Finansinspektionen's Regulatory Code

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Finansinspektionen's general guidelines regarding underwriting risks and reinsurance risks in insurance undertakings;

decided on 17 March 2011.

Finansinspektionen provides the following general guidelines.

Scope

These general guidelines apply to the management of underwriting risks and reinsurance risks in insurance undertakings and apply to both direct insurance and ceded and accepted reinsurance. The general guidelines primarily address non-life insurance, but apply where applicable to all types of insurance.

Underwriting risks and reinsurance risks refer to both pure insurance risks and risks that may arise during administrative handling. These guidelines address both of these types of risks, which are not foreseen when setting premiums.

Systems for identifying, controlling and following up on risks can be designed differently in different undertakings. These general guidelines are therefore formulated in general terms. For example, for insurance policies based on collective agreements, the guidelines pertaining to underwriting instructions, risk assessment and premium calculation are only partly applicable.

The basis for these general guidelines is the requirement set out in Chapter 2, section 4 and Chapter 14, section 2 of the Insurance Business Act (2010:2043) that the operations of an insurance undertaking are conducted in accordance with the Insurance Business Act and other regulations regulating the undertaking's operations.

Definitions

The following definitions are used in these general guidelines:

ceding undertaking: direct insurance undertaking that reinsures large or small portions of its direct insurance activities with another insurance undertaking,

retro-ceding undertaking: insurance undertaking that reinsures large or small portions of its accepted reinsurance activities with another insurance undertaking,

EML (Estimated Maximum Loss): the maximum loss from a single event that could affect an insurance object (or multiple objects in the event of *accumulation*),

EML breakthrough: a loss larger than expected based on the EML calculation, *accumulation:* risk for a loss involving risk concentration, e.g. via multiple insurance objects being so closely correlated that the insurance provider risks incurring a loss on all or more than one of these objects as the result of a single event, and

adverse selection risk: the effect of setting premiums in such a manner that poor risks benefit at the expense of better risks, which e.g. means that the risk group's aggregate loss outcome gradually worsens.

Governance

An undertaking's board of directors should establish guidelines (policy) that are in agreement with the articles of association/by-laws and operational targets. The guidelines should cover both direct insurance and accepted reinsurance and, within the framework of the undertaking's operations, aim to achieve a satisfactory risk spread and an otherwise appropriate composition of the insurance portfolio given the undertaking's solvency.

With regard to reinsurance cessions, the board of directors should adopt a reinsurance program that is suited to the undertaking's unique risk coverage resources and in general in agreement with the undertaking's operations and underwriting guidelines.

To the greatest extent possible, the guidelines and system of rules established by the insurance undertakings for their insurance management should minimise unforeseen risks.

The guidelines should be continually reviewed and adapted to reflect changes affecting the undertaking's operations.

Underwriting risks

Unforeseen risks may arise as a result of deficiencies in the underwriting process. These deficiencies may lead to a poor risk spread or too high risk concentration in certain markets. They can also result in the incorrect classification of risks and, thus, premiums that are calculated to cover risks for a different type of insurance portfolio. Furthermore, an incorrect classification can lead to incorrect reinsurance and subsequently higher retention than was intended.

Unforeseen risks can also arise if, at the time of underwriting, efforts are not made to confirm that uncovered reinsurance exists to the extent assumed in the reinsurance program.

Underwriting instructions

The board of directors should ensure that underwriting instructions that comply with the undertaking's guidelines exist for every insurance class or risk group. The underwriting instructions should cover the following:

Underwriting limits and rules of procedure
The underwriting instructions should contain general underwriting limits within all of the areas covered by the instructions. The instructions should also include:

– maximum gross commitment per risk, estimated maximum loss (EML) that takes into account the undertaking's solvency, liquidity and the reinsurance capacity judged to be available,

– retention limits per insurance class, risk group or individual risk that is in line with the undertaking's reinsurance program,

– rules of procedure for underwriting, and

– underwriting limits that take into account individual managers' responsibility and competence.

Insurance registration

The undertaking should establish a system and procedures for registering all insurances. Registration should take place immediately. The underwriting instructions should contain information about the procedures the undertaking adopted for the registration of insurance policies.

The undertaking's underwriting instructions should be designed to ensure the registration of insurances.

The registration should state the type of insurance, factors that could affect the premiums, the scope, the EML amount, retention and reinsurance. The system should be designed in such a manner as to facilitate the effective monitoring of accumulation risk. Furthermore, the system should be designed in such a manner as to ensure that the information required to calculate the risk profile for the insurance policy is available.

Handling insurance documents

The underwriting instructions should specify the information the insurance documents should provide regarding the relevant conditions for the assessment of the insurance involvement. The instructions should also state how insurance documents should be stored.

Insurance documents should be stored safely and satisfactorily. When storing insurance documents, account should be given to the insurance contract's duration and period for final claim settlement following incurred damages.

Risk assessment

The underwriting instructions should cover for each insurance class or risk group:

– instructions and guidelines for risk selection and risk assessment,

– instructions for follow-up and renewal of insurance policies,

– a definition of accumulation risks within the undertaking's area of operation and instructions and guidelines for managing these risks, and

– instructions and guidelines for managing adverse selection risks.

For non-life insurance (insurance class 1–18) the underwriting instructions should include the following related to risk assessment:

– management of individual risks of such scope that the actual retention in the event of an EML breakthrough or accumulated losses exceeds the undertaking's maximum retention or the maximum retention set out in the technical guidelines and technical documentation, and

– the level of any uncovered risk via facultative reinsurance.

Furthermore, with regard to non-life insurance, it should be taken into account that insurance for which facultative reinsurance is required should not definitively be accepted before the uncovered insurance is considered secured.

Where underwriting contracts have long settlement periods, the underwriting instructions should take into account the specific risks that may arise due to these types of insurances.

For credit or suretyship insurance (classes 14–15) the following should be taken into account:

Obtained pledges in credit or suretyship insurances should not be able to replace reinsurance if the actual retention therewith exceeds the maximum retention set out in the technical guidelines and the basis for the technical calculation.

When assessing the risk of loan guarantees within credit insurance, the difficulty in settling such insurances without a claim arising, which extends the arrangement, should be taken into account.

For accepted reinsurance within each insurance class or risk group, the provisions set out above in respect of direct insurance apply. In addition, the underwriting instructions for accepted reinsurance should cover the following:

– how reinsurance agreements should be designed,

– the assessment of counterparties' (ceding undertakings or retro-ceding undertakings) solvency and capacity to pay,

– consideration for the accepted insurance risk's share of total risk
and the actual risk exposure that this share entails, and

– systems for feedback regarding the reinsurance cession to avoid increased risks associated with retrocession spirals.

Rating

The undertaking should establish procedures to ensure the quality of the rating process in standardised premium calculation systems.

With regard to individual, non-standardised premium calculations for individual insurance policies, the underwriting instructions for non-life insurance (insurance classes 1–18) should include the following:

– premium arguments based on technical assessments and their impact on the premium calculation, and

– premium arguments influenced by commercial considerations, e.g. discounts due to competition, etc.

Insurances brokered by insurance intermediaries

The undertaking should establish guidelines that provide the conditions for the undertaking's acceptance of insurance policies brokered by insurance intermediaries. These guidelines should include a verification that the intermediary is registered with Finansinspektionen for the insurance class being brokered and that the intermediary has the required liability insurance.

With regard to insurance brokered by an insurance intermediary, the undertaking should furthermore conduct its own assessment of the underlying risk profile. The undertaking should always verify the EML calculations provided by insurance intermediaries.

Where insurance policies brokered by insurance intermediaries include conditions that differ from the conditions normally applicable to the undertaking's insurance policies, a special assessment of the risks that could arise from these conditions should be conducted.

Reinsurance risks

Unforeseen reinsurance risks can arise due to insufficient, incorrect or deficient reinsurance protection. Such risks can arise, for example, if the insurance undertaking's reinsurance program is not in agreement with the operations conducted by the undertaking or if the insurance policies brokered by insurance intermediaries include conditions that differ from the conditions normally applicable in the undertaking's insurance policies.

Deficient communication between insurance undertakings and reinsurers can also cause unforeseen reinsurance risks, for example via incongruencies between the insurance policy's original conditions and the conditions of the reinsurance agreement.

Reinsurance program

Where applicable, the reinsurance program should include:

– a list of the undertaking's active reinsurance agreements including, where applicable, group reinsurance agreements that specify retention and limits,

– principles for reinsurance in each insurance class or risk group, taking into account what the undertaking has defined as "a single risk" and "accumulation risk",

– retention limit in each insurance class and risk group. In non-life insurance undertakings, when establishing the retention limit, the undertaking should take into account the maximum retention set out in the technical guidelines and basis for the technical calculation,

– general guidelines for choosing a reinsurer, and

– guidelines for reinsurance cessions in groups to which the undertaking belongs.

Ceded reinsurance

The undertaking should issue instructions for the management of reinsurance cessions that are in line with the undertaking's reinsurance program and instructions for underwriting. These instructions should include

– an assessment of the reinsurer's solvency and capacity to pay (security),

– the design of reinsurance contracts and reinsurance agreements, and

– a reporting and set-off procedure to ensure reporting to reinsurers and monitoring of which reinsurers the undertaking has claimed or may claim unsettled losses.

With regard to reinsurance cessions, in order to avoid excessively high retention, instructions should be issued for management of any EML breakthroughs.

Reporting

The board of directors should ensure that an information system is in place that in a structured and appropriate manner provides information about underwriting and the associated risks.

Furthermore, the board of directors should also ensure that it, and other persons or bodies responsible within the organisation, regularly receives relevant information from the information systems.

These general guidelines shall enter into force on 1 May 2011, whereupon Finansinspektionen's general guidelines (FFFS 2000:5) regarding underwriting risks and reinsurance risks in insurance companies shall be repealed.

MARTIN ANDERSSON

Erik Elvers