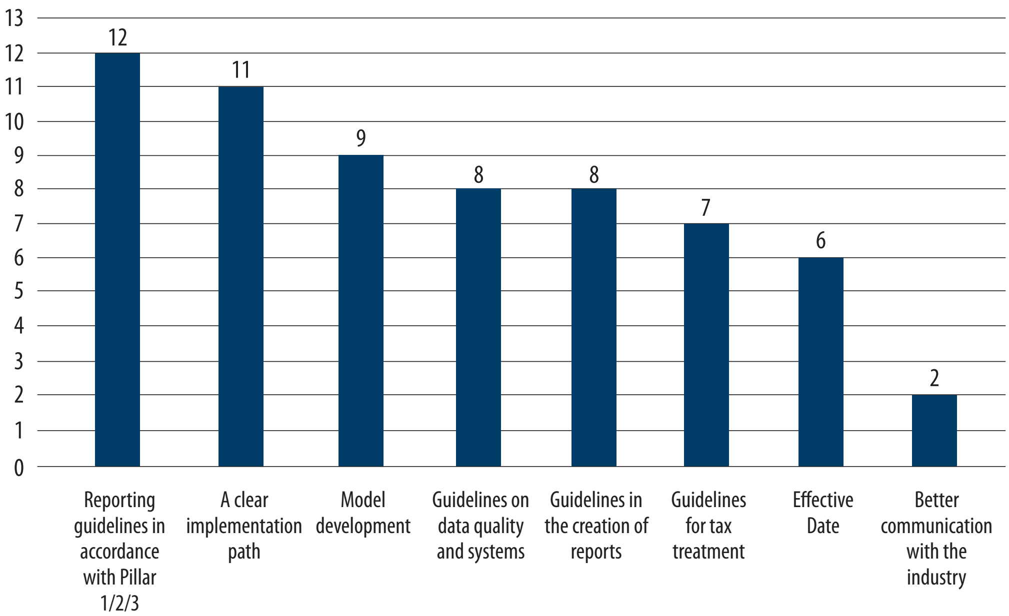
3. If the answer to the previous question is "YES", please indicate what function it is from the above:



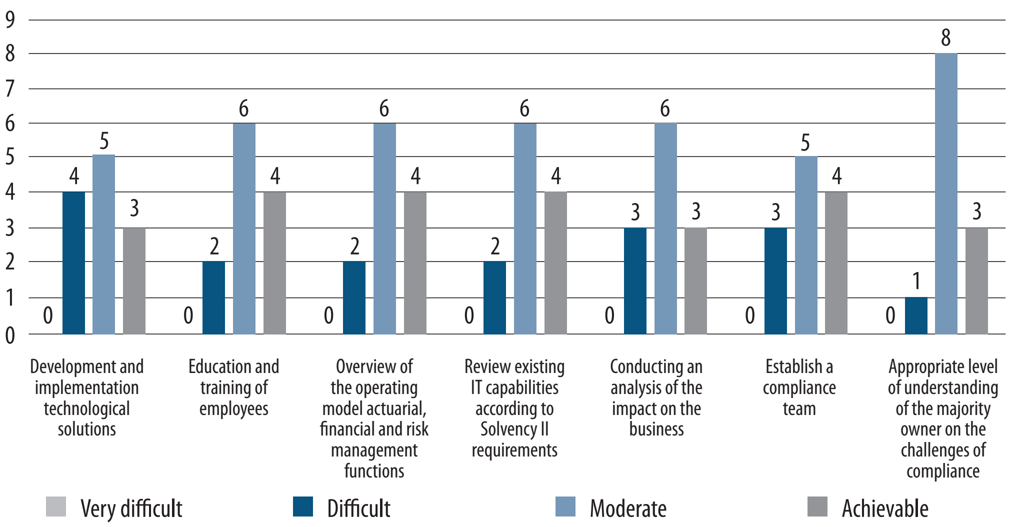
4. Has management and key personnel received any training related to Solvency II requirements?



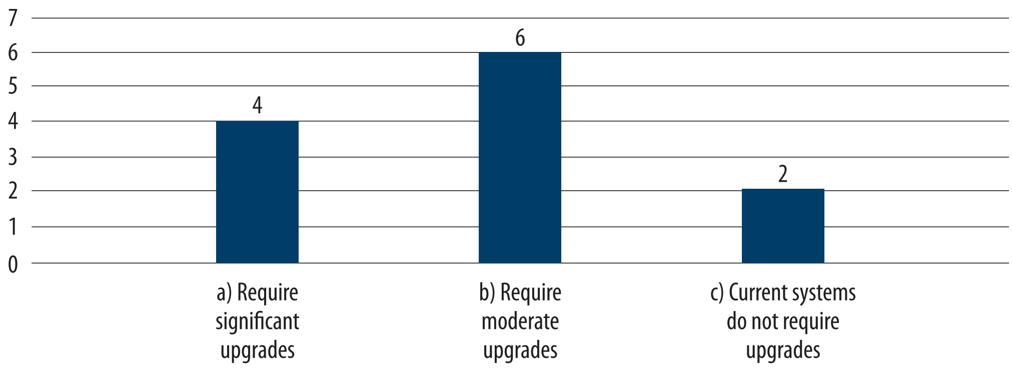
5. In what area do you believe that you need the most support and communication from the Regulator (choose top 5)?



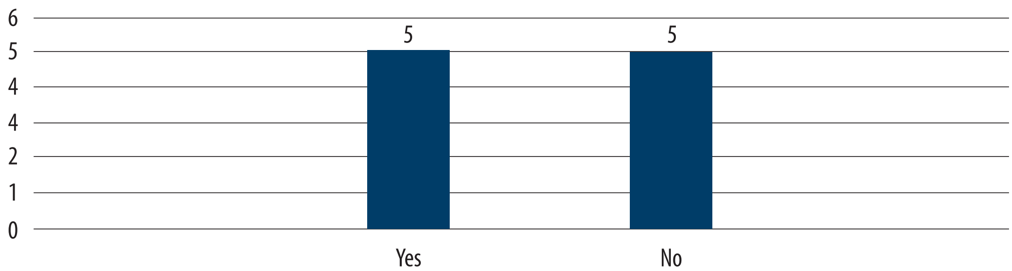
6. What level of difficulty is your organization experiencing in moving through the steps to Solvency II compliance:



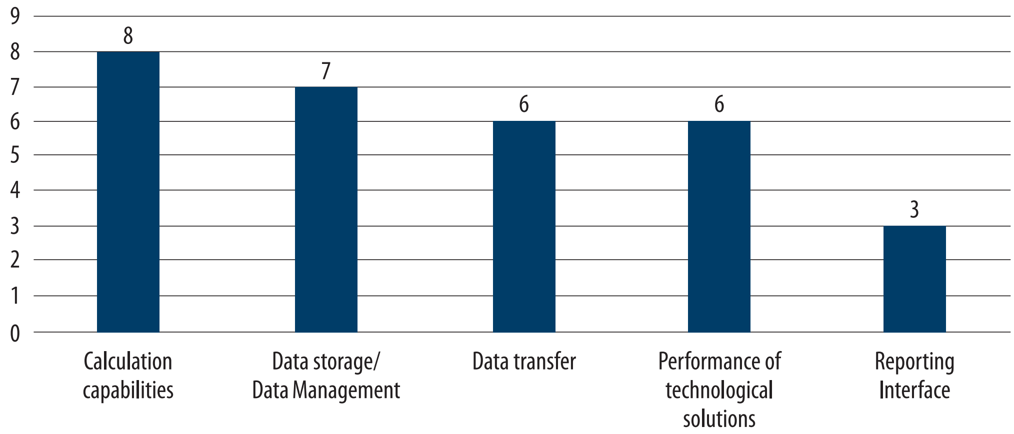
7. To what extent do you believe that your financial reporting, administrative and/or actuarial systems need to be changed and/or upgraded to comply with Solvency II reporting requirements?



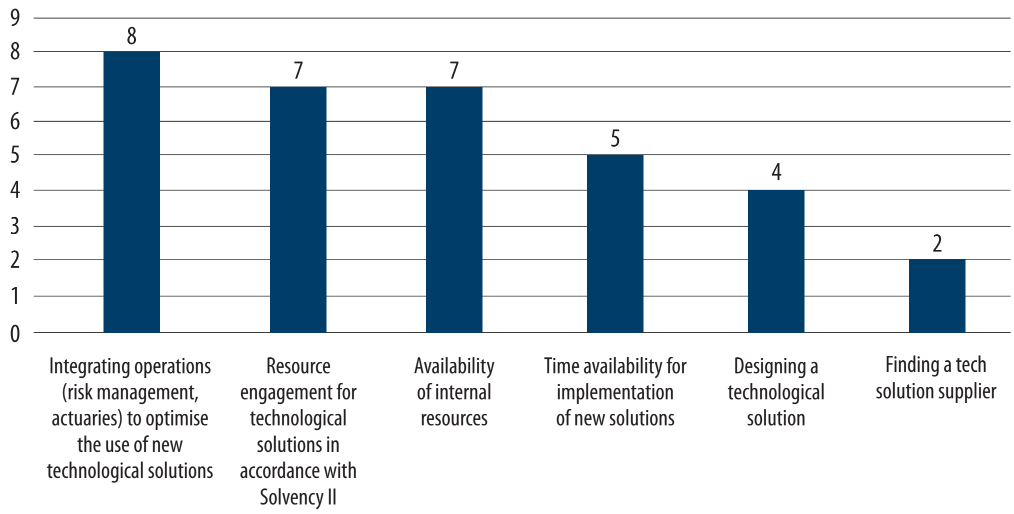
8. If the answer to the previous question is under a) or b), do you estimate that you can make the upgrades in question with your own resources?



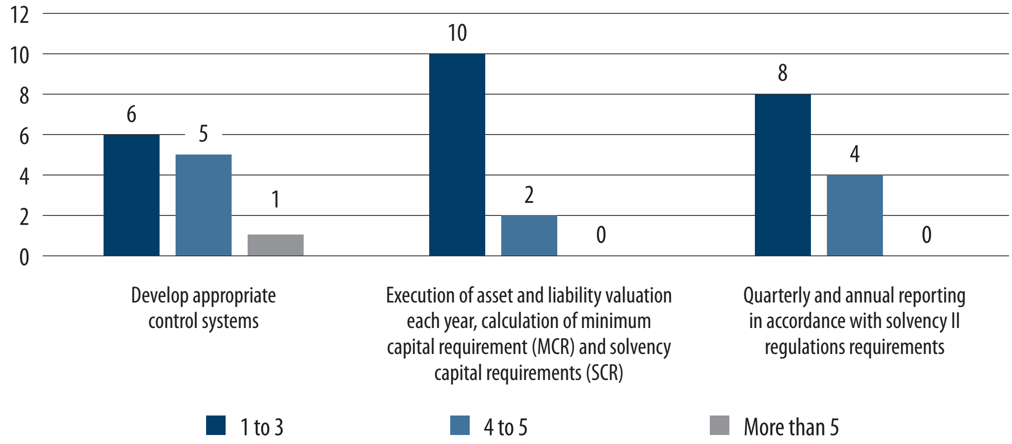
9. In what aspects, when preparing technological solutions to comply with solvency II requirements, do you invest or anticipate to invest the most efforts (choose top 3?



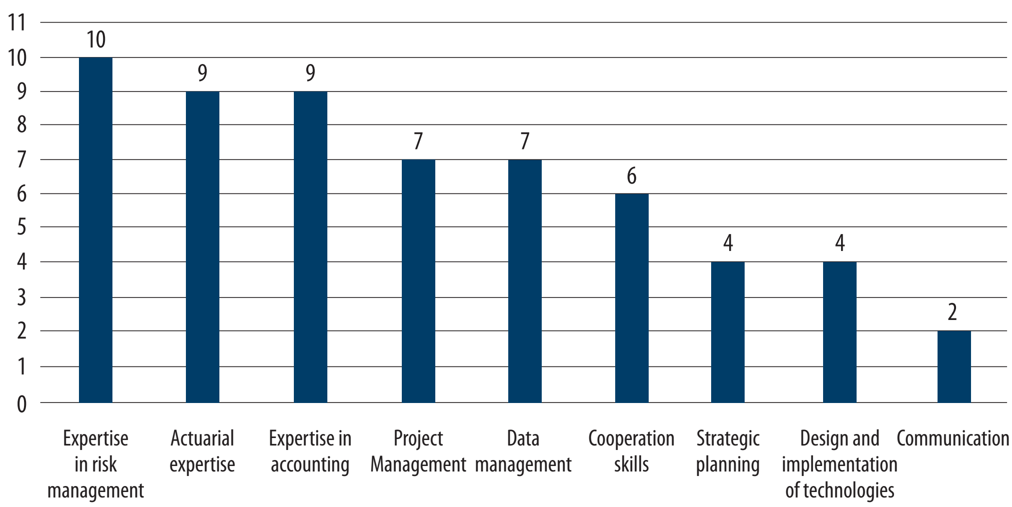
10. With what aspects are you struggling with in implementing your technology solutions (choose top 3)?



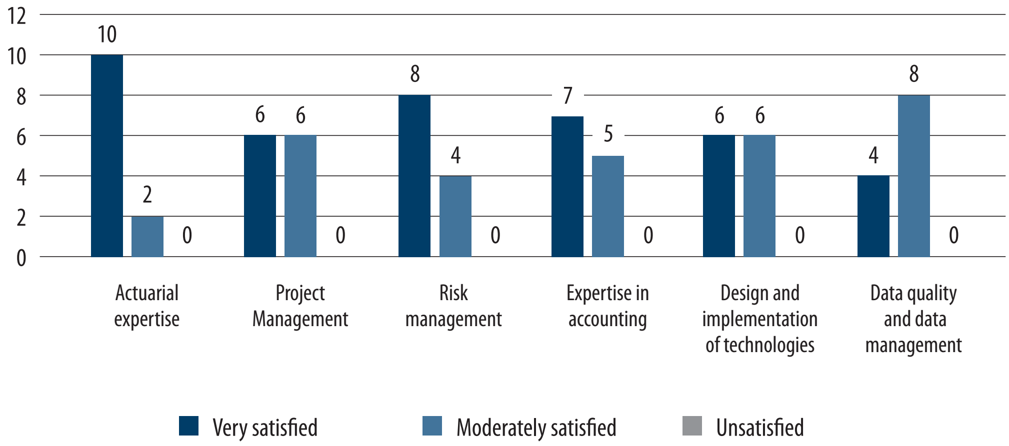
11. How many people do you estimate would be involved in the implementation and:



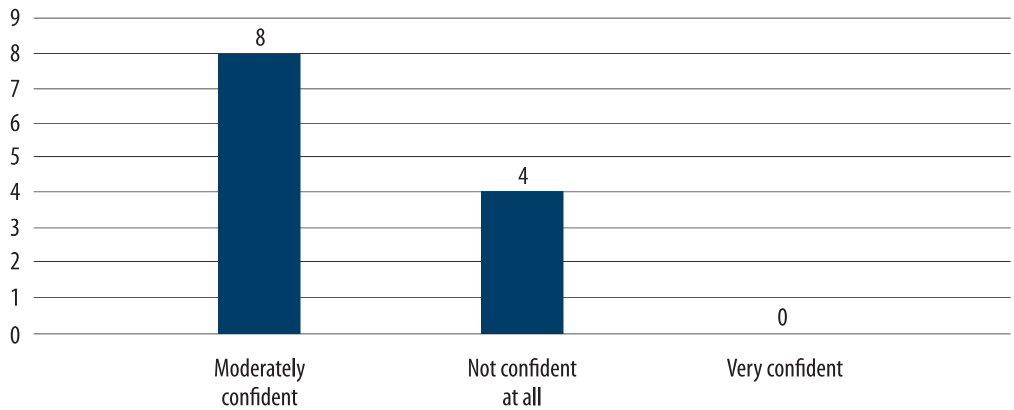
12. Which of the following skills do you think are most necessary for your company for the effective application of Solvency II regulations (choose top 5)?



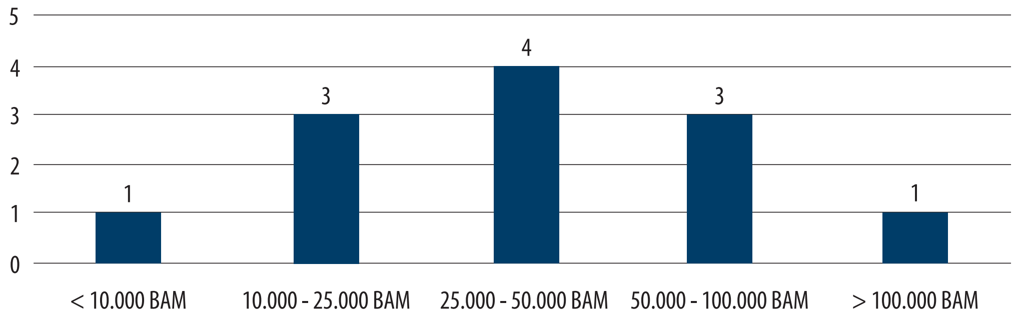
13. Are you satisfied with the level of skills in your company in the following areas :



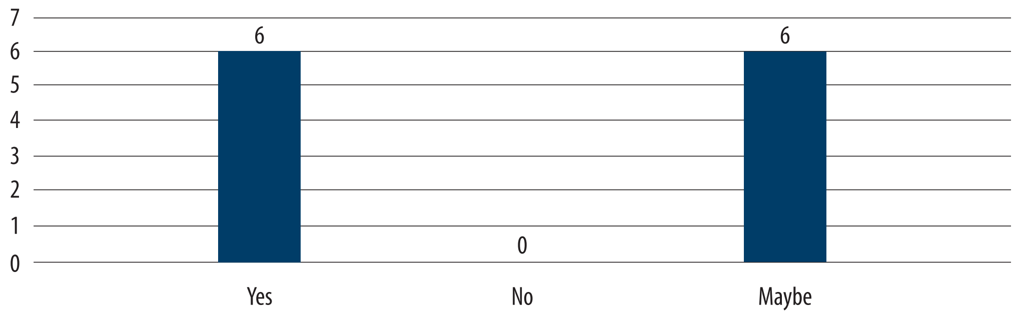
14. How confident are you that all the necessary skills, which need to be acquired, can be obtained in the local market?



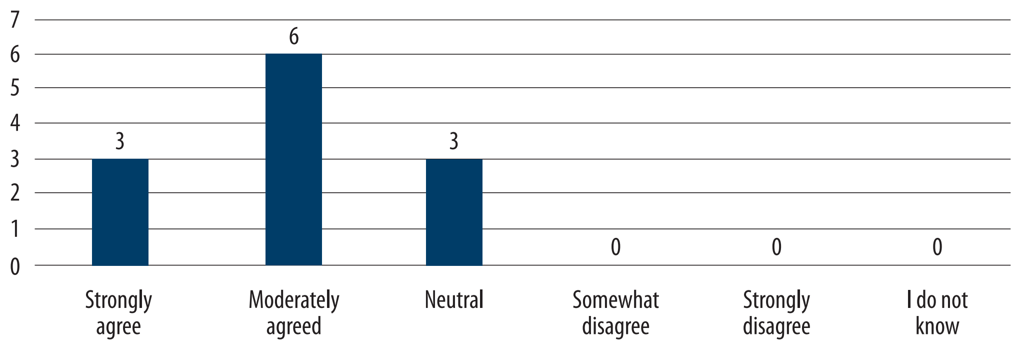
15. According to your estimates and plans, please indicate the budget planned for the implementation of Solvency II within your company?



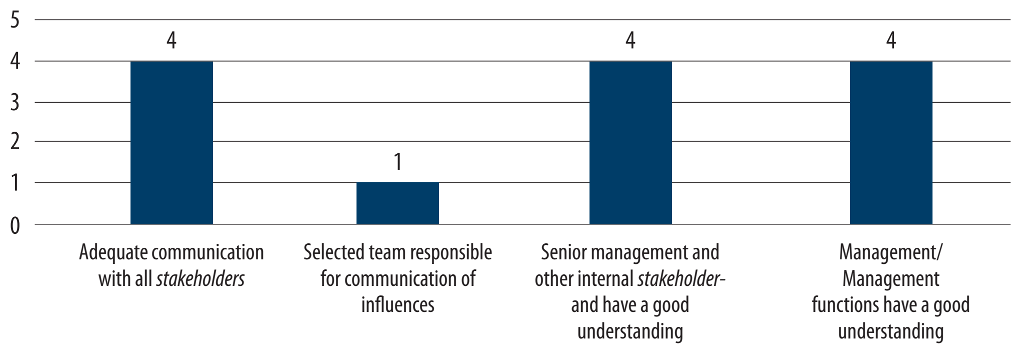
16. Do you believe that the stakeholders of your organization are well informed of the Solvency II requirements?



17. Please indicate your answer: We believe that the main stakeholders of the company are well informed about Solvency II requirements?



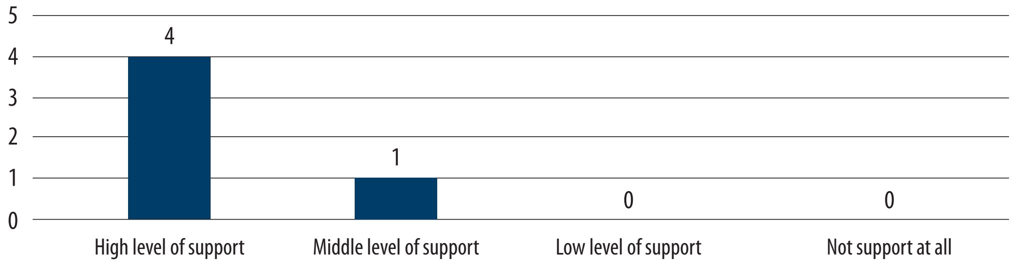
18. Please indicate how adequately your company communicates with stakeholders about the impact of Solvency II regulation ?



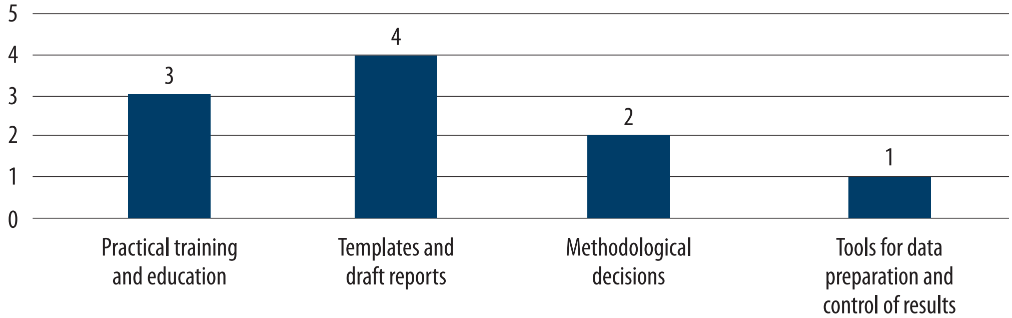
19. Is your company involved in the delivery of reporting packages or data necessary to support reporting in accordance with Solvency II, at Group level ?

All companies that have an obligation to report to the group answered in the affirmative.

20. Have you received guidance and support from the Group regarding solvency II reporting requirements?

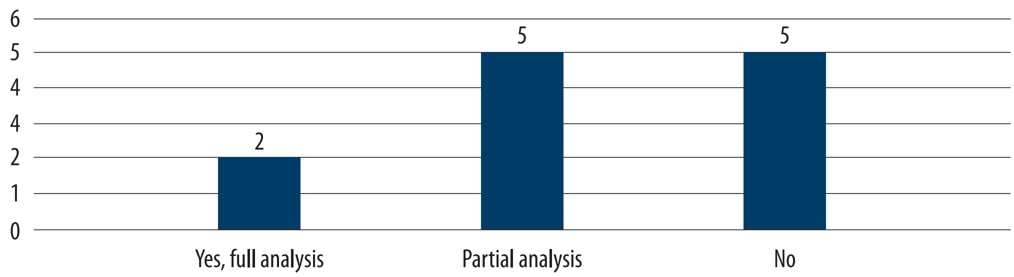


21. What form of support did you receive from the Group?

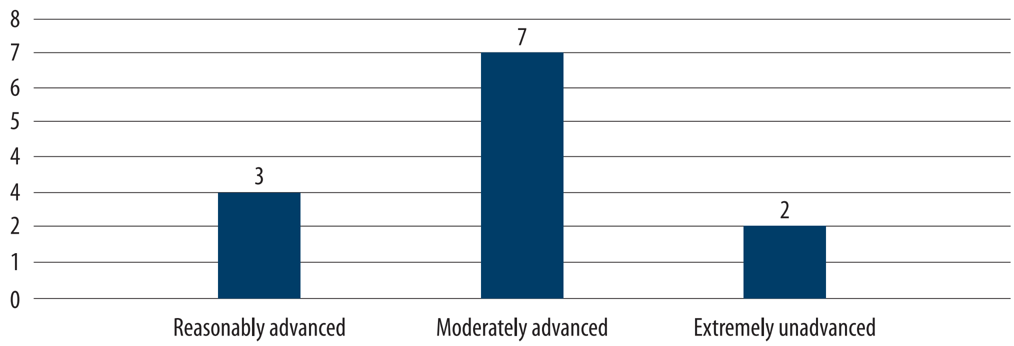


AREA 2: CURRENT DEPLOYMENT STATUS

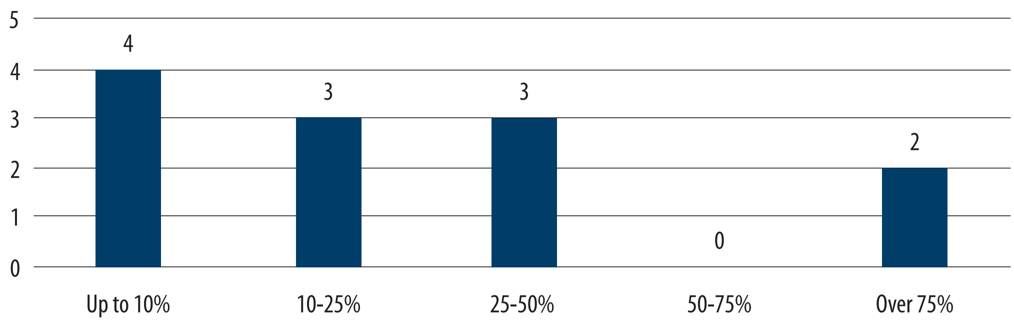
22. Did you, up to this point, perform a gap analysis in order to identify shortcomings in compliance with Solvency II requirements?



23. Can you rate the extent to which you are advanced in preparing to comply with Solvency II requirements?

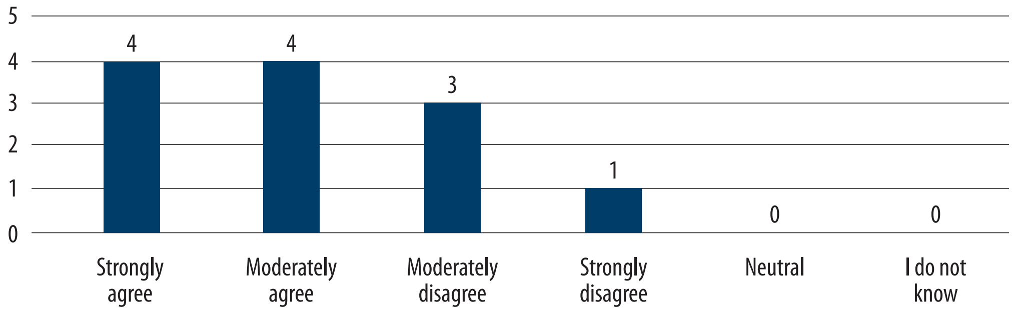


24. At what stage of compliance is your company with Solvency II requirements?

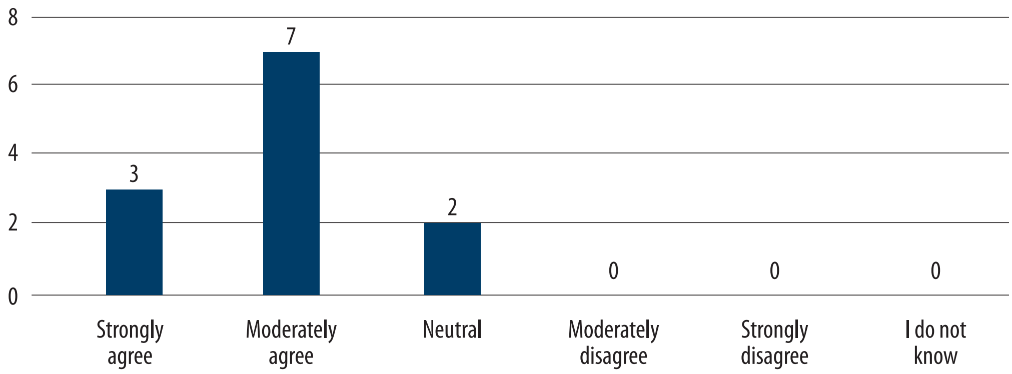


AREA 3: IT CAPABILITIES AND DATABASE MANAGEMENT

25. Please indicate your answer: We believe that we need support and cooperation with the external supplier in improving current IT capabilities?

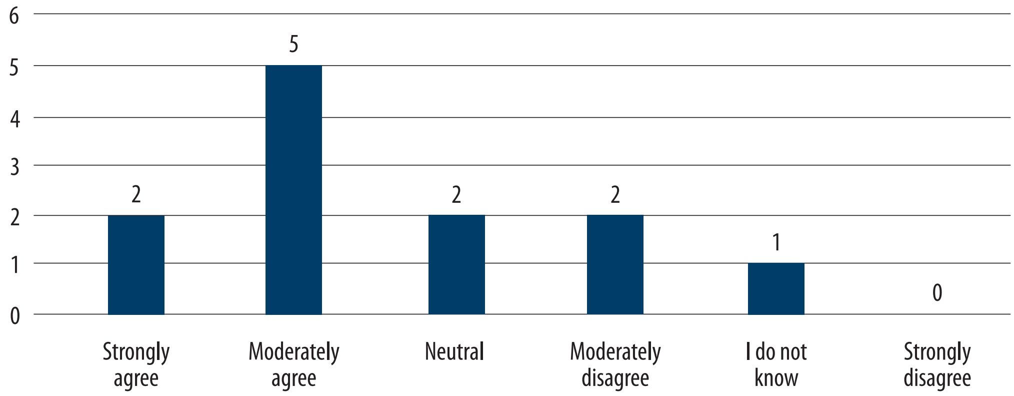


26. Please indicate your answer: We believe that we are able to find the software solutions that are needed to meet Solvency II requirements?



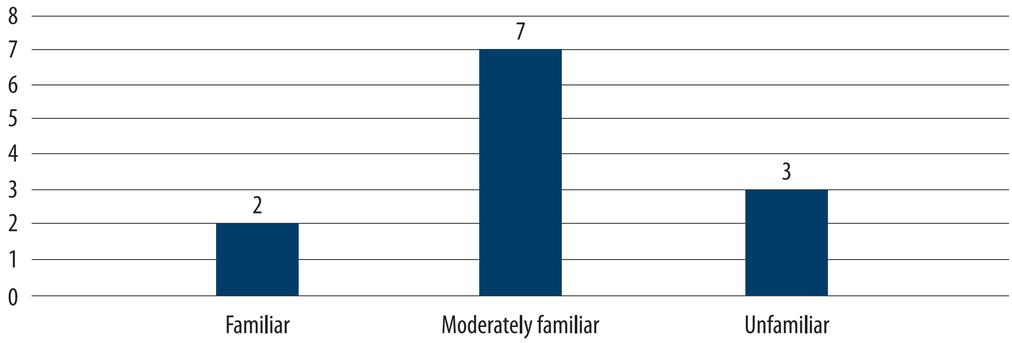
Area 3: IT Capabilities and Database Management

27. Please indicate your answer: We believe that we have enough time to implement the technology, necessary for Solvency II, over the next 2 (two) financial years?

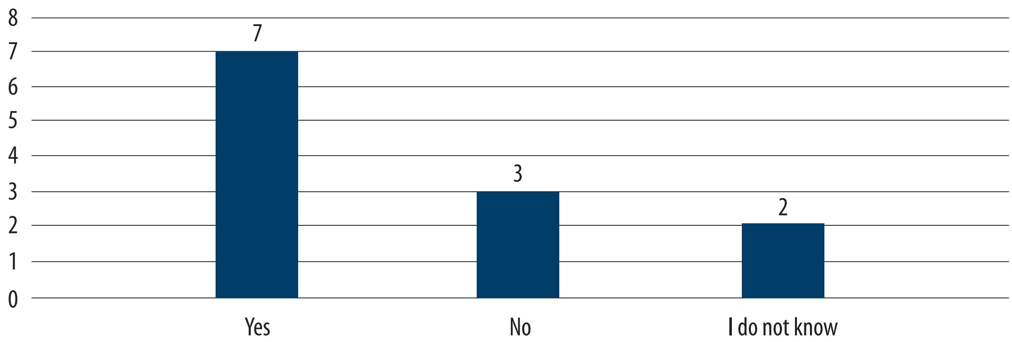


AREA 4: ALIGNMENT WITH SOLVENCY II - PILLAR I

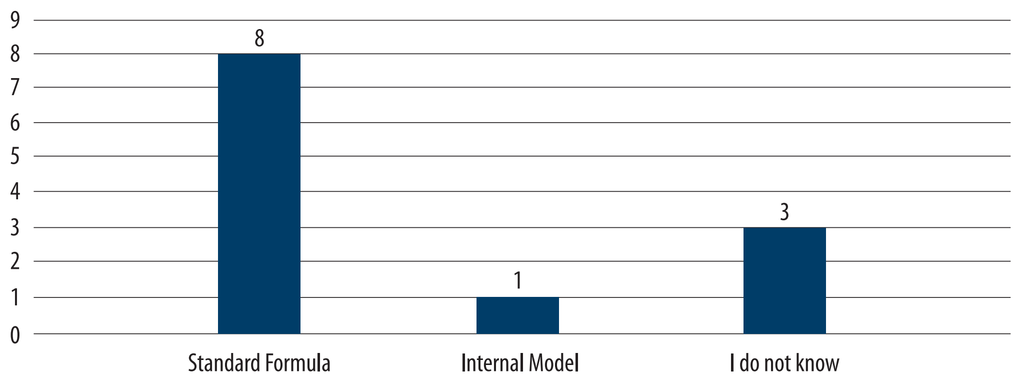
28. Is your financial reporting department familiar with the reporting requirements for Pillar I under the Solvency II directive?



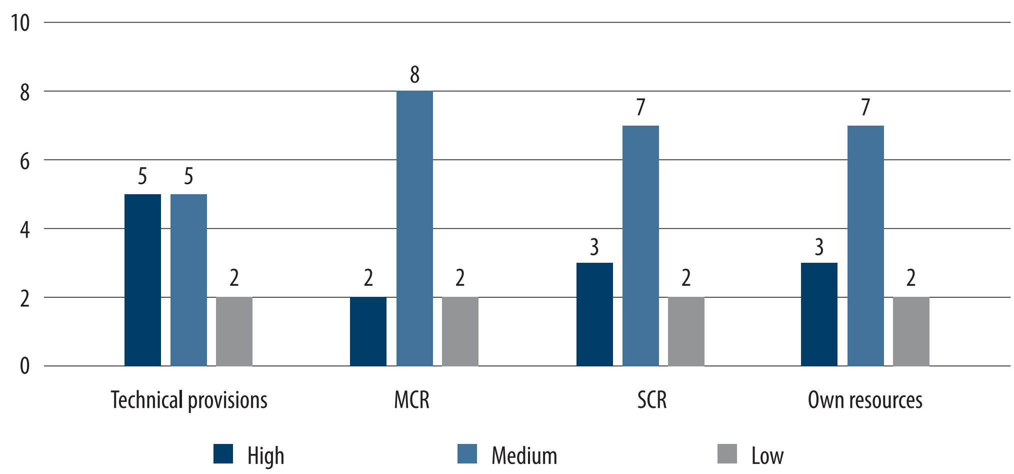
29. Have you considered the requirements for calculating the minimum capital requirement (MCR) and solvency capital requirements (SCR)?



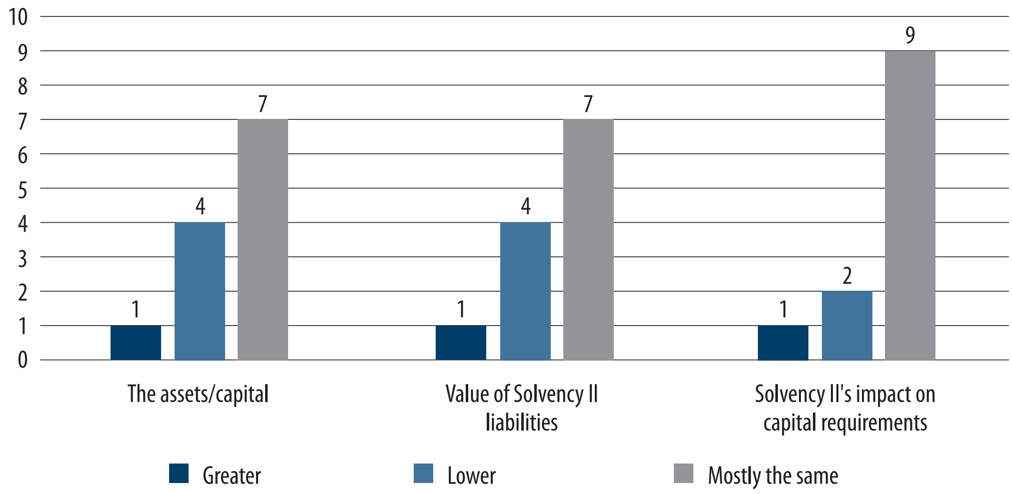
30. Have you considered whether your company will use an internal model or a standard formula for calculating SCR?



31. Please assess your company's technical capabilities for Solvency II in terms of calculations:



32. What are your expectations of regulatory results, after complying with Solvency II requirements?

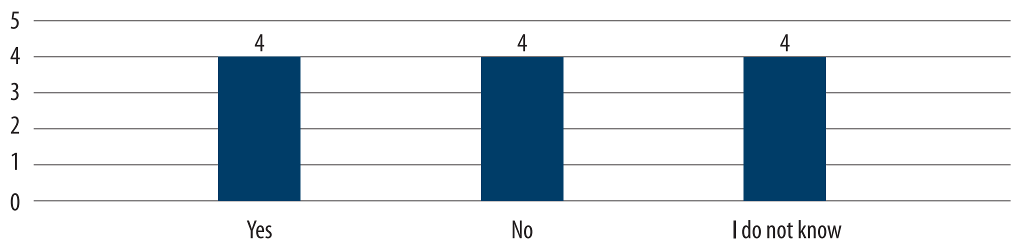


AREA 4: SOLVENCY ALIGNMENT II - PILLAR II

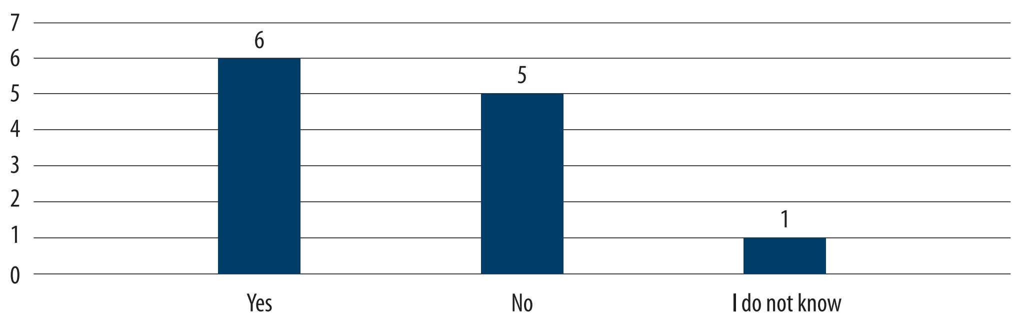
33. Do you have a central risk register ?

    All companies answered in the affirmative.

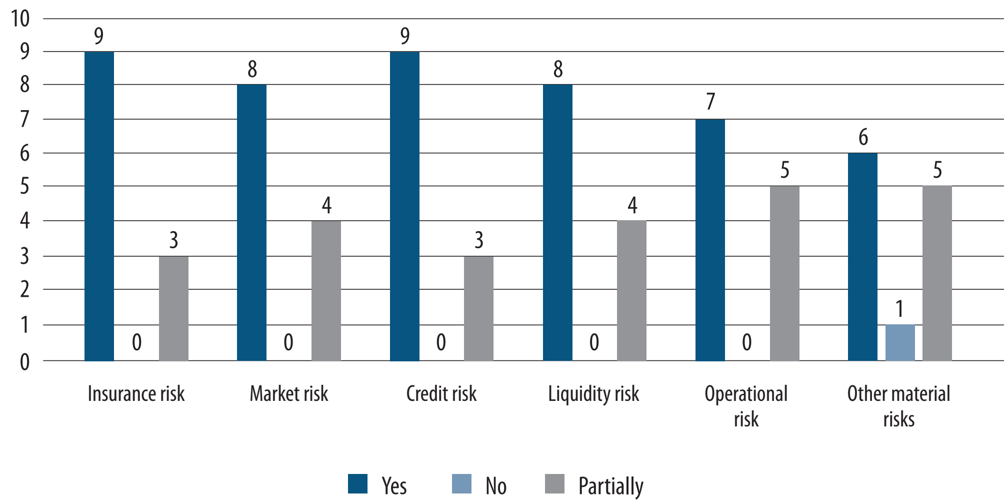
34. Do you have a record of registered losses and incidents?



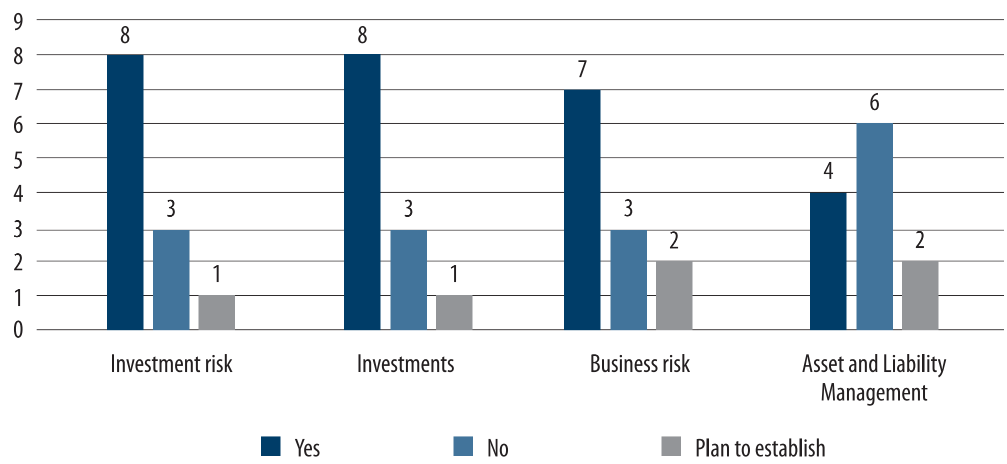
35. Have you analyzed the necessary changes under Solvency II in terms of corporate governance and risk management ?



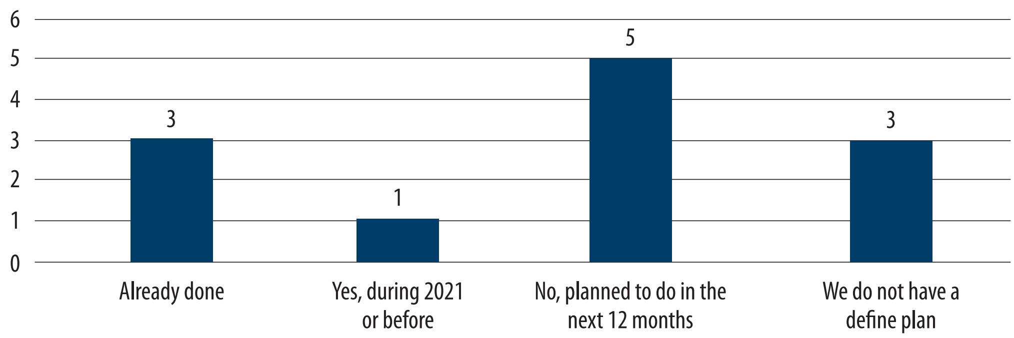
36. Do you have processes for analyzing exposure, concentration, mitigation and sensitivity to the following risks:



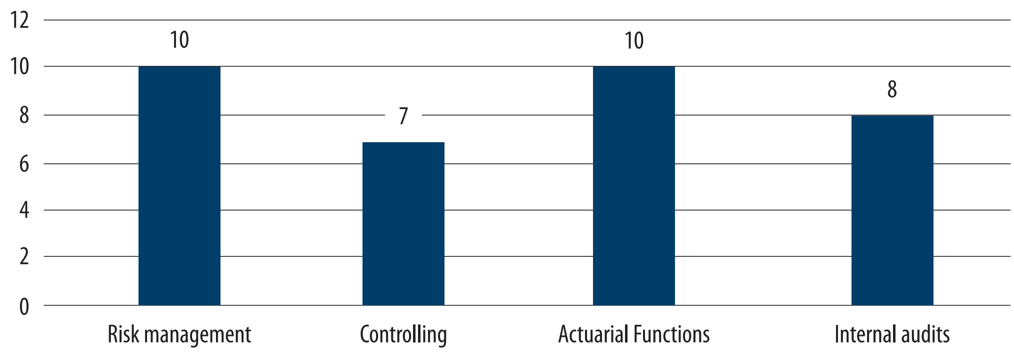
37. Do you have committees in place to oversee these functions?



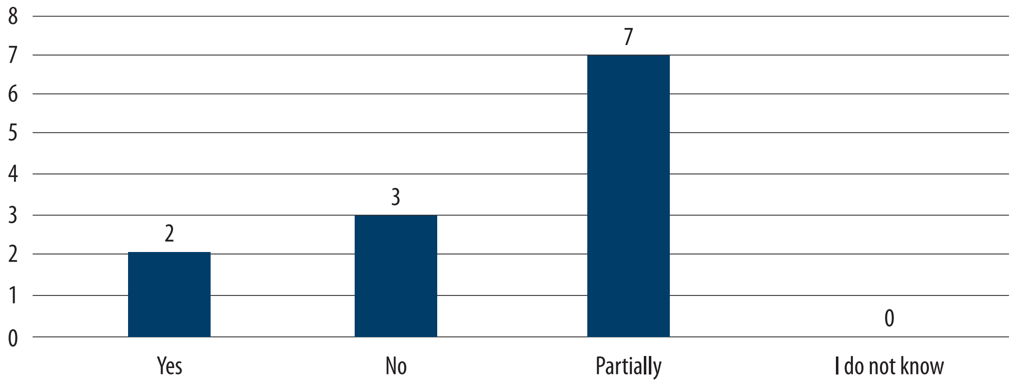
38. Have you started preparations or have you been preparing for ORSA (Own Risk Self Assessment):



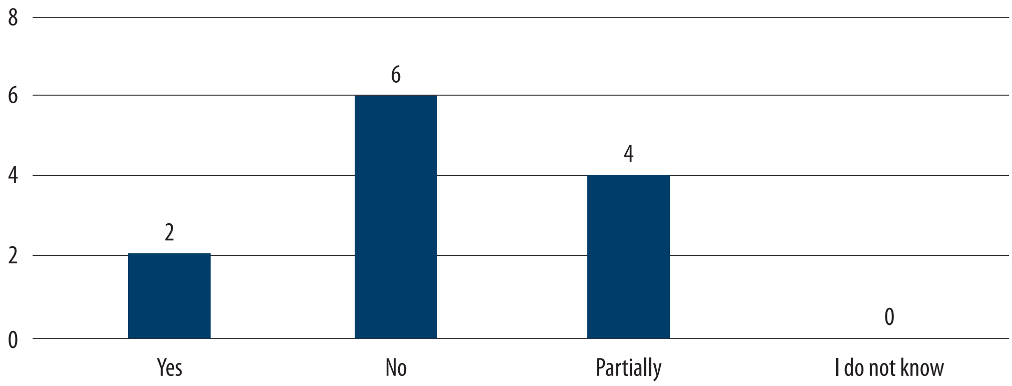
39. How many of your key functions have been established in accordance with Solvency II?



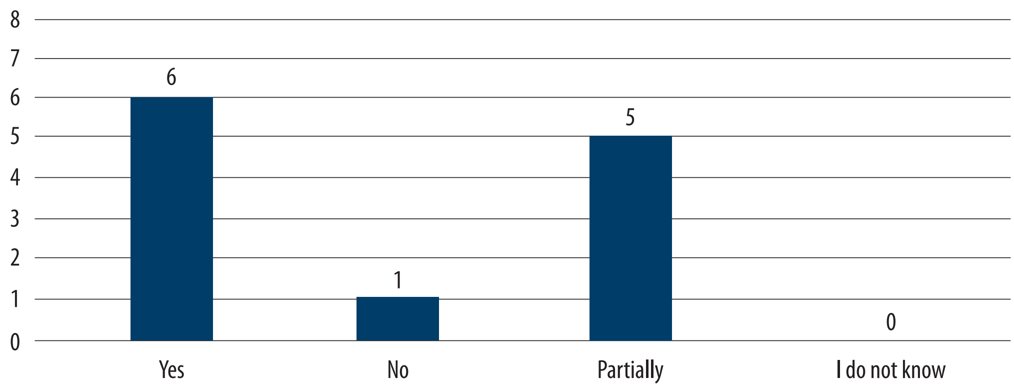
40. Do you have, for all types and risk categories that have been declared as a materially significant, a developed and implemented methodology for calculating the internal capital requirement, that is, an internal model that includes an analysis of the sensitivity of its parameters, as well as testing its outputs/results for stress (based on different 'extreme but plausible' scenarios)?



41. Until you have an ORSA process established in the Company, as a strategic process of centralized and integrated risk and capital management, integrated into the company's corporate governance system both in the domain of strategic planning and in the business decision-making processes of strategic Level, and in the processes of monitoring the exposure of the company's business to materially significant risks?



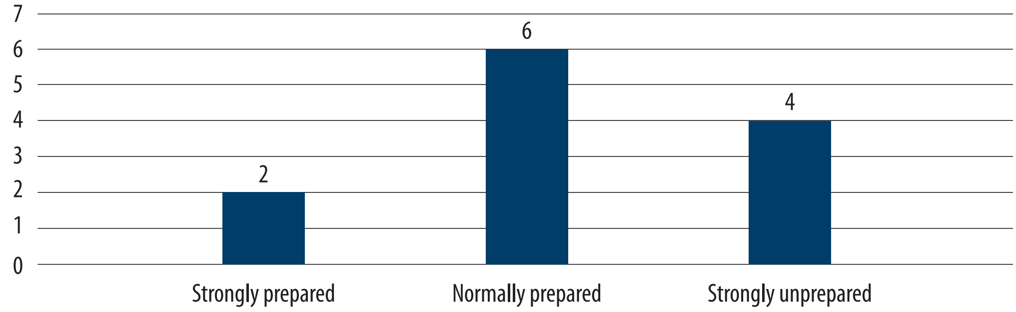
42. Does the Management and Supervisory Board of the Company participate in defining risk appetite and risk profiles of the company?



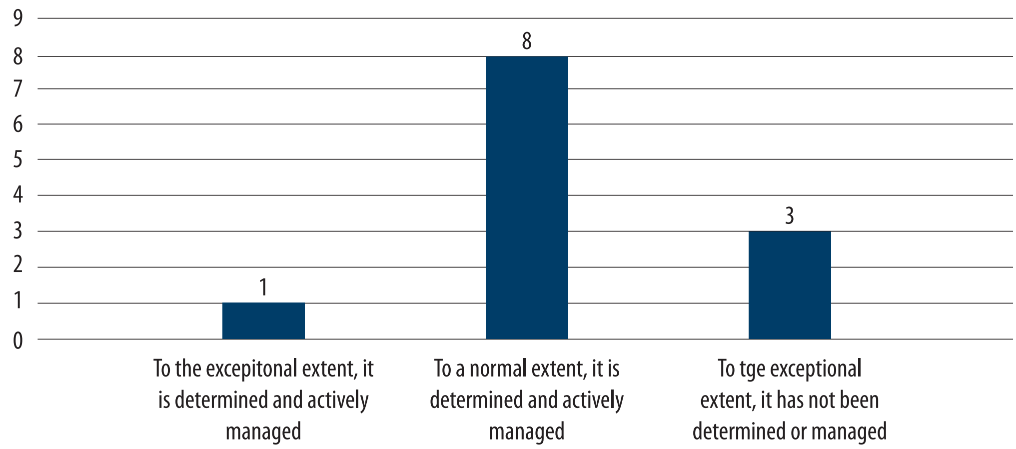
Only two companies answered affirmatively to the question number 41. They stated that they have a defined and documented dynamic and annual schedule of activities within the ORSA process, that the results of the ORSA process have an impact on strategic planning within the company, and that they partially have established key functions in ORSA process.

AREA 4: ALIGNMENT WITH SOLVENCY II - PILLAR III

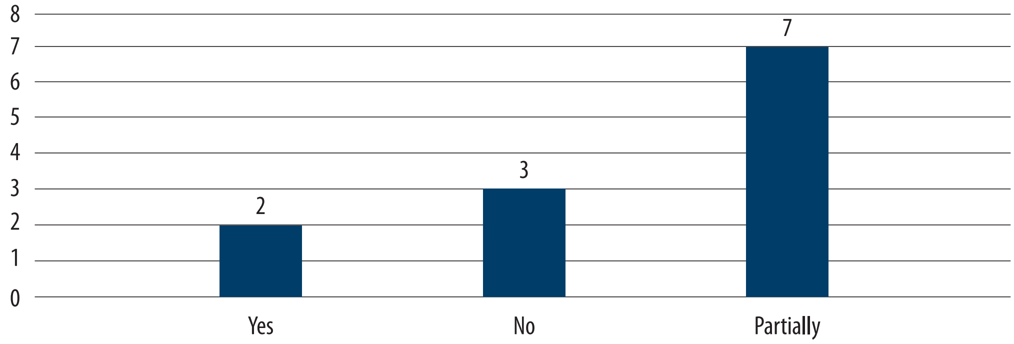
43. To what extent has your strategy and policy been prepared for Pillar III requirements?



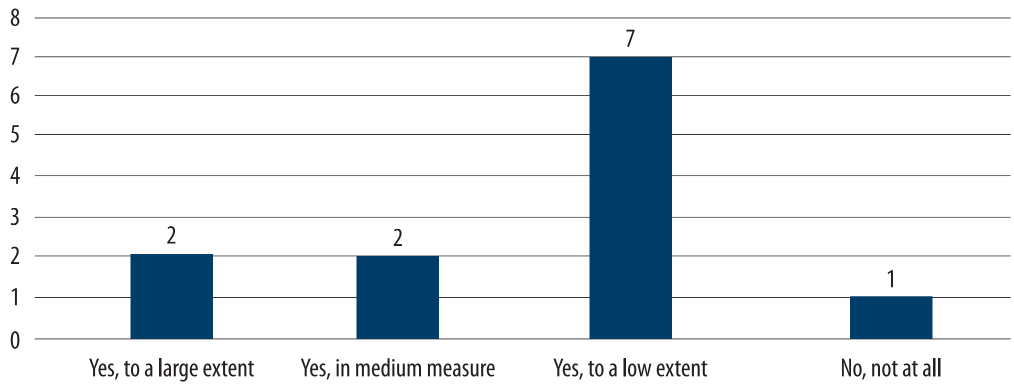
44. To what extent is the quality of the data, implicitly under Solvency II requirements, explicitly determined and actively managed?



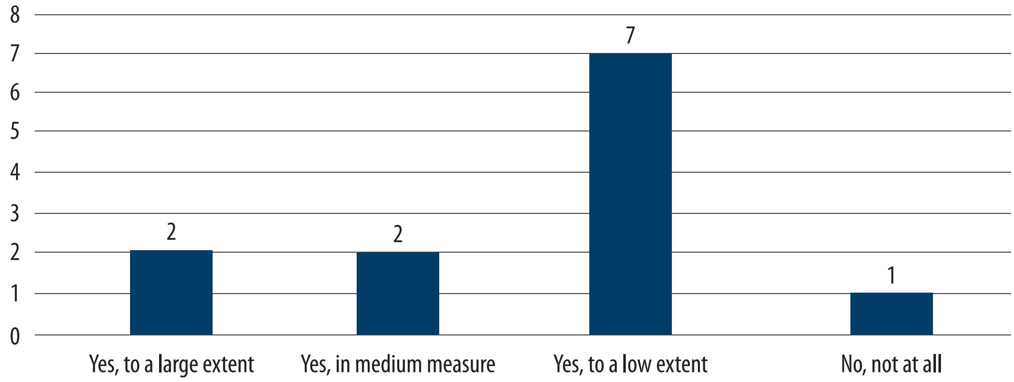
45. Are you familiar with the format and requirements of producing a Solvency Financial Condition Report (SFCR)?



46. How ready is your company at the moment, from the point of view of available resources, knowledge and IT tools, for reporting requirements for the issuance of SFCR on an annual basis?

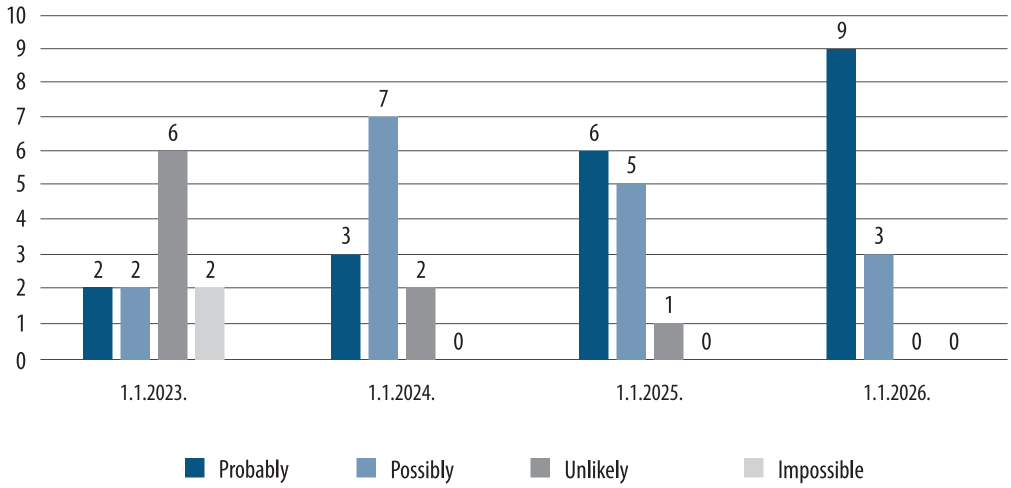


47. Does your company have the capacity to issue quarterly data in accordance with solvency II regulations requirements?

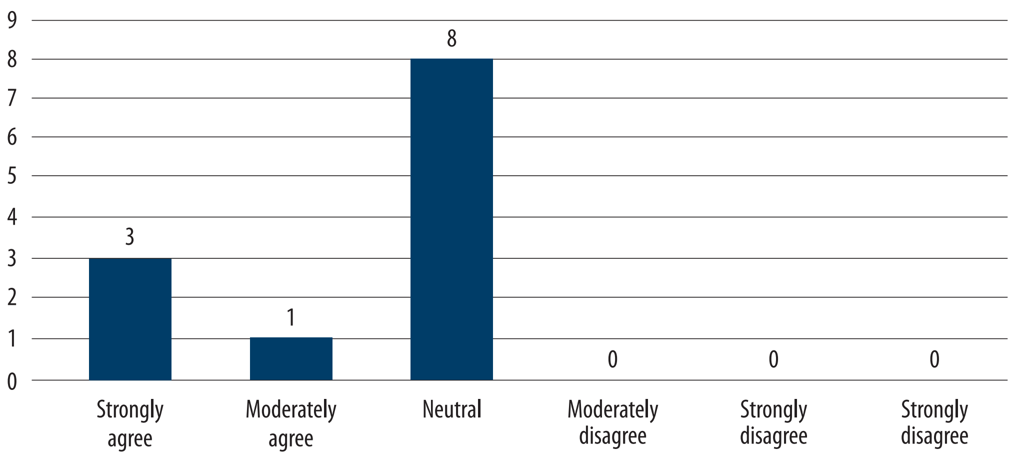


AREA 5: CONCLUDING QUESTIONS

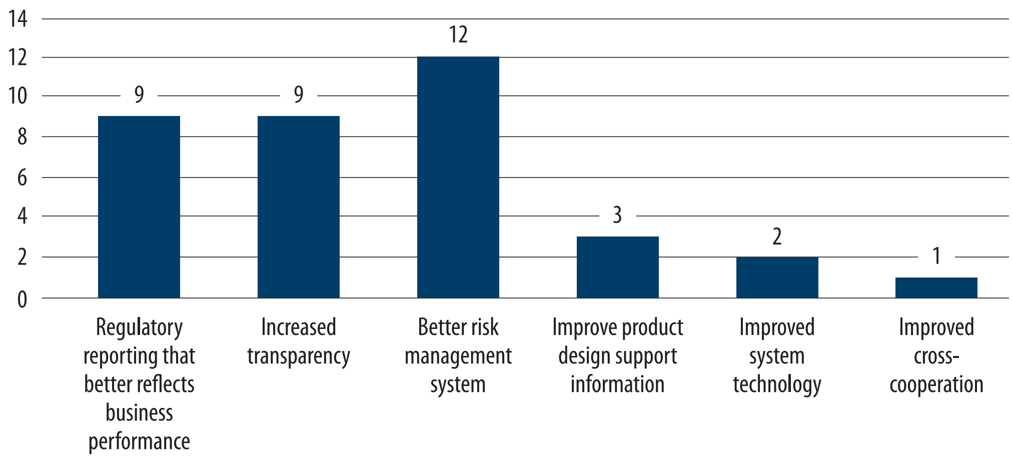
48. How confident are you that your company can, according to the table below, implement the new requirements in accordance with Solvency II?



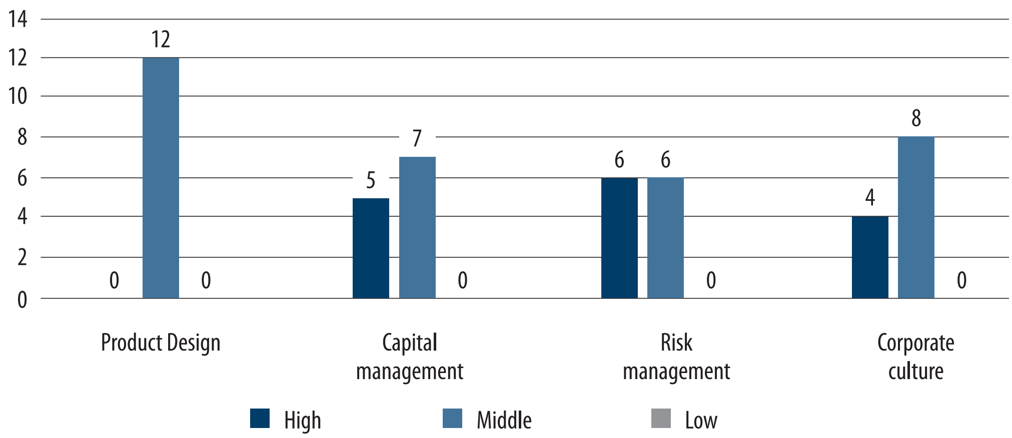
49. For your business activity, the advantage of adopting Solvency II reporting exceeds the expected costs?



50. What are the benefits you have identified for your company after complying with Solvency II requirements (choose top 3)?



51. Can you evaluate the impact of Solvency II implementation on the following:



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