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ROMANIAN INSURANCE MARKET AND SOLVENCY II REGIME

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Abstract: *Introduction of Solvency II regulation will enforce quantitative and qualitative supervisory controls over the insurance undertakings and will require considerably more effort from insurers. Together with IFRS, the accounting standards, Solvency II is going to dramatically reshape Romanian insurance market, to boost competitiveness and professionalism. This task demands a thorough research into the specific business models, organizational structure, scale of activities, information technologies and data flow structure, a course of action can be identified on a more general level.*
Key words: *insurance, solvency, business model, supervision*

1. INTRODUCTION

The Solvency II framework is laid down in Directive 2009/138/CE, adopted on 25 November 2009. Romania will have until 31 October 2012 to give effect to the provisions of the Directive within its jurisdiction.

The main objective of the research is to identify the preparatory measures which should be taken by the Romanian undertakings to implement the Solvency II regulation. A limitation on research has been the lack of an accessible, consistent national database necessary to address certain types of questions.

Through a careful regulation of the insurance market, Romanian market can reduce the globalization risks and can defence itself from the negative effects of this process (Badea & Novac, 2008).

Some reduction in financial globalization may be no bad thing in view of lack of a positive relationship between economic growth and portfolio and debts inflows, as well as pressure for real currency appreciation that these flows have tended to generate (http://www.rbd.doingbusiness.ro).

2. ROMANIAN INSURANCE MARKET TRENDS

Over the last two year, financial markets in Romania have proved that are creditworthy and solid. Insurance market, located in the main interrelated financial and economic sectors, felt, by the decreasing of the volume of gross written premiums on certain lines of insurance, a recoil, caused by an increased prudency of the segment of credits and that of financing by leasing. And this caution of the financial markets is caused by the economic decline, which is supposed to continue in 2010.

In 2009, the Romanian insurance market evolution was temperate in comparison with previous years, being strongly connected with other economic activities such as: real estate business, motor vehicles sales, banking activities, industrial production and non-banking activities.

As a result of the changes in the shareholder structure of insurance undertakings, the shares held by foreign investors in authorised share capital reached 88,65%, while Romanian capital accounted for 11,35%. Investors from foreign countries hold significant shares in the aggregate amounts of share capital, as it is presented in table 1.

Home state	2008	2009
Austria	33,36%	24,39%
France	22,47%	31,73%
Holland	10,38%	15,03%
Great Britain	5,73%	4,17%
Romania	12,07%	11,35%
Other	15,99%	13,33%

Tab.1. Structure of the share capital by home state

The 46 insurance undertakings registered in Romania in 2009 compete for a highly fragmented market. The top 10 insurers accounted for over 76% of the gross premiums written on life and non-life insurance (http://www.csa-isc.ro). The aggregate amount of gross premiums written by insurance undertakings in 2009 amounted to 8.869.746.957 lei, i.e. 5,24% real decrease rate compared with 2008. The trends of the Romanian insurance market are summarized in table 2.

Year	Gross written premiums (mil.LEI)	Net profit/loss (mil. LEI)	Inflation rate (%)	Insurance penetration in the GDP (%)	Insurance density (LEI/ inhabitant)
2003	2.673,82	+ 98	14,1	1,41	123,00
2004	3.476,54	+ 121	9,30	1,46	160,40
2005	4.417,16	+ 390	8,60	1,54	204,00
2006	5.729,28	- 685	4,80	1,67	265,70
2007	7.175,78	-2.532	6,57	1,77	332,40
2008	8.936,28	-5.825	6,30	1,77	415,62
2009	8.869,74	-1.032	4,74	1,80	413,27

Tab.2. Romanian insurance market ratios

3. THE SOLVENCY II REGIME OVERVIEW

The solvency margin is a buffer in a company's assets covering its liabilities. For the supervisor, it is important that the policyholders are protected, but it is also important for him to ensure the stability on the financial market.

Solvency II will lead to a change in the way the supervisors are working. Insurers are going be evaluated according to the existing risks in their portfolios, their assets and liabilities being quantified by economic principles. The implementation of Solvency II will mainly increase the consumers' confidence in insurance products, as the solvency model enables early detection of possible shortcomings and to further adapt the risk management process.

As testified by the De Larosière report in 2009, Solvency II will be the appropriate solution for the insurance industry to help prevent extreme financial crises (http://ec.europa.eu).

Solvency II is based on the three-pillar framework that is also existent in Basel II. Pillar 1 is a calculation of the Solvency

Capital Requirements (SCR), with a risk-based internal model and/or a standard formula (same approach from Basel II).

Pillar 2 is linked more to the enterprise risk management (ERM), with all that it entails: internal control requirements, risk management, governance, compliance and regular reports.

Pillar 3 consists of the improvement of transparency and defines the obligations regarding the level of information and communication for the regulators and with the markets.

During the Solvency II project, there were conducted a number of quantitative impact studies (QIS), the fifth-one being scheduled in August – November 2010.

Romania was part of the process for the first time, in April 2008. During the QIS4 exercise, 27 insurance undertakings of 42 authorised in 2007 submitted data to the Insurance Supervisory Commission (ISC) and only 7 were included in Romania's QIS4 Report. The 7 insurance undertakings account for 51,4% of total gross premiums written on non-life insurance and 59,7% of total gross technical reserves for life insurance.

For QIS5 exercise, ISC invited to participate all insurers will apply the new regime Solvency II, meaning 26 insurance undertakings. Participation at QIS5 exercise is mandatory for those undertakings which use internal model for the calculation of its SCR; till now only 5 insurers asked approval from the supervisory authority.

4. PREPARATORY MEASURES

One of the goals of Solvency II is to encourage the use of modern, up-to-date risk management techniques and its integration in the management of the insurance undertaking as a part of value based management (Rusalovskiy, 2008).

The implementation of Solvency II is a board and senior management responsibility and each insurer should nominate formally a senior individual to be responsible for Solvency II implementation. The benefits case between an internal model and the standard formula approach should be reviewed and a decision on the future direction made. After assembling a project team with representation from at least actuarial, risk, finance and IT, a gap analysis should be initiated in order to define the key requirements and identify the scope of work required to meet the future objectives as a first step of the implementation plan.

There are six key areas of responsibility for the board, covering: implementation, risk appetite and business strategy, risk management system, internal model and internal and external disclosure. The undertaking's implementation plans should be quite well developed till now. If board members have not already been reviewing such plans, exercise QIS5 is the occasion to do it.

How Romanian insurance market is dominated by small and medium-sized insurers, most of them probably will consider reasonable to use the standard formula to estimate their SCR. In this case the task left to the insurer will be the provision of data and reporting system. That will save the costs for designing an internal model (no expensive experts have to be hired), for software-development, for designing a uniform database.

However the price for that will be, first of all, a potentially higher solvency capital requirement, since the undertaking factors cannot be considered. And, second, the use of a standard model can potentially put the insurer in a worse competitive position. It can be a result of both, the higher capital requirement and consequently lower underwriting ability; and worse management decisions since not using the advantages of value based management

The implementation of an internal model will be a much more challenging task. It will require the join efforts of all of the undertaking's departments. Thus, communication of the goals, implications and progress of the model implementation project is very important for the projects success. Every employee must be aware of the importance of the project and informed of his or her role in it.

The analytical and mathematical work needed in design of an internal model solvency model requires competence in the field of mathematics, insurance techniques and portfolio management.

Internal models should be subject to prior supervisory approval, if the undertaking decided to use partial or full internal models rather than the standard formula.

A problem might arise concerning the valuation methods used; the calculation of SCR is based on the market value of assets and liabilities. This will present a problem for Romanian insurance undertakings which should prepare their financial statements according to Romanian Accounting Standards (RAS), but also for those using International Accounting Standards (IAS). In this case only the market value of the assets is available, however, the regulator most likely will provide an approximation procedure, which will allow deriving the market value of the liabilities from the book value.

5. CONCLUSION

At least half of Romanian insurers will apply the Solvency II new regime and they should make a choice between using the standard model prescribed by the regulator or implementing an internal model, which may be better suited to reflect the specific risks of individual companies.

The attitude of the senior management regarding Solvency II is very important because they are also responsible for the identification, assessment and mitigation of risks in the processes for which they are accountable. Their responsibilities should include the maintenance of updated process documentation, the nomination of local process owners who are responsible for either sub-processes or the use of the process in a geographical area. The implementation of key controls that require written evidence is based on a thorough assessment of the process-related risks.

Supervisors will need to understand the internal economic capital models and the new strategies reasoning of the undertakings. There is a clear role for undertakings to clearly communicate and explain their approach to supervisors. There should, however, also be a drive among supervisors to become fully conversant with the new concepts (Doff, 2007).

The major advantage of the regulatory developments, such as Solvency II, is that supervisory requirements are closely aligned with the risk management activities that insurance undertakings do internally and regulatory arbitrage will be avoided.

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