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TECHNICAL NOTE—INSURANCE SECTOR REGULATION AND SUPERVISION

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INSURANCE SECTOR REGULATION AND SUPERVISION

Prepared by
Monetary and Capital Markets Department

This Technical Note was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) mission in Sweden, led by Martin Čihák. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP program can be found at: http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

AML/CFT	Anti-Money Laundering / Combating Terrorism Financing
CDD	Customer Due Diligence
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
ESRB	European Systemic Risk Board
FI	Finansinspektionen (the Swedish financial supervisory authority)
EU	European Union
FLAOR	Forward-Looking Assessment of Own Risks
FSAP	Financial Sector Assessment Program
FSC	Financial Stability Council
GAAP	Generally Accepted Accounting Principles
G-SII	Global Systemically Important Insurer
IAIG	Internationally Active Insurance Group
IAIS	International Association of Insurance Supervisors
IBA	Insurance Business Act
ICPs	Insurance Core Principles
IORP	Institutions for Occupational Retirement Provision
IDD	Insurance Distribution Directive
IMD	Insurance Mediation Directive
LTG	Long-Term Guarantees
MCR	Minimum Capital Requirement
MiFID	Markets in Financial Instruments Directive
MMoU	Multilateral Memorandum of Understanding on Cooperation and Information Exchange
MoU	Memorandum of Understanding
ORSA	Own Risk and Solvency Assessment
P&C	Property and Casualty
PRIIPs	Packaged Retail and Insurance-based Investment Products
SCA	Swedish Consumer Agency
SCR	Solvency Capital Requirement

EXECUTIVE SUMMARY

This technical note provides an assessment of the development of regulation and supervision of the Swedish insurance sector since the Financial Sector Assessment Program (FSAP) in 2011. The note is part of the 2016 FSAP for Sweden.

The insurance sector is characterized by a large number of companies, high concentration, and the predominance of occupational pensions insurance. The five largest life companies, including providers of large collective pension arrangements for industry and labor organizations, account for over 50 percent of life sector assets and the largest four non-life companies for 80 percent of total non-life gross premium income. Most life insurance products offer a savings component. Occupational pensions dominate, now written almost entirely on a defined contribution basis. Sales of unit-linked products have been growing, but traditional products remain popular because they continue to offer guarantees, although at levels now aligned to prevailing low interest rates. With a relatively large duration gap and high levels of past business with guarantees, the life sector remains exposed to low interest rates, more so in combination with a fall in equity or real estate markets, where insurers hold significant investments.

The regulatory and supervisory framework has been enhanced since the 2011 FSAP. Finansinpektionen (FI, the Financial Services Authority) is the principal regulatory body, with responsibility for prudential regulation, consumer protection (in combination with the Swedish Consumer Agency) and macroprudential regulation. The most significant development since 2011 has been the implementation of the EU Solvency II framework from January 1, 2016. Most of the 2011 FSAP recommendations on insurance have been addressed, including higher resourcing (up by 50 percent for insurance supervision) and increased independence from government.

Solvency II has brought higher standards of regulation, but is not being applied in full, on a mandatory basis, to all occupational pensions insurance. The approach to Solvency II implementation has been thorough. Applications to use internal models have been fewer than expected and none has been approved as yet. A relatively market consistent pre-2016 approach to valuation has reduced the need for transitional measures associated with long-term guarantee business. Solvency II has brought improvements in regulatory reporting and group supervision, as well as higher overall solvency coverage. However, the requirements apply in full across only some 40 percent of the market (by assets in savings products). Using transitional measures available until 2019, Sweden has permitted companies to exclude occupational pensions insurance from the application of the main solvency provisions of the framework. Insurers taking advantage of this approach include many of the largest. Solvency II has, however, been applied in full to non-life companies.

Some measures are recommended to strengthen solvency regulation further. Solvency II should be applied in full to occupational pensions insurance, unless the government decides to create a separate national regime for occupational pensions, as exists in many other countries (in which case it will be important to restore the same level of protection across insurance and pensions, as has long existed in Sweden). In the interim, FI should not hesitate to impose additional requirements on companies in respect of business not covered by the new Solvency II requirements, if necessary to reflect risk or facilitate effective supervision. For Solvency II business, early follow-up on likely non-compliance with reporting requirements will be important. FI is encouraged to focus supervisory effort on areas of significant change, including the more principles-based approach to investments. It should use its continuing review of companies' Own Risk and Solvency Assessments as an input into capital requirements to be applied, as appropriate, to individual companies, using the tools it has to impose such requirements.

Some strengthening of the supervisory approach is also recommended, which would require additional resources. FI is implementing an approach to supervision based on a well-articulated risk assessment framework, a mix of firm-specific and thematic work and a matrixed approach to deploying general supervisory and specialist resources. The approach addresses the challenges of large numbers of insurance companies and limited resources and aims to equip supervisors to take a forward-looking, judgment-based approach. It is recommended that FI overlay its risk-based allocation of resources with minimum supervisory staffing levels, an extended range of minimum supervisory activities for the highest impact entities and increased resourcing of the teams supervising the highest risk companies. Increased on-site supervisory work and more systematic written communication of the actions expected of companies in response to supervisory work is also recommended.

FI's approach to consumer protection work would also benefit from increased resources as well as a broader mandate. FI's new and separate consumer protection function (covering all sectors) has equipped it better to identify and address risks to consumers, in cooperation with insurance prudential supervisors and other agencies. Its agenda includes major issues such as the future of commissions-based remuneration. It is recommended that resources be augmented, including for consumer protection supervision of individual companies. A broader mandate from government would avoid the need for FI to seek mandates in respect of new areas of focus, with the delay this can entail.

It is also recommended that the authorities review over time their approach to development and use of macroprudential tools and financial stability work. FI's mandate for macroprudential regulation covers insurance as well as banking, although, as in other countries (and at the EU level), thinking on practical measures for insurance is developing. FI is already monitoring for potential sources of instability, but none of the Global Systemically Important Insurers (G-SIIs), on which recovery and resolution work is most advanced, is present in Sweden. There are, however, large domestic insurers. There has been no experience of failure of a significant company in many years. While microprudential supervision appears to be the priority, it is recommended that the authorities, led by FI, develop a strategy and plan for practical measures, starting with crisis preparedness and extending to recovery planning for the major companies.

Table 1. Sweden: Main Recommendations

Recommendation	Responsible authority	Priority
The authorities should decide as soon as possible on the approach to be taken to the regulation of occupational pensions after transitional measures expire for occupational pensions insurance in 2019. They should ensure that whatever approach is chosen, the same level of protection is provided to occupational pensions as to life insurance. (Paragraph 37 of this note)	Swedish Government	High
In the interim period, FI should place any further requirements on occupational pension insurance not subject to Solvency II requirements which they judge necessary to deliver effective regulation and supervision, including additional reporting. The government should give FI new powers to do this, if necessary. (Paragraph 37)	FI (and Swedish government if necessary)	High
FI should focus early attention on key areas of the new solvency framework where the approach has greatest implications, including investments; and use its review of ORSAs to require companies to meet additional capital requirements where risks or governance and risk management shortcomings are evident. (Paragraph 37)	FI	Medium
FI should overlay its approach to risk-based allocation of resources with minimum staffing levels and an extended range of minimum supervisory work for the highest impact entities and increased resourcing of the teams addressing the highest risk companies. Increased on-site supervisory work and more systematic written communication of the actions expected of companies in response to supervisory work is also recommended. (Paragraph 50)	FI	Medium
Supervisory resources for consumer protection work should be augmented, including for supervision of individual companies. A broader mandate from government would avoid the need for FI to seek new mandates in respect of consumer protection issues, with the delays this can entail. (Paragraph 57)	Swedish Government	Medium
While microprudential supervision appears to be the priority, it is recommended that the authorities, led by the FI, develop a strategy and plan for practical measures, starting with crisis preparedness and extending to recovery planning for the major companies. (Paragraph 62)	FI, the Riksbank, and the Ministry of Finance	Low

INTRODUCTION[1]

A. Scope and Approach of this Note

1. **This technical note provides an update and an assessment of the development of regulation and supervision of the Swedish insurance sector since the Financial Sector Assessment Program (FSAP) in 2011.** The note is part of the 2016 FSAP in Sweden, drawing on discussions in Sweden from April 18 to 29, 2016. A separate technical note records the results of stress tests carried out on insurance companies, as well as on banks and mutual funds.

2. **The note focuses on key issues, with reference to international standards but without presenting a detailed assessment of Sweden's observance.** As an update to the full assessment of observance of the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS) carried out in 2011,[2] the note focuses on developments such as the implementation of the EU Solvency II framework in Sweden, from 1 January 2016. Unless stated otherwise, references in this note to the IAIS ICPs are to the version issued in October 2011, as revised in October 2013 and November 2015. The institutional arrangements for financial sector regulation and supervision are presented in Section B.

3. **The note draws on extensive discussions in Sweden.** Meetings were held with Finansinpektionen (FI—the Swedish financial supervisory authority), which also shared examples of actual supervisory practices and assessments, the Ministry of Finance, the Riksbank, the Swedish National Debt Office, a selection of insurance companies and industry and professional bodies and one rating agency. The author is grateful to the authorities and private sector participants for their cooperation. The work benefitted greatly from their readiness to discuss issues and share information. The author is especially grateful to FI for their close cooperation.

B. Overview—Institutional and Market Setting

The Swedish insurance market

4. **The Swedish insurance sector is large and dominated by life insurance companies**. Total insurance assets exceeded SEK 4,000 billion at the end of 2015, around 20 percent of total financial sector assets and almost 100 percent of GDP.[3] Some 90 percent of insurance sector assets were held by companies in the life insurance sector. There are over 300 registered Swedish insurance companies, but most are small or conduct business on a purely local basis (Table 2 sets out the development of insurance company numbers, excluding smallest companies, as well as occupational

[1] This technical note was prepared by Ian Tower (IMF external expert) and benefited from the input and advice of Timo Broszeit (IMF external expert), who is also the co-author of the Technical Note on Stress-Testing.

[2] Sweden: Financial Sector Assessment Program—Detailed Assessment of Observance of Insurance Core Principles, IMF Country Report No. 11/282, September 2011 (https://www.imf.org/external/pubs/ft/scr/2011/cr11282.pdf)

[3] Insurance penetration was 7 percent of GDP in 2014, in line with the European average (Source: Swiss RE Sigma).

pension funds, which, although not insurance companies, are subject to a similar regulatory framework)[4].

5. **Industry concentration is high.** The five largest firms in the life sector account for over 50 percent of the market (by assets), and the top four in the non-life sector, including a branch of a Danish company, for around 80 percent (by gross premium income). The big four Swedish banking groups are present via subsidiaries in both life and non-life sectors and two Swedish insurance groups own (relatively small) banks.

Table 2. Sweden: Numbers of Insurance Companies and Pension Funds

	2011	2012	2013	2014	2015
Life	40	40	39	39	37
Non-life	48	46	45	44	41
Major local non-life	50	42	40	40	41
Reinsurance	2	2	1	1	1
Captives	41	41	42	44	44
Others (Pension funds)	11	11	11	11	11
Total	192	182	178	179	175

Source: FI

Note: Excludes smallest insurance companies.

6. **The life insurance sector is dominated by pensions business and particularly by occupational pensions.** Most life insurance companies offer both pure insurance and savings products. Occupational pensions dominate, now written almost entirely on a defined contribution basis and accounting for two thirds of premium income.

7. **Much of the business is generated by four large collective pension arrangements managed by employer and labor organizations**[5]. Underwriting of this business is mostly done by three of the largest mutual insurers (the life market is dominated by institutions established as mutual organizations, where policyholders also own the business and bear the business risks). Life insurers also offer private pensions, although new business has been greatly reduced as a result of the recent phasing out of tax advantages, and endowment insurance products.

8. **Unit-linked insurance has until recently been accounting for an increasing share of new business.** In an effort to diversify from capital-intensive traditional products, life companies have been selling more unit-linked policies, where the policyholder bears all the investment risk (more complex forms of the product such as variable annuities are not sold). However, traditional insurance products remain widely available, typically defined contribution occupational pensions insurance policies which guarantee a return of premium in the form of annual payments after

[4] In addition, there are around 80 pension foundations supervised in part by FI.

[5] The four main schemes cover private (mainly blue collar) workers, private (mainly white collar) workers, municipal and central government employees and have up 3 million individual employee members.

vesting or some variation (for example, 80 percent, or more commonly 100 percent of premium plus a modest rate of return)[6]. Products with any form of guarantee are popular and some companies noted in discussion that they have to an extent been taking back market share from unit-linked.

9. **Most life insurers have large books of past business**. Much of this is occupational pensions with guarantees above current market interest rates (the average guarantee across all life business with guarantees is estimated at 3 percent per annum).

10. **The non-life insurance market comprises most product lines, including reinsurance.** Motor insurance is the largest line of business of primary insurers, followed by homeowner and household insurance. Pet insurance is growing strongly. Reinsurance is sourced both from the major international companies and from a small domestic reinsurance sector. There are a number of captive insurers, although their aggregate assets are small.

11. **The Swedish insurance sector has a predominantly domestic focus.** While there are many branches of companies incorporated in other EEA countries, their individual market shares are mostly low. In non-life insurance, however, branches account in total for around 25 percent of premium income and there is a large branch of a Danish non-life company, which is itself part of a UK group. There is no Global Systemically Important Insurer (G-SII) based, or otherwise operating, in Sweden[7]. Most insured risks are domestic, except in the case of reinsurance. Swedish insurers have limited operations outside Sweden and the large majority are in the EEA. A number have operations in other Nordic and Baltic countries or are owned by parent companies in these countries. The one medium-sized reinsurance company in Sweden is a part of group based in Bermuda.

Table 3. Sweden: Distribution Channels at Sales of Life Insurance (percent)

	2010	2011	2012	2013	2014
Own sales force	12	17	17	18	21
Agents and brokers	22	36	33	30	31
Banks	12	14	10	12	14
Corporate benefit portals	49	23	28	28	28
Other	5	11	12	12	7
Total	100	100	100	100	100

Source: Insurance Sweden.

12. **There is a variety of distribution channels for insurance products.** Business is generated by direct sales as well as through intermediaries (tied agents and brokers), which account for the largest share (Table 3). The bancassurance channel is relatively small. Given the importance of occupational pension business, much distribution takes place via corporate benefit channels including employee benefit consultants. Costs of distribution can be especially low, in connection

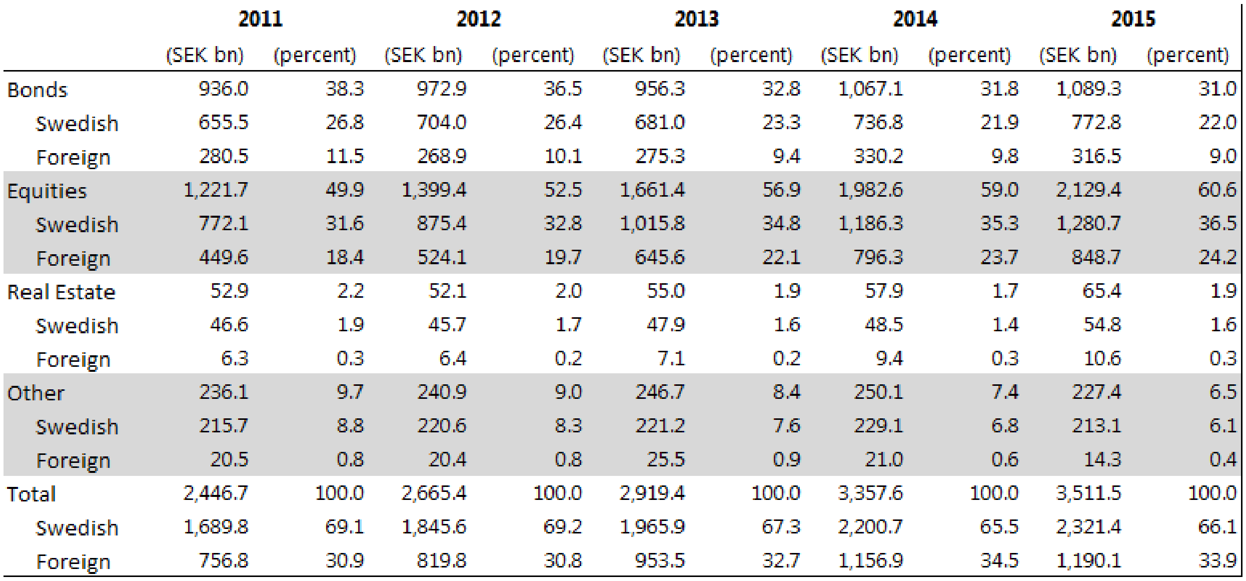
[6] On some products ("regular single premium"), the guaranteed rate is refixed at each premium payment. Some companies have also redesigned pension products so that the payout phase is determined (at 10 to 15 years, for example) rather than lifelong.

[7] FI notes that in addition, no insurer in Sweden falls within the scope of the IAIS's definition (based broadly on extent of cross-border business and overall size) of an Internationally Active Insurance Group (IAIG).

with collective pension schemes. Other sales are remunerated on a commission basis, which is subject to disclosure requirements (there is an active debate whether to restrict or ban the payment of commission and other inducements on advised sales).

13. The low interest rate environment is a major challenge for the life insurance sector[8]. The duration gap between assets and liabilities is among the highest in the EU, according to EIOPA. As well as reducing guarantees offered in new business and increasing sales of unit-linked policies, they have been changing their asset allocation. The financially stronger companies have in particular been taking on more risks, for example moving out of sovereign bonds into corporate bonds and equity (Table 4). Swedish insurance companies have traditionally run high equity exposures compared with their European peers, making the sector vulnerable to the combination of a prolonged period of low interest rates and a fall in asset prices (both equity and property).

Table 4. Sweden: Life Insurance Companies' Assets



	2011		2012		2013		2014		2015	
	(SEK bn)	(percent)	(SEK bn)	(percent)	(SEK bn)	(percent)	(SEK bn)	(percent)	(SEK bn)	(percent)
Bonds	936.0	38.3	972.9	36.5	956.3	32.8	1,067.1	31.8	1,089.3	31.0
Swedish	655.5	26.8	704.0	26.4	681.0	23.3	736.8	21.9	772.8	22.0
Foreign	280.5	11.5	268.9	10.1	275.3	9.4	330.2	9.8	316.5	9.0
Equities	1,221.7	49.9	1,399.4	52.5	1,661.4	56.9	1,982.6	59.0	2,129.4	60.6
Swedish	772.1	31.6	875.4	32.8	1,015.8	34.8	1,186.3	35.3	1,280.7	36.5
Foreign	449.6	18.4	524.1	19.7	645.6	22.1	796.3	23.7	848.7	24.2
Real Estate	52.9	2.2	52.1	2.0	55.0	1.9	57.9	1.7	65.4	1.9
Swedish	46.6	1.9	45.7	1.7	47.9	1.6	48.5	1.4	54.8	1.6
Foreign	6.3	0.3	6.4	0.2	7.1	0.2	9.4	0.3	10.6	0.3
Other	236.1	9.7	240.9	9.0	246.7	8.4	250.1	7.4	227.4	6.5
Swedish	215.7	8.8	220.6	8.3	221.2	7.6	229.1	6.8	213.1	6.1
Foreign	20.5	0.8	20.4	0.8	25.5	0.9	21.0	0.6	14.3	0.4
Total	2,446.7	100.0	2,665.4	100.0	2,919.4	100.0	3,357.6	100.0	3,511.5	100.0
Swedish	1,689.8	69.1	1,845.6	69.2	1,965.9	67.3	2,200.7	65.5	2,321.4	66.1
Foreign	756.8	30.9	819.8	30.8	953.5	32.7	1,156.9	34.5	1,190.1	33.9

Source: Statistics Sweden.

14. In the non-life sector, risks are more diverse. Market risks on investment portfolios are similar to those of the life sector. However, underwriting results have been strong in recent years, reflecting the non-life companies' ability to adjust premiums regularly and the challenges for new companies to enter the market. The widespread use of reinsurance makes companies at least partially immune to the tail risks to which they are exposed, particularly windstorm. There are risks from potential claims inflation. Non-life companies have been affected by falls in investment income, but have remained consistently profitable in recent years, based on strong underwriting performance.

[8] Risks and vulnerabilities are discussed more fully in the Technical Note on Stress-Testing.

Regulatory and supervisory arrangements

15. **The FI is the principal supervisory agency for insurance sector.** FI has responsibility for prudential supervision and for conduct of business[9]. It also licenses and supervises insurance brokers and carries out indirect supervision of insurance intermediaries via its supervision of insurance companies. FI's wider responsibility for macroprudential supervision of the financial sector includes insurance. The Swedish Consumer Agency (SCA) has oversight responsibilities and enforcement powers in respect of insurance companies' and intermediaries' compliance with marketing and unfair contract terms requirements. The Consumer Ombudsman, a function of the agency, may initiate actions against insurance companies on behalf of policyholders. Separate bodies mediate on consumer complaints and provide information and advice to insurance consumers.

16. **The FI's insurance work is mainly carried out by the Insurance and Consumer protection departments.** Insurance comprises 71 staff in total, most of which are divided between a legal function (19 staff) providing legal input and support for supervision and handling regulatory transactions, insurance risk supervision, including actuaries, capital and accounting specialists (23), and an insurance supervision section (22). The Consumer Protection function was established only in 2014. Its work covers all financial sector activities. Of its 30 staff, seven cover bank and insurance conduct consumer protection specifically[10].

17. **FI is responsible to the Ministry of Finance, and its budget is approved by the Parliament.** FI levies fees and charges on the regulated companies broadly equal to the FI's planned expenditure, as approved in the government budgetary process[11]. In practice, FI has in recent years sought and obtained significant additional resources, including an overall increase of 56 percent between 2011 and 2016, from which it increased the resources available to insurance sector work by 49 percent. The ministry is responsible for the development of broad regulatory policy, including the overall approach to implementing EU legislation, and for presenting proposed new legislation to Parliament.

18. **The government has been increasing the scope of powers available to FI to issue binding rules.** New powers were given to FI, for example, in 2011 to issue binding rules on solvency and related issues. In other areas such as consumer protection, however, its powers remain relatively narrowly defined. Where FI identifies a need to set requirements in new areas, it makes a request to government for additional mandates. In recent years, such new mandates have generally been granted. Provisions for government involvement in some operational supervisory decisions of FI, including licensing of financial institutions, have been removed from relevant legislation.

[9] FI also has responsibilities for oversight of occupational pension funds (11) and some responsibilities for oversight of larger pension foundations (about 80) – which are outside the scope of this note.

[10] Others are responsible for the supervision of fund asset management companies, investment firms, insurance intermediaries, payment services companies and cross-sector risk assessment.

[11] The size of the fees and charges, as well as, for example, which types of matters should be subject to charge, is decided by the government (in cooperation with FI).

19. Arrangements have been made to promote cooperation among the authorities. At the most senior level, the Financial Stability Council (FSC), comprising the Government, FI, the Swedish National Debt Office and Riksbank discusses issues of financial stability and financial imbalances. (The Minister for Financial Markets takes the chair.) In case of an actual financial crisis, the FSC would function as a forum for the discussion of possible crisis management measures. Insurance sector issues, such as the implications of low interest rates on life insurance, have been considered by the FSC. There are various mechanisms for practical cooperation, including an agreement between FI and the SCA in respect of cooperation on consumer protection issues.

20. FI is an active participant in European Union (EU) insurance regulatory work. Much of the insurance regulatory framework already derives from EU legislation, including the solvency requirements (the Solvency II framework) and the regulation of intermediaries (Insurance Mediation Directive (IMD) and soon to be implemented Insurance Distribution Directive (IDD)). The EU framework for occupational pensions regulation (Institutions for Occupational Retirement Provision - IORPs) is also relevant in Sweden. The European Insurance and Occupational Pensions Authority (EIOPA) issues technical standards and guidelines on a wide range of issues, including on the supervisory approach and the functioning of colleges of supervisors. EU legislation and EIOPA material also covers an increasing range of issues related to consumer protection.

MAIN FINDINGS AND RECOMMENDATIONS

A. Overview of the Implementation of the FSAP 2011 Recommendations

21. Most of the recommendations of the most recent FSAP assessment of insurance sector regulation and supervision have been implemented. The 2011 assessment noted that there was a high level of observance of the ICPs[12]. Most were assessed as observed or largely observed and only in the powers, resources and independence of the supervisory authority and the regulation of derivatives was the approach found to be only partly observed. A key finding was that the FI lacked the resources required to carry out effective regulation and supervision. As mentioned, FI's commitment of resources to insurance supervision has increased significantly and provisions for government intervention in operational decisions have been removed.

22. The implementation of Solvency II has in principle addressed many of the gaps identified in regulation, although the new requirements have not been applied in full to all insurers. Capital standards have been strengthened, as have requirements on corporate governance, internal controls and the suitability of key persons. As discussed in Section B of this note, however, not all the new requirements apply to all occupational pensions insurance. In addition, FI has strengthened the supervisory process (Section C), increased its oversight of the reinsurance programs of primary non-life insurers and developed its consumer protection work (Section D), as recommended.

[12] The 2003 version of the ICPs was used in the assessment, although account was taken of early work on the revised version issued in 2011.

23. The authorities have decided not to take action on other recommendations. While all other recommendations have been considered, the authorities have not found it necessary to change FI's objectives for insurance supervision, to require publication of the reasons for dismissal of board members or the Director-General of FI or to require annual regulatory returns to be audited. FI has not yet applied to be a signatory to the IAIS Multilateral Memorandum of Understanding, although it maintains bilateral relations with other supervisors (Section C).

24. A summary of the FSAP 2011 recommendations and Sweden's responses is set out in the Annex to this note.

B. The Implementation of Solvency II

25. The approach to the implementation of Solvency II has been well-considered and thorough. The provisions have been implemented through changes to the Insurance Business Act (IBA), the main insurance legislation, and rules and guidance issued by FI. FI benefited from work undertaken under EIOPA's two-year preparatory framework[13]. Surveys were undertaken of insurance company readiness – several, mainly smaller, companies were found not to have made adequate preparations and action was taken by FI. Swedish companies were included in the 2014 EIOPA stress test, which was carried out on a Solvency II basis.

26. Implementation will be fully tested only when insurance company reporting under the new framework begins. Concerns remain over the readiness of companies to begin reporting on the new basis. The first reports were due in late May 2016. It will be important that FI follows up on late or inaccurate reporting. FI's own internal preparedness (to capture the reports and perform analysis) will also be tested and there may be strains, despite its preparations to date.

27. The implementation of Solvency II has, however, been greatly complicated and its impact reduced by the limited scope of its application to occupational pensions insurance. Sweden has made use of a transitional provision in the Solvency II Directive not to apply Solvency II in full on a mandatory basis to occupational pensions insurance. (Box 1 sets out the background and approach in more detail.) As a result, only some 36 percent of Swedish life and occupational pensions insurance business[14] is now subject to the modern risk-based standards represented by Solvency II (Figure 1), the majority (much of it conducted by many of the largest firms) remaining on the weaker Solvency I-based regime. It may be unclear to stakeholders which companies are subject to which regime[15]. FI's task has been complicated by the need to apply two regimes, in many cases (where companies have significant life as well as occupational pensions insurance business) to the same company.

[13] This covered (i) business organization and risk management; (ii) forward-looking assessment of own risks (FLAOR); (iii) pre-application for internal models; and (iv) reporting.

[14] Measured by "insurance capital" – the total amount of accumulated value in savings products.

[15] There will be full transparency to the public when the insurance companies issue their first full published reports, due in May 2017. In the interim, FI will ensure that the market is informed.

Box 1. Occupational Pensions Insurance in Sweden's Solvency II Implementation

In the absence of full international standards for occupational pensions regulation, Sweden has traditionally applied the same regulatory requirements and supervisory approach to life and occupational pensions insurance, as permitted under EU legislation on Institutions for Occupational Retirement Provision (IORPs). This approach has apparently served Sweden well, providing in particular for relatively well-funded occupational pension commitments.

However, the government decided in late 2015 to apply large parts of the EU Solvency II framework, on a mandatory basis, only to life insurance, making use of transitional arrangements that expire in 2019. The government's view was that because work on a new EU directive on occupational pensions regulation (IORPs II) was continuing, it would have been inappropriate to apply full Solvency II on a mandatory basis to occupational pensions insurance from 2016 with the potential for further changes in only a few years.

The Solvency II implementing measures provide for insurers with occupational pensions business to be able to continue to apply existing solvency requirements, based on Solvency I, to that business (and also to their life insurance business, if it constitutes less than 5 percent of the total); or to apply Solvency II requirements, if they prefer (and on notification to the FI). Companies with both occupational pensions and life insurance are not required by law to fully separate the two areas of business, for example into distinct funds within the company (although the IORPs Directive of 2003 (IORPs I), Article 4, required ring-fencing). Assets covering technical provisions must, however, be separated in registers for the two areas of business.

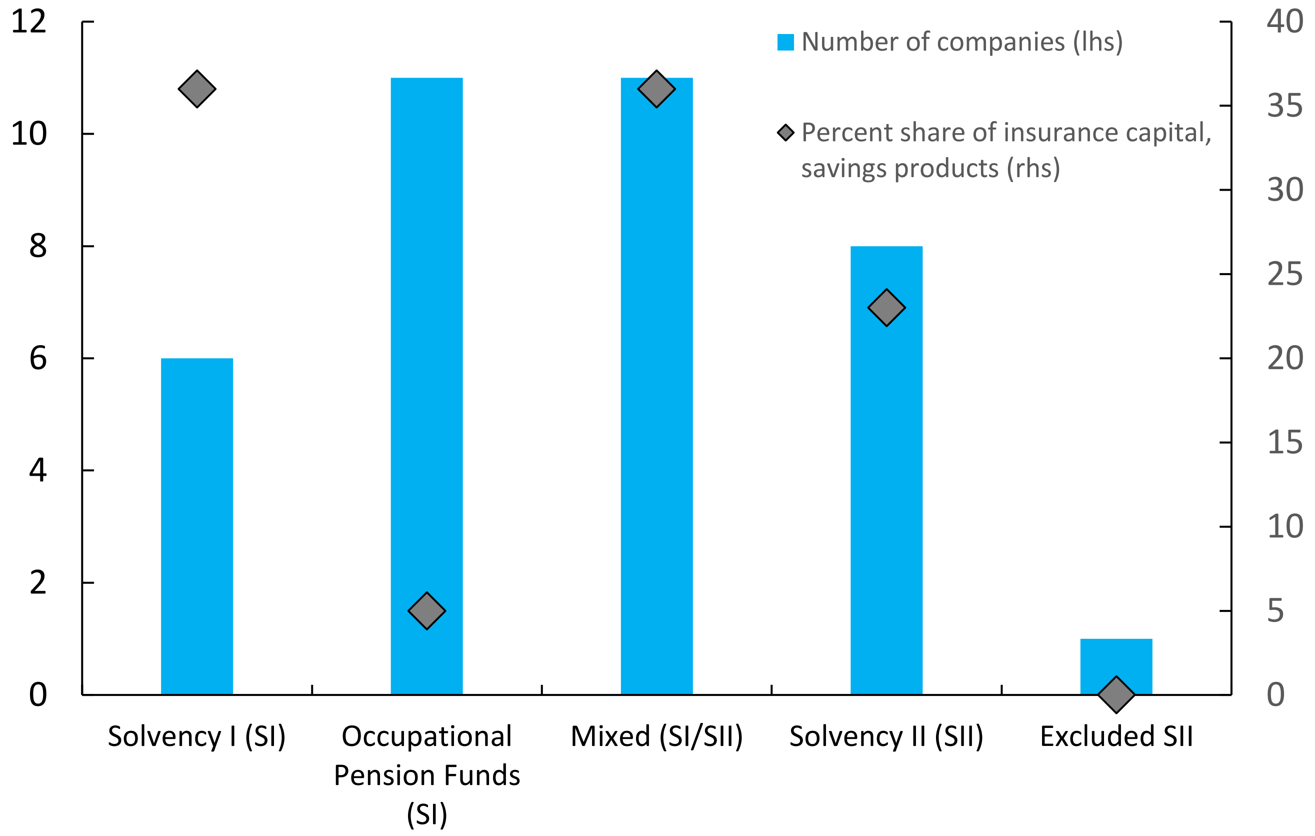
All insurers have nonetheless been required to comply with the new Solvency II requirements in relation to corporate governance and group supervision. However, core financial requirements, including those on valuation of assets and liabilities, investments and capital adequacy (and associated intervention provisions), are not applied in relation to business remaining on the existing requirements; nor are the new reporting requirements or the requirement to develop an Own Risk and Solvency Assessment (ORSA).

All parties agree on the need to bring forward proposals now for a framework to take effect by 2020, the choice being between application of Solvency II to all insurers and the development of a separate national regime for occupational pensions (as a common EU solvency framework is not expected). The FI prefers that the regime will continue to provide for an equal level of protection, continuing to provide for an equal level of protection. Insurance companies' views differ, with some preferring Solvency II to be applied to all insurers and others preferring a national regime that could be more tailored to the nature of the business.

28. **In discussions, the authorities emphasized that there are significant mitigants to the risks created by limited application of Solvency II requirements.** In addition to the application of governance and group requirements, as mentioned, these include:

- The continued application of FI's stress-testing framework to business subject to the Solvency I-based requirements: under the "traffic lights system", FI has been requiring insurers (since 2006) to carry out and report the results of a simple stress test based on individual risk factors with a simple correlations approach[16]. However, the traffic lights system, while it has contributed significantly to the movement to a risk-based capital regime, does not create binding minimum requirements (it is a supervisory tool), is not comprehensive in its risk coverage (compared with Solvency II[17]) and is not calibrated to generate as much capital in practice as the new requirements (FI can and has regularly changed the calibration through relatively small adjustments and updates). The traffic light results for individual companies do not have to be disclosed.

Figure 1. Companies and Business in the Life and Pensions Sector Divided by Regulatory Regime



Source: FI.
Notes: Occupational Pension Funds (friendly societies, which are pure IORPs) are included for completeness (these remain on Solvency I by law, under separate transitional arrangements, with no option to apply Solvency II)
Of the mixed companies, 23 percent of business is on Solvency I and 13 percent on Solvency II.
Not shown above are 11 life risk specialist companies, with total technical provisions of SEK 8.5 billion, all subject to Solvency II.

[16] These requirements are being discontinued for business subject to Solvency II solvency requirements, which are themselves based on sensitivities to single-factor shocks.

[17] For example, the traffic lights system does not include capital for operational risk.

- Some companies wholly or mainly applying Solvency I requirements are expected to participate in EIOPA's 2016 stress-testing exercise (based on Solvency II), although the basis on which they will do so is currently unclear.

- FI has agreed with the two largest companies not subject to full Solvency II requirements that they will share detailed information with FI on a voluntary basis (e.g. on investment assets) to facilitate supervisory assessment in the transitional period; and some companies have been developing Own Risk and Solvency Assessments (ORSAs) on a voluntary basis and presenting them to FI. Discussions with companies during the mission suggested that some, but not all, those subject to Solvency I will monitor solvency on the new requirements as well as the Solvency I methodology and traffic lights.

- FI expects that, while companies with a mix of Solvency I and Solvency II business are required to segregate only assets which cover technical provisions, they should also have a policy on the allocation (between life and occupational pensions insurance policyholders) of surplus assets for the purpose of calculating capital requirements. There is no requirement in the transitional arrangements that companies comprehensively ring-fence the two blocks of business, and there is a risk of regulatory arbitrage, requiring intensive supervision by FI.

29. **The impact of the Solvency II requirements, where applicable, on solvency ratios is expected to be significant but not to result in major non-compliance.** In common with other EU insurance supervisors, FI is awaiting initial reports. Based on surveys, the EIOPA stress tests and quantitative impact studies during the development of Solvency II, the coverage of solvency ratios (i.e., the extent to which actual capital exceeds requirements) is expected to be much lower than under pure Solvency I requirements and also lower than under the application of the traffic lights system. FI is monitoring a small number of companies that may be challenged to meet their Solvency Capital Requirement (SCR). One has already reported likely non-compliance with the SCR and FI will require a recovery plan, if necessary, in line with the response set out in Solvency II.

30. **Some of the impacts of Solvency II felt in other countries have been mitigated by measures prior to 2016 to align Swedish requirements to the emerging EU approach.** FI had already, at the start of 2014, adopted an approach to valuation of liabilities similar to Solvency II (prevailing risk free market interest rates, with extrapolation to an ultimate forward rate after a certain point in the curve). Even before that, the valuation approach had been relatively market consistent for many years, subject to adjustment during periods of volatility (most recently in mid-2012 and at the start of 2014) to dampen the impacts and address potential procyclical pressures.

31. **Similarly, some of the transitional measures included in Solvency II have not been needed by Swedish companies.** Because their valuation basis was already market consistent, insurers derive little or no benefit from using transitional measures in relation to the valuation interest rate. Companies may use the volatility adjustment, but benefits are likely to be limited at

present.[18] They may also use the matching adjustment[19] (subject to approval by FI), but are unlikely to satisfy the demanding conditions in practice. Overall, the impact of these measures, parts of the long-term guarantee (LTG) package included in Solvency II, is currently modest. Accounting standards are also well-aligned to the new solvency approach in practice.

32. The differential approach to solvency regulation poses challenges to public understanding of insurance company solvency. Sweden will not face the issues caused by the proliferation in some EU countries of measures of solvency for the same company[20]. Equally, the differences in reported solvency ratios entailed by the approach to occupational pensions insurance will complicate comparisons across companies (and for companies with mixed Solvency I and II business), when full disclosure takes effect in 2017. It will be important for the authorities to be prepared with public information, as necessary. While individual policyholders or prospective policyholders may be insensitive to published financial information, advisers may (and should) be aware, giving scope for misinterpretation and potentially bad advice.

33. FI has not had to consider large numbers of applications for internal models or undertaking-specific parameters. Having originally expected 18 model applications, FI was expecting only one and no application had been received at the time of the mission[21] (it had decided on one application for use of undertaking-specific parameters). This outcome apparently reflects the uncertainties over occupational pensions regulation, delays in finalizing the Solvency II framework, expectations that internal models would not deliver reductions in the SCR (compared with the standardized approach) as large as had been expected and a preference by some companies to use models for internal risk management and ORSA purposes only. FI made clear in a number of cases at an early stage that model applications were weak.

34. FI is relatively well-advanced in assessing ORSAs[22]. FI reviewed drafts in the Solvency II preparatory phase, sometimes more than once, and has given feedback on general points (via a publication) and to individual companies, mainly on the process and governance aspects. FI has plans to assess the quantitative aspects in more depth in its supervisory program for 2016. In discussions with the mission, some insurers noted they were seeking more detailed feedback on their ORSA submissions in the future.

35. Overall, Solvency II has greatly strengthened the regulatory framework in key areas covered by the ICPs, with an important qualification in relation to occupational pensions insurance. Both qualitative and quantitative requirements (at solo and group level) have been

[18] The volatility adjustment aims to avoid pro-cyclical investment behavior by insurers when bond prices deteriorate owing to low liquidity in bond markets or exceptional expansion of credit spreads. The adjustment has the effect of stabilizing the capital resources of insurers and is set by EIOPA.

[19] The matching adjustment is made to the yield curves for the valuation of predictable liabilities which are cash-flow matched using fixed income assets – where matching assets can be held to maturity and the insurer is consequently not exposed to price movements, only to the risk of default.

[20] Companies using transitional measures will have to publish their ratios with and without the impact, for example – when full disclosure requirements take effect in 2017.

[21] A second internal model application was received shortly after the FSAP mission.

[22] In the Solvency II preparatory phase, known as Forward-Looking Assessment of Own Risks (FLAOR)

strengthened, reporting and disclosure requirements greatly extended (from relatively light requirements previously, plus the traffic lights system, as described above), and supervisory understanding of risks enhanced. FI also increased its available expertise during the preparatory phase and has reallocated resource in response to the shortfall in internal model applications. Nonetheless, the lack of full implementation in respect of occupational pension insurance, in particular with regard to quantitative requirements and reporting on the EIOPA basis, is a major qualification and has an impact on the extent to which Sweden can be said to meet international standards of insurance regulation and supervision.

36. The challenge now, as for all EU insurance supervisors, is to adapt to the new requirements and to maintain adequate supervisory resources. The Solvency II framework has introduced a number of more principles-based approaches than have been featured in the previous EU or Swedish requirements. It will be important for FI to be equipped and ready to exercise judgment in areas such as the application of the prudent person approach to insurers' investments and governance requirements; and to be prepared to impose capital add-ons, require use of internal models or undertaking-specific parameters or impose other measures in the circumstances envisaged in the regulatory framework and in response to risks identified, for example in the ORSA process.

37. It is recommended:

- In relation to the issues with regulation of occupational pensions insurance:

  i. that the authorities resolve as soon as possible the uncertainties over the approach to regulation to be taken following the end of the transitional period in 2019; and that whatever regime they choose for after 2019, they ensure that the same level of protection is provided to occupational pension business as to life insurance, recognizing the similarities in products and risks[23]; and

  ii. that in the interim, FI should not hesitate (and should be empowered as necessary) to place any further requirements on the business still subject to the Solvency I framework which they judge necessary to deliver effective supervision, including requiring further additional reporting and enhancements to ORSAs (or equivalent tools of internal capital and risk management).

- In relation to the issues raised by the implementation of Solvency II, that FI should:

[23] Accepting that if the government's decision is to develop a separate national regime for occupational pensions (Box 1), then business subject to that regime is likely no longer to fall within the scope of the ICPs which do not extend to IORPs.

i. follow up inaccurate or incomplete reporting at an early stage to ensure that any significant misreporting is not embedded;

ii. focus early attention on key areas of the new framework where the new approach has greatest implications for companies and supervisory approach, including the new principles-based approach to investments regulation (enhancing the significant work on this issue is already planned);

iii. increase, taking on a risk-based approach, its feedback to companies on their ORSAs and require them to meet additional capital requirements where risks or governance and risk management shortcomings are evident; and

iv. develop a communications plan to support public understanding of the new solvency measures to be disclosed by companies from next year, including the different measures for companies with occupational pensions insurance.

C. Insurance Supervision

38. FI has significantly strengthened its supervisory function in parallel with the implementation of Solvency II. Following the increase in resources in recent years, 71 insurance supervision staff now supervise around 150 companies covered by Solvency II (out of the around 400 in total). Expertise has been acquired, mostly by hiring from the market. Training has been increased on risk and regulation, mainly externally sourced, a large part of it from EIOPA's training program for supervisors. FI is able to contract with external resources for supervisory work, but prefers not to do so. A new IT system is being implemented to support increased supervisory reporting under Solvency II and the appropriate analytical capacity.

Supervisory framework

39. A new framework for supervision work is also being implemented. This is consistent with, but also significantly builds on the EIOPA guidelines on the supervisory review process. It covers some 150 companies. Companies are surveyed under a risk assessment framework. Supervisory plans are then drawn up. Supervisory action is carried out (a key tool is the "investigation") and supervisory measures are then applied in response to the findings.[24]

40. There is extensive thematic supervisory work, much of it carried out as investigations. Recent and current projects include:

- An extensive investigation into the impact of the low interest rate environment on life insurers, which involved both on-site and off-site work, quantitative and

[24] The full details of the framework were discussed with FI as part of the assessment, but have not been made publicly available.

qualitative, and which resulted in a published report making findings available to all insurers;

- The implementation of the new Solvency II approach to investments in 2016 (the prudent person principle); and

- A wide-ranging analysis of the impact of IT failures and associated continuity planning, again being carried out in 2016.

41. However, firm-specific investigations are limited. Only eight on-site firm-specific investigations are to be carried out in 2016 (and only nine were completed in 2015)[25]. FI points out that these numbers cover formal investigations only. There is also regular contact with and discussions with companies on particular issues, as part of the work program or as event-driven action, including work carried out on the firm's premises[26]. This work is included in supervisory plans and recorded in a useful surveillance history document maintained for larger companies. It is only through investigations, however, that in-depth assessment is carried out – because using the formal procedures associated with an investigation mitigates legal risks such as FI being unable to use the results of such work to require follow up action or impose sanctions.

42. FI is also using its risk assessment framework to shed light on resource gaps, which appear significant, though they will be easier to evaluate when Solvency II is embedded. In the planning process, FI seeks to identify the difference between the level and type of work that should be undertaken under the supervisory model and work that can be delivered in practice, given resource constraints and commitments such as Solvency II work. While the model is at an early stage of implementation and future workloads are subject to uncertainty (for example, approvals for internal models could escalate), there are clearly resourcing challenges, including in relation to the staffing of on-site work.

43. The mission also discussed the extent to which this relatively sophisticated supervisory process is matched by readiness to make judgments and require companies to take action in practice. It was clear that FI's supervisors are making forward-looking judgments on issues of supervisory concern with the aim of requiring remedial action. There is considerable caution, however, over the risk that a communication which may be seen as prescribing or prohibiting a course of action is open to challenge as a de facto legal sanction that has not been subject to due process[27]. Required actions arising out of supervisory work therefore tend not to be communicated by FI to a company in writing, although they are recorded internally, together with the company's response, where it has agreed to act. The FI believes this does not compromise the efficacy of the supervisory approach. There may be a risk, however, that companies respond in practice less effectively to unwritten communications; or that supervisors settle for weak remedial action, to

[25] A further eight on-site examinations on a specific topic are also being considered.

[26] FI does not distinguish between off-site and on-site work (or use this language) in its planning for supervisory activities or in its organization of its resources.

[27] This is an issue that many risk-based supervisors face. They often seek to clarify that such requirements are to be seen not as sanctions but as necessary measures to reduce the risk of non-compliance in the future.

facilitate agreement with the company, mitigate the risk of challenge and avoid the cost of having to take the route of formal action. The mission did not see evidence of such risks arising in practice.

44. Separate supervisory approaches apply to intermediaries and for consumer protection issues, although work is coordinated. Risk assessment of insurance intermediaries is covered under the consumer protection framework, reflecting the main risks in relation to their business and the large number of individual entities (over 1,000). Consumer protection issues are included in supervisory plans, drawing on input from the separate unit within FI (Section D), but the risk assessment described in this section is aimed fundamentally at assessing the impact and probability of financial failure rather than mistreatment of consumers (Section D).

45. Separation of the risk assessment processes, as well as separation of resources, seems appropriate given the different focuses of prudential and consumer protection supervision. However, there is also overlap, particularly in relation to issues such as the allocation of surplus in life and pensions business. At present, FI appears able to make the connections and work cooperatively across the insurance supervision and consumer protection sections.

Group, conglomerate and cross-border supervision

46. FI has identified 17 groups subject to Solvency II and is further reorientating its approach from a solo to a group focus. The change from previous EU requirements (the supplementary supervision model) to full group supervision under Solvency II is a major development, entailing for example increased group information, the inclusion within group solvency calculations and other requirements of certain holding companies[28] and a focus on intragroup transactions (which will be reported in detail). Equally, some of the largest insurers are not parts of groups at all (or other group entities are not significant). Supervisory effort and, under the risk-based approach, resource allocation are therefore not always aligned with major groups.

47. FI is fully engaged in the EU process for cross-border supervisory co-operation. FI is the group supervisor and chair of the supervisory college for five Swedish insurance groups (all of which involve EU/EEA supervisors only) and participates as host supervisor in a further nine[29] - again, excluding some of the largest insurance groups which do not have cross-border business. Every college is supported by Coordination Arrangements on the EIOPA model, which include crisis preparedness provisions in an annex[30]. Risk assessments have been developed by the colleges led by FI, again on the EIOPA model. Arrangements have been put in place, for domestic as well as cross-border groups, for reporting of risk concentrations and intra-group transactions above certain thresholds set by FI with reference to EIOPA guidelines. Some joint working has been undertaken within the college arrangements. FI has a network of Memoranda of Understanding with relevant foreign authorities.

[28] Insurance Holding Companies and Mixed Financial Holding Companies

[29] Including the college for the group operating in Sweden through a large branch of an EU entity, where FI has access to the college because of the significance of the branch.

[30] The emergency Plan for colleges of supervisors

48. FI noted that the depth of analysis of groups and college risk assessments is likely to change significantly with the availability of more extensive information at group level. FI will be reworking its approach to take account of the increased availability of group information, which will be reported to FI but can be shared within the college. This process will be complicated by the fact that some companies subject to the college process remain on Solvency I for parts of their business under the transitional arrangements for occupational pensions insurance (Section B).

49. Insurance supervisors also participate in financial conglomerate supervision, mostly led by bank supervisors. There are nine financial conglomerates involving insurance business in Sweden. FI is the lead supervisor for six of these[31], of which two are insurance-led conglomerates (in practice, where the insurer owns the (relatively small) bank; only one of the two is an insurer of significant scale). FI applies the approach set out in relevant EU legislation. There appears to be effective cooperation within FI between bank and insurance supervisors, taking into account the relative significance of the elements of each conglomerate, both within each sector and within the conglomerate group. Given the distinct business models and separate regulatory frameworks, most supervisory work is appropriately focused on the sectoral issues.

50. It is recommended that FI:

- notwithstanding the clear need for a risk-based supervisory framework, increase its supervisory resourcing and extend its range of minimum supervisory activities for the largest institutions, regardless of risk, given the scale of the large companies in Sweden, at least in the early stage of implementation while the risk assessment framework has not been validated by experience;

- review its approach to on-site supervisory work, particularly whether there is scope for greater definition of the approach to on-site supervisory work within the category of "ongoing supervision", which is currently focused mainly on off-site analysis, using its investigations tool for where in-depth investigation is most necessary. This would help mitigate a risk that insufficient on-site work is carried out on firm-specific basis. It is also recommended that FI consider whether and how to mitigate the risks arising from its approach to communication of supervisory messages identified in the analysis of this note;

- further increase the overall level of resources for insurance supervision work, taking account of the effects of Solvency II implementation (and decisions on the future of occupational pensions regulation). FI should consider assigning more resource in particular to continuous supervision of the largest insurers, "red supervisory plan firms" (where not also large companies) and for on-site supervisory work, including investigations; and

[31] Others are supervised in Finland, France, and Norway

- continue to review its recruitment and retention approach for insurance supervision, developing a preferred model for the longer term (accepting that the current staffing reflects the demands of Solvency II implementation), which balances external and specialist hires with generalist staff and aims to raise retention experience as far as possible given the risks and constraints which FI faces.

D. Insurance Conduct of Business Regulation and Supervision

51. FI has significantly stepped up its consumer protection work on insurance in recent years. The establishment of a separate consumer unit has enabled FI to increase its focus on broad consumer issues, including those (such as commissions and inducements) which are common to different sectors, while continuing to address long-standing issues such as the fair treatment of policyholders in relation to the allocation of surplus in life and pensions insurance business. An annual publication sets out, with notable clarity, the agenda and key areas of concern. FI has not hesitated to propose wide-ranging remedies for identified problems, including the banning of commissions; or to seek new mandates from government where it lacks the authority to take action under existing powers.

52. FI applies a risk-based approach to consumer protection work. It uses a risk assessment framework to evaluate consumer protection risks annually, drawing on data such as complaints, input from other agencies, market intelligence and supervisory work; and identifies between five and 10 key risks. It typically then constructs a work plan with surveys or investigations to assess risks in more depth and to identify the need for action, which has included sanctions against individual companies, both insurers and intermediaries.

53. Cooperation with other agencies appears to be working. Sweden has many different agencies with responsibilities for consumer protection, information and advice for consumers and disputes mediation (only the courts can provide binding outcomes to disputes). In practice, responsibilities appear to be clearly defined – although this is not always apparent to consumers themselves, resulting in costs and inefficiencies from the need to redirect enquiries and complaints. Communication between agencies, particularly FI and the SCA as government bodies, appears to be effective, as evidenced by regular exchanges of information and cooperation on initiatives. The creation of its consumer protection unit has enabled FI to act to some extent as a hub for insurance (and other) consumer protection activity.

54. Key issues in insurance consumer protection are in life insurance and life intermediaries, with a particular focus on the quality of advice. These include commissions and inducements, where FI has sought a new mandate from government, which is expected to be addressed in the context of the implementation of recent EU legislation[32]. A long-standing issue has been transfers of pension policies from one provider to another, where FI is working with the

[32] The Insurance Distribution (IDD), the second Markets in Financial Instruments (MiFID II) and Packaged Retail and Insurance-based Investment Products (PRIIPs) Directives.

industry, under a government initiative, to improve disclosure of key information to consumers as well as reviewing the basis for transfers directly in its supervisory work[33]. As mentioned, FI continues to investigate the allocation of surplus in life and pensions business, the mandate for which has been bolstered with new powers in the Solvency II implementing legislation.

55. The approach is primarily cross-firm and thematic, partly reflecting the limited available resources. There is, however, cooperation with the insurance supervisors - consumer protection work may be included in their supervisory plans[34]. Given the high degree of market concentration, the largest companies are regularly covered in investigations. The unit is expecting to develop more focus on governance issues in the context of EIOPA's initiative on product oversight and governance.

56. Available resources for supervisory work are low given the range, complexity and severity of the issues which FI has identified. There may be a risk that the credibility of FI's commitment to enforcement of consumer protection requirements will be questioned if, having identified significant risks in its public statements, it is not seen to be following up with effective supervision and sanctions, as appropriate.

57. Overall, FI's work in this area appears to have advanced significantly and it is increasingly well-equipped to identify risks as well as taking a strategic approach to risk mitigation. However, it is recommended that:

- FI review the available resources for insurance consumer protection work, taking a forward-looking assessment of the likely level of future risks and the scope for FI to address them, and seek additional resources.

- The government review whether there is scope to give FI a broader general mandate for consumer protection supervision – to reduce the need for FI to seek additional mandates, which even where granted (as they have been in the past) may lead to delays in FI being able to address significant consumer risks promptly. (While this recommendation is framed in terms of consumer protection, it may also be applicable to future developments in other areas of supervision, including macroprudential work – see Section E).

- FI consider, subject to available resources, the further enhancement of its approach in two areas:

[33] Improving the transferability of pensions taken out before increased transferability was made available on new policies is the subject of a wider government review. Increased transferability will of course create risk as well as benefits for consumers, if not accompanied by sound advice.

[34] The main objective of FI's insurance supervision is that "policyholders and other beneficiaries are highly likely to receive the compensation to which they are entitled under insurance contracts they have entered into" – which may not encompass all consumer protection activities, for example, ensuring the contract is suitable for the customer's needs.

i. Data collection, where in addition to collecting complaints data from companies in the future, as is planned (available complaints data at present relate only to complaints to agencies), it would benefit from collecting data on product sales (maybe divided into advised and non-advised) in order to help better identify companies where supervisory activity should be targeted.

ii. The development of regular supervision of individual companies and intermediaries (or at least the largest companies) that would complement the thematic approach with assessment of the adequacy of governance and controls in relation to risks to consumers (including product oversight governance, drawing on current EIOPA work). This would help to ensure, as far as possible, that at least those companies with the highest consumer impact are addressing risks appropriately.

E. Financial Stability, Macroprudential Regulation, and Crisis Preparedness

58. FI and the Riksbank consult each other on financial stability issues in insurance. FI covers insurance sector issues in some detail in its regular publication Stability in the Financial System, reporting, for example, on life insurance exposure to low interest rates. The Riksbank's Financial Stability Department monitors the sector (its resources are more limited) and reports as appropriate in its own Financial Stability Report. It can make formal recommendations to FI to take specific action in relation to issues in insurance, but has not so far done so. FI and the Riksbank consult each other on issues such as the changes (most recently in mid-2012 and from the start of 2014) to the discount rate to be used in valuing life insurance liabilities. Both bodies represent Sweden in the European Systemic Risk Board (ESRB).

59. FI's general mandate for macroprudential regulation encompasses insurance, but the approach in practice will develop in line with EU initiatives. Without a G-SII and with limited cross-border business in insurance, FI is not engaged in Financial Stability Board (FSB) and IAIS work on developing and implementing relevant measures such as recovery and resolution planning and higher loss absorption capacity for the largest groups. (FI does however monitor the work done by FSB and IAIS in this area.) The strategy is to work within, and at the pace of, the EU process, including forthcoming EIOPA and ESRB work on insurance recovery and resolution and further European Commission work on the same issues, and on insurance guarantee schemes. Sweden has no guarantee scheme at present and there is no EU framework.

60. The mission reviewed, at a high level, key areas for potential action, drawing on the recent work of the ESRB[35] and IMF[36] as well as relevant ICPs including ICP 24 (macroprudential supervision):

[35] Report on systemic risks in the EU insurance sector, December 2015

[36] Global Financial Stability Report April 2016

- Evaluation of potential systemically important insurers: Sweden's insurance sector is characterized by life insurance institutions that are large relative to the size of the economy (the largest with assets equivalent to 20 percent of GDP and numbers of policyholders equivalent to 25 percent of the population). FI is planning to develop an approach to assessing systemic significance of domestic institutions. Its assessment of the impact of individual insurance companies and groups within its risk assessment framework (Section C) gives it elements of a tool for doing so.

- Identification of non-traditional, non-insurance business (activities that may give rise to systemic concerns – according to the IAIS framework – because of the implications for liquidity and maturity transformation, leverage, complexity or interconnectedness): FI assesses that there is limited such business (which includes more complex variable annuities, for example) undertaken by Swedish insurers (or their wider groups); and that the monitoring of such business will be facilitated by the extensive data reporting, including on groups, to be introduced as a result of Solvency II (where those reporting requirements apply).

- Addressing areas and implications of potential procyclicality in the requirements: the new framework on valuation and capital requirements based on Solvency II are relatively sensitive to changes in market prices, while the high common exposures to asset classes such as equities and covered bonds creates risks of (mainly life) insurers selling assets into, and exacerbating, falling markets; there are elements in the requirements that dampen the effects, such as aspects of the Solvency II discount rate to be used in valuing liabilities (including the Ultimate Forward Rate) and volatility and equity risk[37] adjustments. FI has adjusted the discount rate before, as mentioned. There is no general framework or specific mandate to take measures in case of pressures in the future specific to Sweden[38].

- Crisis planning and preparedness: most of the work in this area has been in connection with the colleges of supervisors (Section C) – where there are particular challenges on cross-border coordination - and has not encompassed large or otherwise significant domestic companies and groups; nor has any simulation or related exercise been undertaken, the priority reasonably being crisis preparedness for banks.

- Recovery and resolution: as mentioned, no work has been undertaken so far in this area, although FI sees its work in related areas, particularly its current initiative on IT risks, which will include a dimension on recovery from severe shock, as starting on the process of recovery planning; FI priority is to consolidate the improvement in microprudential supervision under Solvency II; nonetheless, life insurers are

[37] Under Solvency II, for the calculation of the SCR standard formula, the equity shock is 39%, but in case of "overheated" markets it can be as high as 49% and in times of equity market slumps as low as 29%. (Article 106 of the Directive and Article 172 of the Delegated Regulation).

[38] apart from measures in Solvency II such as the possibility to extend the recovery period in line with Article 138.4.

particularly exposed to the "double hit" scenario (low interest rates and a significant decline in other relevant asset markets – especially, for Sweden, the equity markets) and the largest are not part of well-diversified groups, as in many other countries, with the extra resilience that can entail. There is limited recent experience in Sweden of managing an insurance company failure[39]. Sweden has transferred the EU insurance regulation on insolvency and winding-up into national legislation[40]. Furthermore, the general Swedish bankruptcy rules (e.g. the Bankruptcy Act) apply to insolvent insurance companies. The requirement for a register of assets backing technical provisions is an additional source of policyholder protection in case of failure.

- Identification of general insurance companies which, because of the high share of a particular line of business (capacity which it would also be hard to replace in the short term), may cause significant disruption to activity in the real economy should they fail; FI has identified one company of this type and has already subjected it to relatively intensive supervision in line with its risk assessment framework.

- Development of the safety net: there are no plans to introduce an insurance guarantee scheme ahead of EU initiatives. Although the issues were considered after the most recent case of distress at an insurer (in 2010), FI sees no immediate need for work on a scheme ahead of further European Commission initiatives and their view is shared by other authorities.

61. **Overall, the Swedish approach of moving forward on these issues in line with the EU seems appropriate and actions already taken are well-judged.** Nonetheless, there are material risks from the "double hit" scenario to many insurers and loss of confidence in a significant institution facing difficulties could have damaging effects on the whole sector.

62. **It is recommended that:**

- The authorities develop a plan and priorities for developing macroprudential and related measures in the insurance area, which would include identifying where the EU framework will suffice and where there may be a need for national measures and any need for additional mandates for FI, for example in relation to the application of additional capital buffers or information requirements, as well as the associated additional resources;

[39] There have been only two failures in the period 2000 to 2015, both of relatively small insurers, where the companies were resolved through transfers of portfolios to other insurers with no policyholder loss.

[40] The Swedish National Debt Office (SNDO) is the resolution authority for banks, but has no role or authority in relation to insurance.

- FI satisfies itself that it has sufficient information on insurers not subject to the full Solvency II requirements to enable it to identify non-traditional, non-insurance business and otherwise to monitor for the build-up of risks across the sector;

- FI consider whether:

  i. To apply relevant elements of the framework for crisis preparedness applicable to cross-border groups to the larger domestic companies, for example planning for data requirements in case of a crisis developing; and

  ii. To begin a discussion on recovery planning with some of the largest institutions, accepting that the immediate priority is likely to remain consolidation of the recent regulatory and supervisory changes at the microprudential level.

Annex I. Sweden's Response to the Recommendations of the 2011 FSAP

IAIS ICP (2003 version)	**Rating**	**Recommendations to Improve Observance of ICPs**	**Comments**
2. Supervisory objectives	O	The authorities are advised to consider adopting explicit supervisory objectives for the insurance sector, including FI's role in protecting policyholders.	No developments – this has not been considered urgent in the light of Swedish experience.
3. Supervisory authority	PO	The authorities are advised to: a) Review the adequacy of supervisory resources for effective implementation of a more robust risk-based supervision; b) Consider a more principle-based approach in respect of the scope for FI to issue secondary regulations; c) Review the role of the government in institution-specific supervisory issues; d) Consider reviewing whether the legal protection available to FI and its staff members are at the level envisaged by ICP3; and e) Require publication of the reasons for the removal of board members and the DG of FI.	(a) FI's resources for insurance sector supervision have been increased by 50 percent since 2011, a period in which FI has also been enhancing its risk-based supervisory approach. The increase in resources which FI is seeking in the current three-year budgetary process includes further resources for insurance supervision. (b) Following the 2011 revisions to the Insurance Business Act (IBA) noted in the 2011 FSAP (giving FI a mandate to issue regulations in the areas of solvency, liquidity and risk management), a further revision at 1 January 2016 enabled FI to issue regulations on small insurance companies. FI has identified some significant issues in business conduct where it lacks a mandate to issue regulations and is in discussion with the Swedish government. (c) The role of the government in licensing has been removed – under the revised IBA, FI is the sole authority. The government's role in interventions, sanctions, mergers and license revocations has also been removed. (d)The regulations on legal protection for employees at FI (which is the same for all

			civil servants) has not been changed since 2011. FI considers it inconceivable that a personal liability could ever arise in the case of actions taken in good faith while discharging the employee's duties and considers it unlikely even in case the employee has caused the damage intentionally or with gross negligence. (e) No developments – this has not been considered urgent in the light of Swedish experience.
4. Supervisory process	O	The authorities are advised to consider reviewing the impact of judicial review on the ability of FI to make timely interventions to protect policyholders' interests.	FI has reviewed the issues. It considers that, while a decision on "immediate application" of a sanction can be appealed, such cases have priority at the courts and have in practice been determined rapidly.
5. Supervisory cooperation and information sharing	O	The authorities are advised to expedite Sweden's accession to the IAIS multilateral MoU.	FI has not applied to be a signatory to the MMoU pending resolution of legal issues. FI is taking a bilateral approach to developing supervisory contacts with (the relatively few relevant) non-EEA country jurisdictions on group supervision and supervisory colleges, especially with jurisdictions deemed equivalent to Solvency II under the EU process.
6. Licensing	LO	The authorities are advised to: a) review the government's role in the licensing process under the IBA; b) extend the fit and proper assessment to senior management of insurers; c) consider empowering FI to impose licensing conditions; and	(a) See above ICP 3. (b) Fit and proper assessment has been introduced as part of Solvency II implementation (IBA Chapter 10, Section 5). (c) FI has not been empowered to impose conditions for licensing. FI has the power to limit licenses if this should be necessary due to special circumstances.

		d) consider having a definition of insurance business in the IBA.	(d) The issue has been considered but no definition of insurance has been introduced into IBA.
7. Suitability of persons	LO	The authorities are advised to consider: a) explicit provision for FI to assess the fitness and propriety of senior management of insurers as well as their auditors and actuaries; and b) requiring insurers to notify FI of circumstances that may affect the fitness and propriety of its board members, MD, senior managers, auditors and actuaries.	(a) Requirements have been introduced, including for key functions, with Solvency II implementation (IBA, Chapter 10, Section 5). The onus on assessment of fit and proper compliance is placed in the insurance company. (b) There is no explicit requirement. However, insurers must notify FI if a relevant person has been replaced, because he or she no longer fulfils the fit and proper requirements. (IBA, Chapter 10 Section 5).
9. Corporate governance	LO	The authorities are advised to establish clear corporate governance standards for insurers on: a) The minimum level of independent directors and criteria for independence; b) Establishment of relevant board committees, taking into account the nature, scale and complexity of their operations; c) Policies and procedures to assess the effectiveness of their boards; d) The role and accountabilities of senior managers; and e) Providing actuaries with direct access to the board and board committee on a timely basis.	None of these issues in (a) to (d) has been included in regulatory requirements. FI relies on the supervisory process to assess effective corporate governance. There are, however, requirements on limited companies which are prohibited to pay dividends and mutual companies that more than half the board members are not employees of the company or employees or board members of another company in the same group (IBA Chapter 11, Section 7 and Chapter 12 Section 25). (e) As part of Solvency II implementation, one of the requirements of the actuarial function and persons responsible for the function is to inform the board and senior managers of the reliability and adequacy of the calculation of technical provisions. Solvency II governance requirements have been applied to all insurers, even those with only occupational pensions business.

10. Internal controls	O	To strengthen the checks and balances of insurers' operations, FI is advised to consider adopting explicit provisions to ensure that internal auditors have unfettered access to the board and senior management as well as appropriate status to ensure that senior management acts upon its recommendation.	As part of Solvency II implementation, FI has required that the internal audit function is objective and independent from the operational function. (IBA Chapter 10 Section 17). Internal audit must evaluate the system of governance and report to the board on certain matters.
11. Market analysis	LO	It is important that FI enhance its capacity and resources to analyze the developments outside the Swedish market on a regular basis including Swedish insurers' exposures to foreign risks.	FI notes that this issue is under discussion and that increased resources will be made available for the analysis of foreign markets, macroeconomic developments and the exposure to such risk that may fall on Swedish insurers and policyholders.
12. Reporting to supervisors	LO	FI is advised to: a) formulate a more robust risk-based supervision approach based on both the impact and probability of failure, supported by an appropriate baseline supervision; b) review the adequacy of resources for off-site monitoring; c) establish clear regulatory requirement for insurers to report their reinsurance strategy and program, outsourcing arrangements and off-balance sheet exposures including derivatives transactions; and	(a) The supervisory process including baseline supervision has developed since 2011 in line with Solvency II with a risk assessment framework that distinguishes between impact and probability of failure. (b) The general increase in FI's insurance supervision resources since 2011 has also made available more resources for off-site monitoring. (c) Such reporting has increased substantially with the Solvency II requirements (although their application of limited in the case of occupational pensions); (d) No developments – not considered urgent in the light of Swedish experience.

		d) require annual regulatory returns of insurers to be audited.	
13. On-site inspection	LO	FI is advised to improve the robustness of on-site inspection and ensure that the planned baseline onsite supervisory program is supported by adequate supervisory resources.	FI has reviewed its approach to on-site work as part of the development of its broader framework of risk-based supervision. The general increase in resources since 2011 has also made available more resources for on-site monitoring.
15. Enforcement or sanction	LO	The authorities are advised to: a) Empower FI to order a compulsory transfer of insurance portfolios of an insurer in distress; b) Strengthen FI's intervention powers against unregulated entities within an insurance group or financial conglomerate; c) Consider how best to empower FI in taking necessary measures to protect the interests of the public pending the completion of police investigations; and d) Review the government's continued involvement in enforcement and sanctions at institution-specific level	(a) There have been no developments on resolution issues generally pending initiatives at the EU level (to which FI is contributing). (b) Solvency II implementation has given FI increased power over unregulated entities, where required for effective group supervision, which applies to all insurers even those with only occupational pensions business. (c) The issue has been considered. FI considers that its regular powers laid out in IBA Chapter 18, for example, to appoint an accountant or an actuary may be useful in this context. (d) See ICP 3.
16. Winding-up or exit from the market	LO	The authorities are advised to strengthen protection of policyholders and legitimate beneficiaries by: a) ensuring adequate controls over assets covering technical	(a) Following Solvency II implementation, insurers subject to the full requirements will be reporting all their assets, item by item, to FI quarterly. The regulation of investments is now based on the prudent person principle. Regulations issued by FI require that a Special Register of assets to which

		provisions including quarterly submission of the special register of assets; and b) establishing clear rules on how existing assets of an insolvent insurer are to be distributed amongst policyholders	policyholders hold a priority should be kept and maintained in such a way that the undertaking can show the contents of this register at any time in the last twelve months so that FI can analyze the Special Register when necessary. The methods of analysing the Special Register of assets have not yet been developed pending the start of full assets reporting in May 2016. (b) FI sees no urgent need for such further rules of distribution as the existing legislation in the Rights of priority Act provides that the policyholders are preferential and Section 9 provides in which order the preferential claims shall be distributed amongst them (as other claims may also be preferential). Section 1 of the Rights of Priority Act provides that if claims are of the same preference, the creditors (in this case the policyholders) shall be paid in proportion to their claim.
17. Group-wide supervision	LO	The authorities are advised to consider: a) reviewing the adequacy of supervisory resources, particularly for the effective supervision of cross-border groups/conglomerates; b) harmonizing the supervisory approach for insurance groups and conglomerates, e.g., in the area of risk concentration; and c) formulating appropriate regulatory requirements applicable to non-regulated holding companies	(a) The general increase in resources since 2011 has also made available more resources for group supervision. (b) The issue has been addressed in the course of Solvency II implementation and by ensuring communication between supervisory departments within FI. (c) The issue has been addressed by Solvency II implementation under which the non-regulated holding company is included in the scope of group supervision. The relevant provisions apply to all companies covered by FI's implementation of Solvency II, including occupational pensions insurance business.
18. Risk assessment	LO	FI is advised to develop policies and processes to	This issue has been addressed through Solvency II implementation, for example the

and management		monitor the adequacy of insurers' risk management systems on a regular basis including requiring insurers to report on their risk management system as part of the annual returns.	Regular Supervisory Reporting and Own Risk and Solvency Assessment requirements (although these do not apply uniformly to insurers undertaking occupational pensions insurance). Supervisory work is focusing on risk management in response to the new requirements and reporting.
19. Insurance activity	LO	FI is advised to: a) review the adequacy of reinsurance programs as part of its routine off-site surveillance instead of the current limited scope review; and b) establish policies and procedures to check that insurers properly account for all risk transfer instruments	(a) Solvency II implementation has provided FI with increased information on reinsurance and off-site surveillance of reinsurance programs is expected to develop. (b) Procedures and policies for a proper accounting of all risk transfer instruments has been developed, but further work may be needed.
20. Liabilities	LO	The implementation of Solvency II will strengthen FI's supervision over insurers' technical provisions.	This is expected as a result of implementing Solvency II, where applicable (i.e. excluding large parts of occupational pensions business).
21. Investments	LO	FI is advised to enhance the robustness of its supervision of insurers' investment operations and update its regulations on investment management by insurers.	As a result of Solvency II implementation, more regulation is in place and more information is available on investments.
22. Derivatives and similar commitments	PO	The authorities are advised to expedite the issuance of regulations governing insurers' derivative activities	FI regards the Solvency II implementation on corporate governance as sufficient, in particular regarding the required risk management function. In addition, FI has issued regulations on investments in financial instruments, including derivatives, and diversification of risk. (Chapter 5 Section 2 of FFFS 2015:8).

23. Capital adequacy and solvency	LO	The implementation of Solvency II with effect from January 2013 will facilitate FI in implementing a more robust and risk-sensitive solvency regime.	This is expected as a result of implementing Solvency II, where applicable (i.e. excluding large parts of occupational pensions business).
25. Consumer protection	LO	25. Consumer protection The authorities are advised to: a) review the adequacy of current regulatory requirements for conditional bonus and transfer of policies; and b) consider articulating more clearly the roles and accountabilities of various agencies involved in consumer protection to improve efficiency and promote better understanding by consumers	(a) Conditional bonus and transfer of policies have been reviewed to some extent in FI reports since 2011. FI regulation on information in relation to transfer of policies has been amended during the period. (b) Reports to Parliament and the government have analyzed the rules and accountabilities of the agencies involved. The government has addressed the issues in its communications with the agencies. There remains some confusion amongst consumers as to agency responsibilities, but enquiries and complaints are directed to the appropriate agency, as required.
26. Information, disclosure and transparency towards markets	LO	To facilitate market discipline, FI should formulate plans to implement the IAIS supervisory standards on public disclosures.	The regulation on public disclosure under Solvency II has been implemented and FI expects it to sufficient for the present needs (but it does not apply to large parts of occupational pensions business).
28. Anti-money-laundering, combating the financing of terrorism	LO	The authorities are advised to: a) review the adequacy of resources for AML-CFT supervision; and b) update the legal requirements where insurers rely on intermediaries to perform customer due diligence (CDD)	(a) The resources for AML-CFT supervision have not been changed significantly since 2011. (b) FI notes that the legal requirements have been updated (Chapter 2 Section 3 of the Act on Measures against Money Laundering and Terrorist Financing). Insurers are now required to obtain CDD information immediately if insurers rely on third parties to perform CDD.