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FINANCIAL SECTOR ASSESSMENT PROGRAM

February 20, 2020

TECHNICAL NOTE

INSURANCE SECTOR: REGULATION, SUPERVISION, RECOVERY, AND RESOLUTION REGIME PROSPECTS

Prepared By
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Austria. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at
http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

ALM	Asset and Liability Management
APAB	Audit Oversight Body of Austria
BMF	Federal Ministry of Finance
CIS	Collective Investment Scheme
ECJ	European Court of Justice
EIOPA	European Insurance and Occupational Pensions Authority
FMA	Financial Market Authority
FMSB	Financial Market Stability Board
FOE	Freedom of Establishment
FOS	Freedom of Services
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSI	Financial Soundness Indicator
FTE	Full Time Equivalent
GDP	Gross Domestic Product
IAIS	International Association of Insurance Supervisors
ICP	Insurance Core Principle
LTG	Long-Term Guarantee
MCR	Minimum capital requirement
MOCE	Margin Over the Current Estimate
MoU	Memorandum of Understanding
MMoU	Multilateral MoU
OeNB	Oesterreichische Nationalbank
OGH	Austrian Supreme Court
ORSA	Own Risk and Solvency Assessment
ROE	Return on Equity
SCR	Solvency Capital Requirement
ULP	Unit-Linked Policy

EXECUTIVE SUMMARY

The insurance sector is experiencing low growth, stemming mainly from life business and a prolonged low-interest-rate environment. While the total assets have increased in nominal terms, it has underperformed GDP growth. Some segments, in particular single-premium products in life insurance, are suffering from material declines of premiums. Insurers are coping with the challenges with large-scale mergers domestically and international expansions. The duration gap between asset and liabilities was one of the highest among the European peers. The average guaranteed rates remain high, while the investment returns continue to decline.

The Financial Market Authority (FMA) has implemented Solvency II with enhanced data quality and analytical capacity. The FMA and Austrian insurers managed to implement Solvency II relatively smoothly, and all insurers were able to meet capital requirements without relying on transitional and long-term guarantees (LTG) measures in 2017. New risk management and reporting requirements helped the FMA and insurers to monitor the risk more closely and accurately. The FMA has made significant efforts to improve data quality and analytical capacities and has established stress testing as a yearly practice.

Although Solvency II implementation has improved the capacity of risk analyses of both insurers and the FMA, clear and targeted communication from senior FMA officials on strategic and implementation issues to each entity needs reinforcement. While sophisticated analyses enable the FMA to identify risks and vulnerabilities in insurers' strategies; business model; and activities, the translation of this work to actionable measures, with a clear timeframe and firm commitment toward the resolution of identified issues, should be an area of increased focus and top-down steering.

Proper implementation of Solvency II needs ongoing validation and scrutiny by regulators, which could be at risk if supervisory resources with skills and expertise are not retained. By design, Solvency II relies on a significant number of internal models (both for valuation of assets and liabilities and capital requirements calculation). Without proper and ongoing monitoring by regulators, there is a significant risk of manipulation and delay of regulatory actions. Asset allocation of insurers is shifting to less liquid assets, which makes the reliable valuation of assets more difficult. Regarding market risk models, the FMA and Oesterreichische Nationalbank (OeNB) validated the internal models used for calculation of this sub-risk module jointly, and this close cooperation should continue to improve the reliability of models used for Solvency II calculation. Sufficient levels of supervisory resources with appropriate skills should be preserved in both the FMA and the OeNB.

Higher legal, reputational, and conduct risks are posing additional pressures to the life insurance sector. Recent court decisions, both at the European Union (EU) and at the domestic level, combined with unclear cancellation rights in Austrian law, provided significant right of cancellation to the policyholders. Complaints from policyholders have increased significantly in 2018. The Austrian parliament has recently amended the Insurance Contract Act, clarifying the cancellation rights of the policyholders. However, insurers are still facing legal risk, and this could become worse in case of market turmoil, as more policyholders may try to cancel their unit and index-linked products when capital markets are underperforming.

Market conduct supervision should be enhanced, with active use of enforcement powers in addition to the insights that studies launched by the government will provide. There have not been any FMA enforcement cases to date with respect to insurance intermediation, other than those brought through insurance companies and banks. This may be due to the FMA's lack of powers over these insurance intermediaries, which are supervised by 106 regional district supervisors. However, the FMA has taken corrective actions of administrative enforcement proceedings regarding market conduct and disclosure in relation to intermediaries within its scope. The government is encouraged to initiate studies of conduct risks of insurance intermediaries at the local level, with a view to assessing the effectiveness of the existing framework. At the same time, the FMA should enhance cooperation with current supervisory bodies of insurance brokers and agents at the district level to improve the analysis and oversight of market conduct, based on the present legal framework.

The FMA's ongoing discussion on improvements to the insurance law is a welcome step toward a clearly articulated recovery and resolution framework. In light of domestic and international developments, and based on internal analyses, the FMA is aiming to complete the existing insurance framework and ensuring legal certainty. Ongoing discussions suggest enhancing the effectiveness of the FMA's supervisory toolkit in crisis preparedness and to broaden its powers. Importantly, discussions included the formal adoption of the overarching principle that losses must be borne first by shareholders and other creditors before they affect policyholders' and beneficiaries' claims. If such conclusions were adopted, the FMA would essentially be introducing a fundamental building-block toward a formal recovery and resolution framework, in line with global guidance. A new formal recovery and resolution framework should introduce the new powers that are sought, with appropriate safeguards and legal protection, as well as a clear delineation of the scope and respective responsibilities of authorities (supervisory and resolution) to avoid overlaps and potential conflicts of interest.

Table 1. Austria: Recommendations on Insurance Regulation, Supervision, Resolution, and Crisis Management

Recommendations and Responsible Authorities	Timing[1]	Priority[2]
Improve targeting of entity-specific communication from senior levels to the insurance firms on strategic as well as implementation concerns, with a clear timeframe and commitments for the resolution of identified issues. (FMA)	C	H
Continue to focus stress tests on entities with identified vulnerabilities. (FMA)	ST	H
Conduct stress testing on the segments/business lines in which future profitability is a material contributor of the own funds and impose appropriate level of enforcement actions, such as capital add-on or other measures to address the medium-term uncertainty. (FMA)	ST	H
Enhance additional information sharing with the host supervisors, as part of the annual supervisory cycle, in particular where Austrian insurers have significant local market share, regardless of the materiality at the group level. (FMA)	ST	H
Initiate studies of conduct risks of insurance brokers and agents. (Government)	MT	M
Enhance cooperation with current supervisory bodies of insurance brokers and agents at the district level to improve the analysis and oversight of market conduct based on the present legal framework. (FMA)	ST	M
Enhance crisis management preparedness by including pre-emptive recovery planning for insurers, adequately scoped and based on microprudential and macroprudential considerations, and with due consideration to the proportionality principle. (BMF and FMA)	ST	M
Develop a resolution regime in line with international standards, introducing the overarching principle that losses must be borne first by shareholders and other creditors before they affect policyholders' claims in the context of a formal recovery and resolution framework proposal. (BMF)	MT	H
Review the adequacy of skillset, expertise, and level of human resources for the continuous improvement of the Solvency II regime, market conduct supervision, and its enhancement with a recovery and resolution framework. (FMA)	MT	M

[1] C = continuous; I = Immediate (within one year); ST = Short Term (within 1- 2 years); MT = Medium Term (within 3–5 years)

[2] H= High; M= Medium; L=Low.

INTRODUCTION

A. Scope and Approach

1. **This technical note (TN) provides an update on the Austrian insurance sector and an analysis of certain key aspects of the regulatory and supervisory regime.** The note is part of the 2019 Financial Sector Assessment Program (FSAP) and has been prepared by Nobuyasu Sugimoto (IMF) and Spyros Zarkos (External Expert), drawing on discussions in Austria during May 15–June 5, 2019.[1] The TN references the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS) in October 2011, as revised in November 2018.

2. **The note analyzes regulation and supervision in relation to key issues identified in previous FSAPs, as well as material changes since the last FSAP.** The note does not provide a detailed assessment of observance of the Insurance Core Principles (ICPs). Thus, no grading of the level of observance of the selected ICPs is provided.[2] The most recent assessment, conducted based on the 2003 version of the ICPs, was carried out in 2008. The 2013 FSAP also provided an update on the insurance industry and an analysis of its regulatory and supervisory regime. The main focus of this note is on recent developments in the regulation and supervision of the insurance sector, including Solvency II implementation,[3] as well as developments in specific areas highlighted in the previous FSAP (such as operational independence of the FMA, actuarial function in nonlife insurers, the coverage of risks of the FMA stress test, and FMA contribution to cross-sector macroprudential supervision).[4] In addition, cross-border cooperation has been added to the scope, given the importance of operations in the Central Eastern and South-Eastern European (CESEE) region.

3. **This note also covers the current situation and potential changes in the crisis management and early intervention framework of the insurance sector.** It focuses on issues relevant to a long-standing policyholder protection mechanism, early intervention powers—existing and under discussion—and crisis management and resolution arrangements for insurance companies and groups.

4. **The note refers to laws, regulations, and other supervisory requirements and practices that are in place, as well as proposed reforms, including organizational restructuring.** The authorities provided responses to questionnaires and data requests, supported by anonymized examples of actual supervisory practices and assessments. The institutional arrangements and the

[1] The authors are grateful to the authorities and private sector participants for their excellent cooperation. The authors benefitted greatly from the inputs and views expressed in meetings with insurance regulators, supervisors, insurance companies, industry associations, and professional organizations.

[2] The IAIS ICPs apply to all insurers, whether private or government controlled. Specific principles apply to the supervision of intermediaries.

[3] Please refer to the TN—Euro Area Policies: Insurance, Investment Firm, and Macroprudential Oversight, June 2018, for a discussion of the regulatory arrangements in EU, and the risks and vulnerabilities. This note focuses Solvency II implementation relevant to Austrian groups and implications to FMA supervision.

[4] Issues related with bank resolution and crisis management are reviewed in another TN.

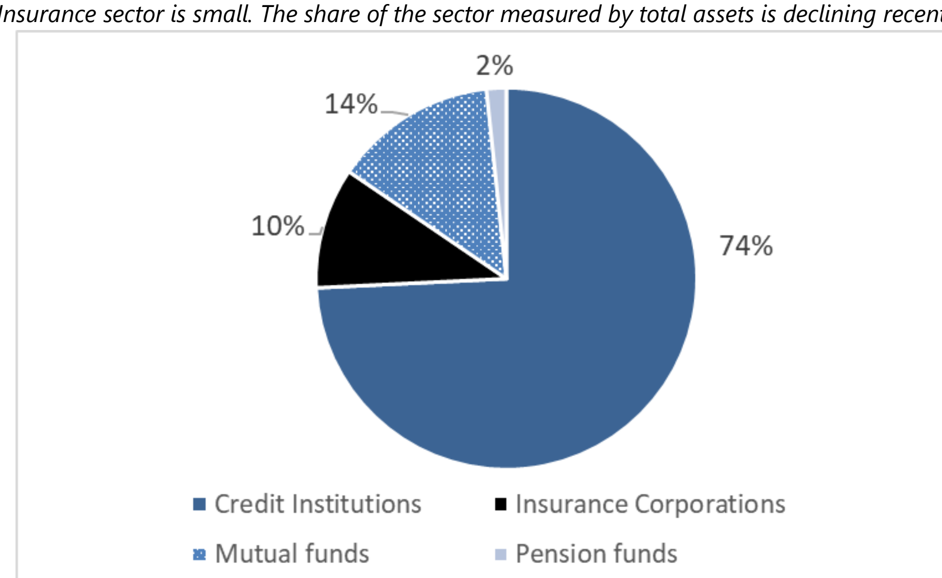
restructuring plans for financial sector regulation and supervision are outlined in the section titled "Institutional Setting" of this note.

B. Market Structure, Insurance Products, and Industry Performance

5. In recent years the insurance sector has experienced low growth, driven primarily by life business in the domestic market. The sector's total assets are EUR 133 billion at end-2018, approximately 40 percent of Austrian GDP. It is a concentrated market of EUR 18.5 billion gross written premiums. Premiums in the life segment have been steadily decreasing over recent years (-17 percent in the last four years; -3 percent in 2018, EUR5.5 billion) with little new production of single-premium products in the domestic market. At the same time, profitability remains under pressure in an environment of low investment returns in which insurers need to increase interest-related provisions. The industry is coping with the challenges through large-scale mergers domestically[5] and the expansion of cross-border business. The nonlife and health segments are growing steadily: gross premiums have increased by 4 percent and 18 percent respectively during 2014–2018. Although the insurance sector's total assets have increased in the last decade, the rate of growth has underperformed in relation to GDP growth.

Figure 1. Austria: Size of Insurance Sector

Insurance sector is small. The share of the sector measured by total assets is declining recently.



Sources: FMA

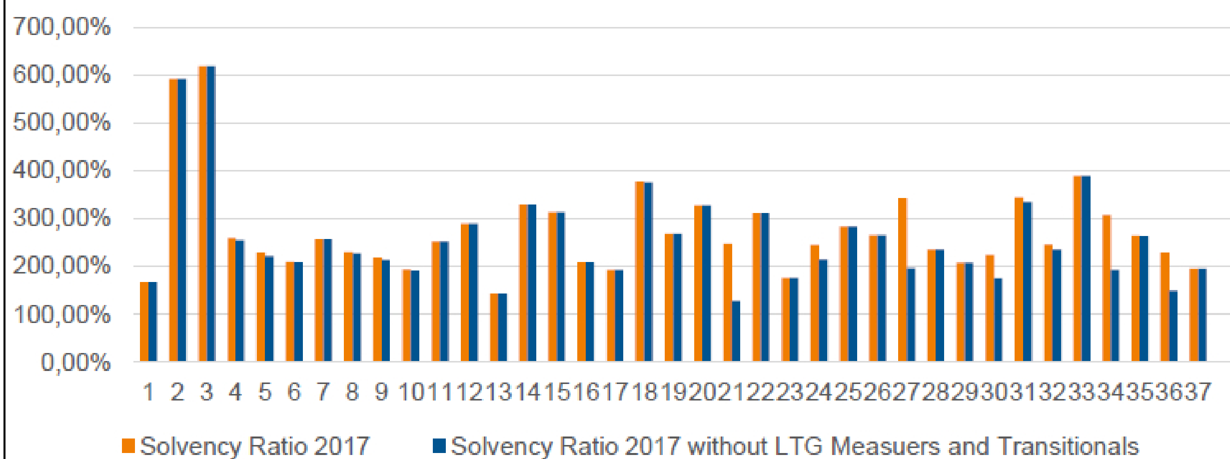
[5] The number of insurance companies has declined from 106 in 2011 to 87 in 2017, mainly due to consolidation of life insurers.

6. The Austrian insurance market remains concentrated and dominated by five major insurance groups, which have links with banking groups. Five major groups account for 56 percent of the total premium written in 2017. Composite insurers (which have both life and nonlife business) dominate the market.[6] While there is one group (Bausparkasse Wüstenrot AG und Wüstenrot Versicherung AG) that qualifies under the definition of financial conglomerate and, thus, is subject to supplemental supervision,[7] three more groups (VIG, UNIQA, and Grawe) have relationships (such as through minority ownership or securities lending programs) with banks.

7. While the coverage ratio of solvency capital requirement (SCR) is higher than the European average, careful consideration of risks is needed. The SCR coverage ratio (weighted average) is 284 percent as of the third quarter of 2018, while the European average was 243 percent. All Austrian entities meet the minimum SCR ratio (100 percent) without LTG and transitional measures. Moreover, the average SCR ratio without LTG and transitional measures is 243 percent, which is much higher than the EU average of 172 percent, as LTG and transitional measures were used on a moderate level in Austria. However, careful consideration is needed to assess the overall soundness of the insurance sector, as Austrian insurers (especially the large groups) are exposed to less-quantifiable risks, including political risks, in long-term health business.

Figure 2. Austria: SCR Coverage Ratio With and Without LTG and Transitional Measures

Insurance sector has high profitability and solvency coverage ratio with some negative pressure recently.



Sources: FMA

8. Austrian insurers have more illiquid assets than the European average. Investment on illiquid assets (such as properties and related-parties' investment) are higher than the EU average. For example, property investment is more than 5 percent of total assets, while the European average

[6] Given the dominance of composite insurers, all figures in this note are based on the total figures combining both life, nonlife and composite insurers, unless mentioned otherwise.

[7] Financial Conglomerates Directive (FICOD, 2002/87/EC) establishes the regulatory framework and definition of Financial Conglomerates. FICOD provides certain thresholds, such as 10 percent of solvency requirement or EUR 6 billion of the smallest financial sector, which allow NCAs to exempt a group from the supplemental supervision.

is about 1 percent. In addition, deferred tax liabilities are much higher than the European average.[8] While investments in property may be generally suitable as long-term investments, this could expose the insurers to liquidity risk in the scenario of higher redemption. The FMA is carefully monitoring the exposure to properties.

9. Some large Austrian insurance groups rely substantially on future profits. Solvency II allowed insurers to recognize the expected profit in future premiums as part of their own funds (Tier 1) with certain conditions and disclosure. In Austria, the average share of Expected Profits Included in Future Premiums (EPIFP) is over 10 percent.[9] In particular, the two largest Austrian insurance groups include such future expected profits as a substantial part of their own funds. While the firms would still meet SCR in the absence of these instruments, it is important to ensure that those groups manage market conduct carefully.

10. While new products are increasing the industry's total gross premiums, legacy traditional life insurance still dominates the technical provisions of the insurance sector. As of 2017, traditional life insurance, with minimum benefit guarantee and profit sharing, still accounted for 70 percent of the technical provision. Some of these legacy liabilities (which have been underwritten domestically) have minimum investment guarantee up to 4 percent, which is significantly higher than the long-term government bond yield (10-year Austrian government bond yield was close to zero in May 2019). While most Austrian insurers offering traditional life products run a diversified business model, the industry is addressing the risk of duration gaps by purchasing hybrid, perpetual, and infrastructure bonds, among others. However, these mitigating strategies are small in terms of absolute volumes. In 2017 the average asset-weighted modified duration of life insurance (excluding index and unit linked) was seven years. However, the duration of liabilities is still substantially longer than those of assets, which could pose challenges to the life insurance sector under low-for-long interest rate scenario

11. Asset allocation is generally conservative, with some signs of search for yield. More than 50 percent of the assets are invested in bonds, followed by 20 percent of CIS investment, 13 percent in related-party shares, and 8 percent in property. However, excluding holding companies, the percentage of investment in related-party shares would be 10 percent—which is close to the European average. The real estate share (8 percent) in Austria is significantly above the European average (1 percent). In addition, the share of related-party investment is also much higher than the European average (7 percent). Anecdotal evidence also suggests that insurers are gradually increasing their investment in some illiquid asset classes, such as infrastructure financing and private

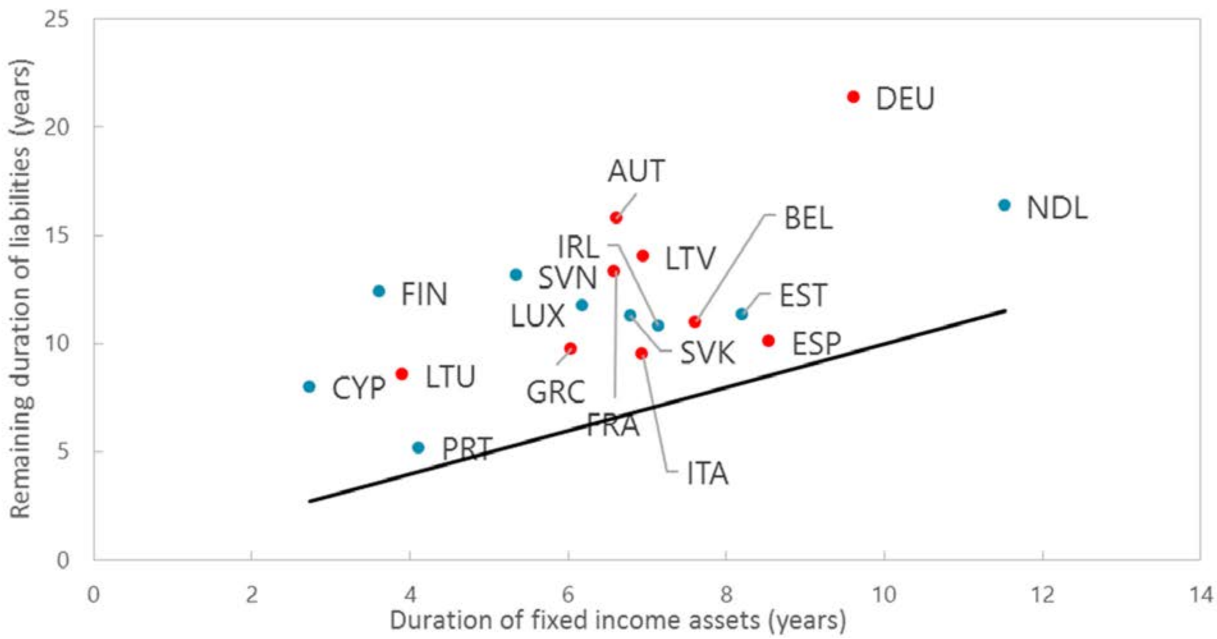
[8] Deferred tax liabilities are the result of the difference between the valuations under general purpose accounting and Solvency II. The level of deferred tax liabilities shows that the Austrian insurers depends more on future profitability than average in the European Union.

[9] See Box 2.1. of EIOPA report (2018).

equities. Until now, investment returns of life insurance companies have remained above the average guaranteed interest rate (2.2 percent), while the margin has been shrinking gradually but steadily.

Figure 3. Austria: Duration Mismatch of Life Insurers

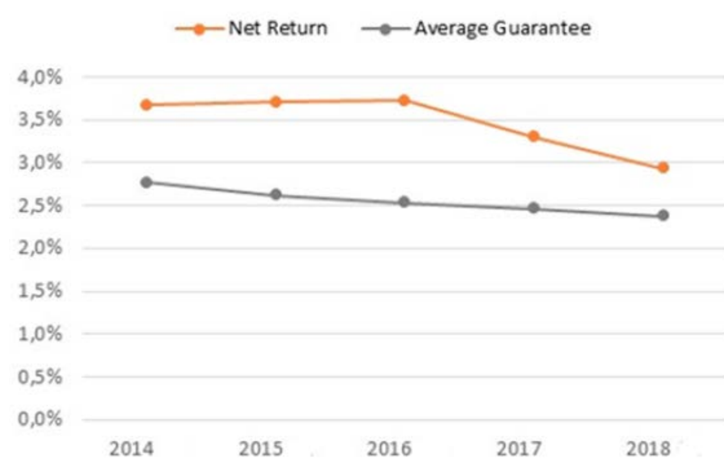
Austrian insurers had relatively larger duration mismatch as of the end 2015.



Sources: EIOPA

Figure 4. Austria: Investment Margin

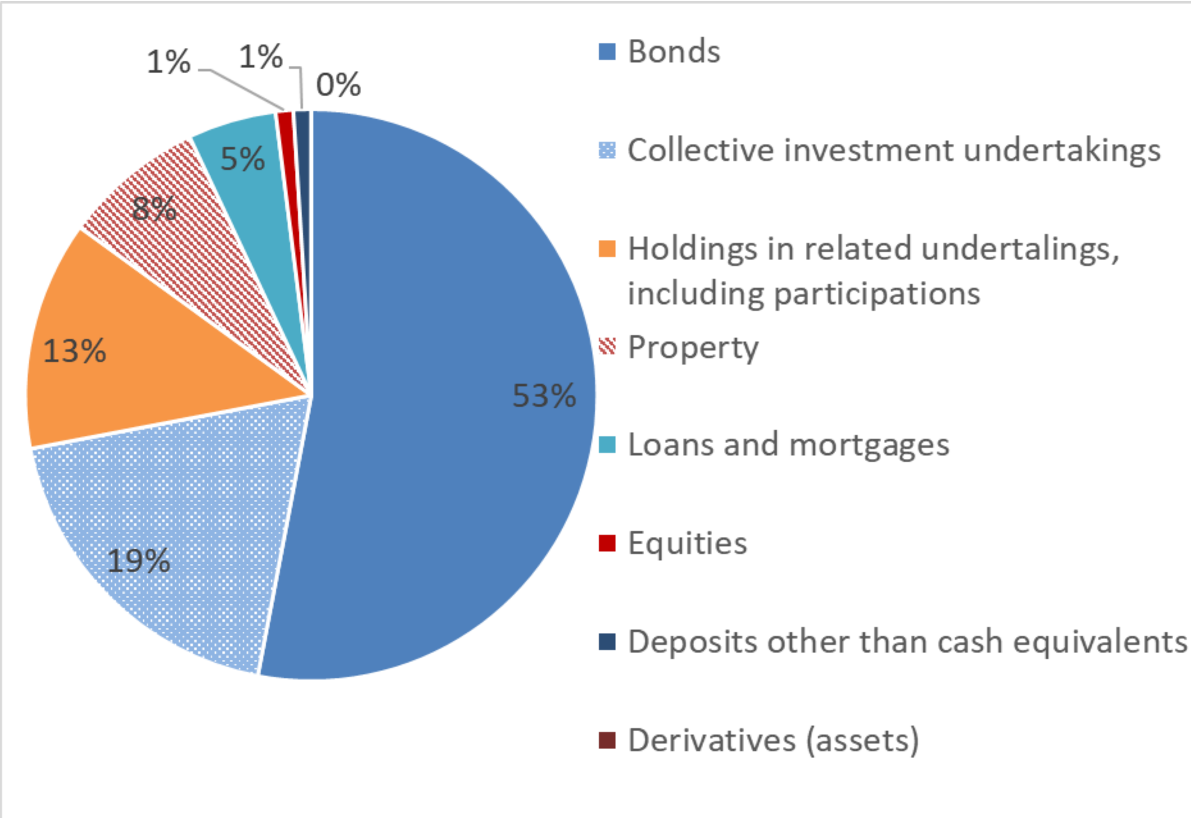
Investment return has been declining more than the average guaranteed rate.



Sources: FMA

Figure 5. Austria: Trend of Asset Allocation of Life Insurers

There are some signs of search for yield behavior.



Sources: FMA

12. Slow domestic growth has encouraged internationally active Austrian insurers to expand further their business abroad, particularly into the CESEE region where they already hold significant positions in most markets; foreign business accounts for about 40 percent of premiums. Five groups (Vienna Insurance Group, Uniqa Group, Grawe Group, Merkur Group, and Wüstenrot Group) are active via subsidiaries or related entities, mainly in CESEE markets. In 2017, 96 Austrian insurers operated in 27 countries, and the share of foreign business is about 40 percent of written premiums. According to the FMA,[10] the key markets for the internationally active Austrian insurers are in the following six countries: Czech Republic, Croatia, Hungary, Poland, Romania, and Slovakia. In all the CESEE countries where Austrian insurers are present, except for Belarus, Turkey, and Ukraine, the overall exposure is also significant from a host-jurisdiction's perspective.

[10] The FMA publishes annually a detailed report on the Austrian groups' foreign insurance business activity (see the dedicated webpage here https://www.fma.gv.at/en/insurance/disclosure/foreign-insurance-business-austrian-insurance-groups/). A key market is defined as one that generates 4 percent or more of the total foreign gross premiums.

Figure 6. Austria: Share of Foreign Business

Foreign markets are divided into the following four regions: Western Europe (WE), Central Europe (CE), South Eastern Europe (SEE), and EE (Eastern Europe).

	2017		2016		
	Written Premiums	Ratio	Written Premiums	Ratio	∆ in %
AUSTRIA	**8.370**	***60%***	**8.345**	***57%***	***0%***
FOREIGN MARKETS	**5.533**	***40%***	**6.381**	***43%***	***-13%***
WE	250	*5%*	1.458	*23%*	*-83%*
CE	3.641	*66%*	3.359	*53%*	*8%*
SEE	1.323	*24%*	1.279	*20%*	*3%*
EE	319	*6%*	285	*4%*	*12%*
Total	**13.903**	***100%***	**14.726**	***100%***	***-6%***

Sources: FMA.

13. While positions are still small, Austrian insurance groups are exposed to currency risk from their increasing activity in the CESEE region. As the currency composition of the technical provision is not available, it is difficult to quantify the importance of currency mismatch. However, anecdotal evidence suggests that large insurance groups in that region have both investment and underwriting in foreign currencies, while hedging of those currencies with EUR could be difficult over stressed periods in some of these financial markets. It should also be noted that foreign activities are much smaller in terms of the total assets (for example, UNIQA group has about 82 percent of its group total asset in its Austrian subsidiary). The FMA is encouraged to fill the data gap to detect currency mismatches between the assets and liabilities.

14. Austrian insurers hold more related-party investments than their EU peers do, on average. The ratio of related-party holdings (such as equity investment) to total assets is 13 percent, much higher than the European average of 7 percent. This high ratio is due partly to group structure of four large groups (VIG, UNIQUA, Grawe, and Wüstenrot Group). The FMA is monitoring the exposures carefully and observing that the exposures are gradually declining, due to consolidation and strategic change of business models. This type of exposure is subject to relatively high capital charges (typically 22 percent), which encourages insurers to reduce it. The FMA is encouraged to continue to monitor developments and take appropriate actions if excessive risk is identified.

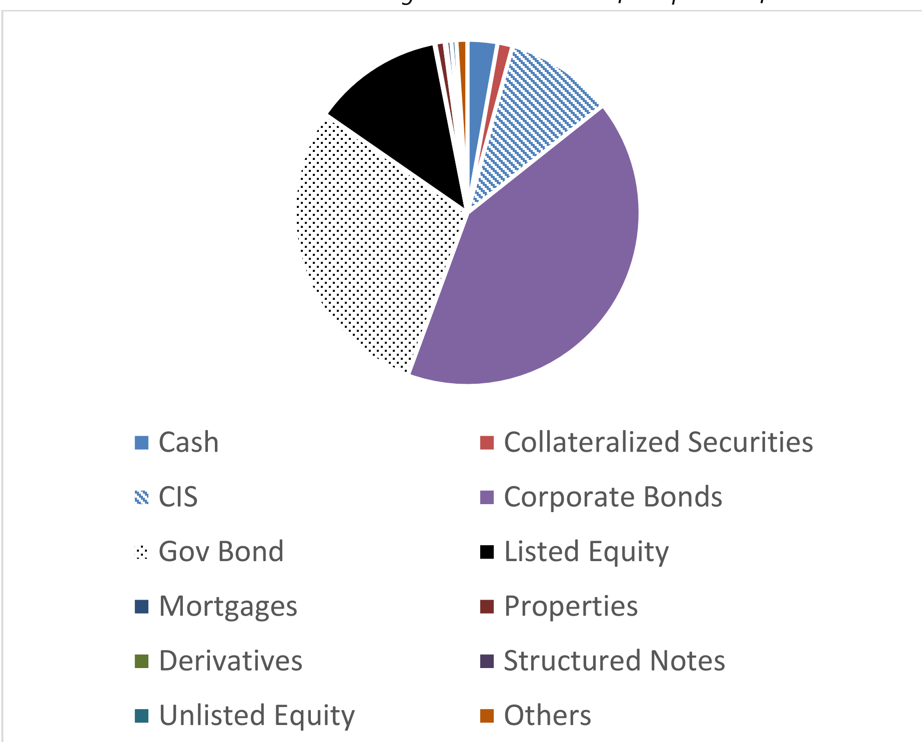
15. The Austrian insurance sector has a unique product where also banks are providing guarantee to insurance products. State-sponsored retirement provision (Prämienbegünstigte Zukunftsvorsorge/PZV) was introduced by the government to provide a third pillar pension solution through the private financial industry. The assets under management of this product are estimated at EUR 8.9 billion as of end-2017, a significant increase from the 2012 figure of EUR 6 billion. The pool of guarantors is made up of 18 financial institutions, while the 3 largest guarantors amounted to a share of 56.5 percent. The guarantees have been provided in various manners, which include insurance (31 percent), reinsurance (29 percent), derivatives (16 percent), and other/mixed forms

(24 percent). The FMA is closely monitoring the development and publishes an analysis of this product every year.[11]

16. Historically, the Austrian insurance sector has grown in close relationship with the banking sector. Bancassurance was and is still one of the most important distribution channels of insurance products. The share of premium of bancassurance channel is about 13 percent. Banks and insurers have not only alliances and partnerships, but also some investment and other exposures with each other. The level of exposures from insurers to banks is high compared to other advanced jurisdictions. The FMA is monitoring the linkage between insurers and other financial sectors closely. In addition, Austrian insurers have large investments in CISs, 20 percent of the total assets (see Figure 7). Recent observations on the linkages between insurance and other segments of the financial sector are summarized in Box 1.

Figure 7. Austria: Sample of CIS Investments Including CIS in Index and Unit-linked Products

Derivative investments through CIS is limited as of 4th quarter of 2018.



Sources: FMA.

[11] See the dedicated webpage.

Box 1. Interlinkage Between Insurers and Other Financial Sectors

Globally, the contribution of the insurance sector to systemic risk has increased since the global financial crisis. The extensive analysis of the insurance sector in the IMF April 2016 Global Financial Stability Report identified increased commonalities in the exposure to aggregate risk within the insurance sector, and other financial sectors. The changing nature of insurance activities (shifting to more asset management-type business models) may contribute to higher commonalities with other financial sectors.

All five major Austrian groups have ownership linkages with banks. The linkage between insurance and banking sectors is typically via business partnerships for the distribution of insurance products. All five Austrian major insurance groups, however, have stronger linkages than only business partnerships. For example, Raiffeisen group owns 11 percent of UNIQA group and UNIQA holds a small participation in Raiffeisen Bank International. ERSTE group owns a minor stake in the biggest subsidiary of VIG group. Grawe group fully owns Hypo Bank Burgenland. Wüstenrot Versicherung is a subsidiary of Bausparkasse Wüstenrot. Bank Austria is the major banking sales partner of ERGO Austria, which also holds another long-term agreement with Volksbank.

The FMA has not observed large-scale movements of assets or liabilities between insurers and other financial institutions. One exception was a large-scale securities lending agreement between a large insurer and a large bank. The transaction size was up to EUR1.5 billion or 16 percent of the coverage funds of the life insurance entity. Regulation is in place to require full collateralization and segregated custody of the collateral. Furthermore, the Deckungsstock trustee appointed by the FMA monitors the coverage fund of life insurers and reports quarterly.

While insurers have large exposures to banks through their bonds, the exposure has been declining in the last six years. The median allocation of total assets to banks was over 20 percent in 2012; it has since declined to approximately 13 percent as of end-2018. In addition, the FMA monitors insurers' exposure to "bail-in-able" assets, which include cash, deposits, equity, structured notes, mortgage bonds, and unsecured loans. The total market-wide exposure to "bail-in-able" assets, including index and unit-linked contracts, is approximately 12 percent of total assets. Approximately 30 percent of the "bail-in-able" exposure is held by index and unit-linked products. FMA requires insurers to disclose such exposures and risks to the policyholders. A few insurers have invested more than 20 percent of their total assets into "bail-in-able" bonds in an apparent search for yield.

Insurers have high investments into collective investment products. Austrian insurers have a relatively high allocation (19 percent) of the total asset to collective investment products (CIS), and some smaller insurers are particularly reliant on CIS products.

17. Some insurers are facing higher operational and IT risks due to consolidation of business, growth through mergers and acquisitions (M&As), and outdated internet technology (IT) systems. M&As have been used by some large insurers to expand their cross-border business as well as for domestic consolidation, which increases operational challenges. In addition, many insurers have legacy IT systems used to manage long-term outstanding business (up to 50 years). This makes it difficult for insurers to upgrade their systems in a timely manner in order to meet increasing customer expectations. The Austrian insurers have not been impacted by a serious cyber-risk incident to date. Nonetheless, the FMA is monitoring developments closely and issued the "FMA guide IT Security in insurance and reinsurance undertakings" to promote the preparation and enhancement of operational and IT risk-management practices. Some groups are implementing, with delays in relation to possibly optimistic timelines, significant investment projects targeting a substantial enhancement of their IT systems. Regarding the provision of cyber insurance, only three insurers are providing cyber-risk policies, and the total premium was less than EUR 500,000 in 2017. However, some existing policies do not explicitly exclude cyber incidents and, thus, insurers are subject to silent cyber risk.

18. The FMA is incorporating climate-change risks in its supervisory stress testing and is also conducting a sector-wide thematic study on the subject. While Austria is not exposed to material natural catastrophe risks, studies on climate change show some negative impact on Austria and the CESEE regions where insurers have presence. Some observations and forecasts include: (i) more frequent and longer heat waves; and (ii) more frequent and more severe windstorms and floods. The 2018 EIOPA stress test covered natural catastrophe events, such as windstorms, floods, and earthquakes. The impact of those scenarios to an Austrian participating group was almost negligible, due partly to the mismatch between the scenario and the group's exposure in the geographical area selected by EIOPA for the exercise.

19. Management of liquidity risk is particularly important, and investments in less liquid assets need to be closely monitored. Austrian insurers have a large share of highly rated government and corporate bonds, which could address liquidity needs arising from claim payments and other short-term liabilities. Regarding life insurance products, both tax benefits and redemption penalties discourage policyholders from lapsing their long-term policies. For example, major savings products (such as endowment and unit-linked products) are subject to lower tax (such as 4 percent of insurance premium); however, if a policyholder surrenders the policy within 10 or 15 years, it would be subject to higher tax rates (such as 11 percent of insurance premium). Nevertheless, some insurers are gradually increasing their illiquid investments (such as EM bonds, infrastructure financing, and property investment). The FMA is monitoring the liquidity mismatch positions of insurers closely through offsite analysis and stress testing.

20. While there are activities that are exempted from some regulations, including Solvency II capital requirements, they are not material. Those include exposures from the following entities: (i) small mutual associations that have limited scope of activities; (ii) personal insurance activities by corporations under public law, whose policyholders are their only members; (iii) certain auto assistance activities, when the assistance is provided in the event of an accident; (iv) insurers that only engage in funeral cost insurance when the benefits do not exceed the average funeral costs, or where the benefits are provided in kind. The total assets for small mutual associations are only EUR 85 million. There is currently no data available on the size of insurance activities by corporations under public law: such corporations are limited to specialized professionals, such as lawyers and accountants.

21. The main distribution channel of insurance products is through insurance firms' employees, followed by brokers. Bancassurance still remains important and the online channel is quite limited. FMA and industry representatives are aware of potential disruption of digitalization and higher competition with new Insurtech entrants. Although aggregators and new entrants with reduced price are active Austria, those companies don't seem to be very successful yet and have not brought material threat to the traditional insurance distribution channels.

Figure 8. Austria: Distribution Channel

The main distribution channel of insurance products is through insurance employees, followed by brokers.

Distribution Channels	Percentage on basis of total premium	Percentage on Basis of total contracts
Online (Online-Vertrieb)	0.95%	2.19%
direct (Direktvertrieb)	37.04%	39.01%
agency (Agentur)	16.93%	18.11%
broker (Makler)	25.71%	20.82%
bank (Bankvertrieb)	13.60%	7.22%
other	5.77%	12:66%
	100%	100%

Sources: FMA.

22. EU-domiciled insurers are providing insurance products in Austria under Freedom of Establishment (FOE) and Freedom of Services (FOS). As of end-2018, over 1,000 such entities have been registered and their total written premium is over EUR 2 billion. The premium value seems to have almost doubled since 2013; however, the data before 2016 may not be fully consistent, as it was collected from a number of the national competent authorities. Since 2016, EIOPA has begun to collect information of FOE and FOS activities on an EU-wide basis, and the quality and consistency of data has improved since then.

INSTITUTIONAL SETTING

A. Supervisory Responsibilities, Objectives, and Powers

23. The FMA is in charge of the regulation and supervision of insurers. The FMA regulates and supervises insurers, as well as the distribution of insurance products directly by insurers or banks. Independent insurance agents (who are not part of the distribution network of an insurance company) and brokers are under the oversight of the Federal Ministry of Digital and Economic Affairs. The FMA has a Supervisory Board[12] and an Executive Board (two persons). The FMA's Supervisory Board approves financial matters in relation to the authority (financial plan, which includes elements such as human resources and planned investments, and disposal of real estate), the annual financial statements drawn by the Executive Board. The Supervisory Board must give its consent to the appointment of FMA employees to management functions that are directly subordinated to the Executive Board (second management level). Supervisory decisions are taken by

[12] The Supervisory Board of the FMA consists of the chairperson (appointed by the Federal Minister of Finance), the deputy to the chairperson (appointed by the OeNB), six additional members (three appointed by the Federal Minister of Finance and three from the OeNB), as well as two co-opted members. The co-opted members are named by the Austrian Economic Chambers and have no voting rights. The term of office of the Supervisory Board members is five years; reappointment is possible. For more details, see Financial Market Authority Act, 97/2001, Arts. 8-10.

the Executive Board, with no discussion or participation by the Supervisory Board. The OeNB is involved in relation to the market risk module when an internal model requires approval.

24. The Financial Market Stability Board, Finanzmarktstabilitätsgremium (FMSB), plays a central role in terms of macroprudential oversight and financial stability in Austria, benefitting from the support of OeNB's and FMA's work. The FMSB was established in 2014, with the mission to strengthen cooperation in macroprudential supervision and to promote financial market stability. The FMSB meets four times a year, and its members[13] are OeNB, FMA, the Fiscal Advisory Council, and the Federal MoF, the latter also chairing the proceedings. The FMSB seeks to safeguard financial stability by scanning the horizon for potential systemic risks, issuing risk warnings and presenting recommendations to the FMA when necessary. The FMA is designated by law as the competent authority for applying macroprudential instruments, and it implements FMSB recommendations on a comply-or-explain basis. The OeNB organizes risk workshops with the FMA and other key stakeholders on a quarterly basis to translate research and analyses into actionable plans and measures; it is through this mechanism that the work program and agenda of the quarterly meetings of the FMSB are established.

25. The Audit Oversight Body of Austria, Abschlussprüferaufsichtsbehörde (APAB), and the FMA have recently issued a common Circular[14] that specifies issues in relation to the appointment of statutory auditors at public-interest entities. The insurance law provides a detailed account of the essential responsibilities of the statutory auditors (Art. 263, VAG 2016) and, hence, highlights their contribution to the effective oversight by the FMA (e.g., audit of the SFCR with, in particular, audits of the solvency balance sheet, the framework conditions for calculating the SCR and MCR, as well as the determination, classification, and eligibility of the own-fund items); audit of the effectiveness of the internal control system, of the risk management system and internal auditing as conditions for an effective governance system; and audit of the impact of intra-group transactions on solvency). There is no statutory audit requirement for the ORSA report

MAIN FINDINGS

A. Independence and Resources

26. The Insurance Department (Department II) is responsible for supervision of insurance and pension funds and has a cadre of highly skilled experts. It consists of four divisions: (i) general insurance and pension supervision issues (division 1); (ii) prudential supervision of insurance and pension funds (division 2); (iii) onsite inspections and internal models (division 3), and (iv) analyses and statistics (division 4). Total staff dedicated to insurance supervision is 46.8 ETEs, of whom 45.9 FTEs have special qualification, such as actuaries, lawyers, economists, accountants, asset

[13] The Financial Market Stability Board (FMSG) consists of two representatives each of the Federal MoF and the Fiscal Advisory Council, as well as one OeNB and one FMA representative. The FMSB is chaired by high-level representatives of the MoF.

[14] https://www.fma.gv.at/download.php?d=3369.

management experts, etc. Turnover ratio is less than 5 percent and FMA staff has successfully accumulated supervisory experience obtained over a number of regulatory reforms, including Solvency II implementation.

27. While FMA resources are stable and current turnover ratio is low, human resources are under strain. Proper implementation and supervision of Solvency II requires significant resources for validation of best estimates of insurance liabilities, valuation of illiquid assets, international information exchange, and approval and continuous validation of internal models. It is important that both the FMA and the OeNB (which has a role in market risk model validation) keep the current resource with expertise to continue to support the robust internal model validation.

Recommendations

28. The FMA should retain enough budget and flexibility to retain highly skilled and experienced supervisors and reinforce its range of expertise in line with a broadening scope of activities. The work of the FMA has become more complex, in part because of the international expansion of the large insurers, but also because of the required shifting focus of supervisory intensity from assessment of risks and vulnerabilities to their effective mitigation through determined action and close monitoring. To enable the FMA to continue to perform effective supervision, a sufficient budget level is needed to support the recruitment and retention of staff with specialized expertise (such as in the areas of Solvency II internal model validation, IT, and stress testing). In addition, increasing needs for market conduct supervision in the insurance intermediaries would likely require additional efforts from existing resources in the 106 local supervisors.

B. Solvency II Implementation

29. While the life insurance sector is facing challenges from the low-interest-rate environment, the FMA has managed to implement Solvency II smoothly. Economic valuation under Solvency II required higher valuation on insurance liabilities with high guarantees, and thus lowered the coverage ratio of Solvency Capital Requirement (SCR). In fact, in a very early stage of implementation, the FMA identified a small number of firms that would face difficulties meeting Solvency II requirements and intensified its supervision of those weak firms. As of end-2017, all insurers met the SCR without LTG or transitional measures. The average SCR coverage ratio is higher than that of other EU countries.

30. However, the high SCR ratio is supported by a number of uncertain estimations. To meet the requirements, Austrian insurers are relying on several factors, such as: (i) future profit from long-term business (mainly health insurance); (ii) loss-absorption capacities of technical provisions; (iii) loss-absorption capacities of deferred tax liabilities; and (iv) diversification benefits between life and non-life businesses. While those are legitimate and allowed under the Solvency II framework, the future estimation of many of those factors is subject to some uncertainty and could be adversely affected by future developments.

Valuation of Assets and Liabilities

31. Austrian insurers at the solo level continue to be subject to statutory accounting standards, which are generally more conservative than the Solvency II valuation standard. Assets are generally required to be valued at lower of either cost or current market valuation. Liabilities, including insurance liabilities, are also valued more conservatively than the Solvency II valuation standard, including overall life insurance liabilities.

32. Insurance assets and liabilities are valued consistently with observable market data for Solvency II purposes. Assets are valued at mark-to-market as long as market data is available. Insurance liabilities are valued with the best estimate (probability-weighted average of future cash flow, taking account of the time value of money), plus risk-margin estimation through the Cost of Capital Approach, which mainly corresponds to Margin Over Current Estimate (MOCE). The best estimate is discounted by the relevant risk-free interest rate term structure derived from the European Insurance and Occupational Pensions Authority (EIOPA).

Capital Requirements

33. Solvency II capital requirements cover major quantifiable risks. Austrian insurers are exposed to relatively high risk from (i) asset and liability mismatches; (ii) strategic investment to related parties (including investment to banks); (iii) property risk; and (iv) lapse risk. Those risks are incorporated in both standardized and internal model approaches for the calculation of capital.

34. Risk from asset and liability mismatches is captured by the interest rate risk module, which aims to capture the potential changes of valuation of asset and liabilities under two stressed interest rate term structures. The standardized approach provides up-and-down scenarios, and the shock ranges from 75 percent in the shortest end-maturity to 20 percent in the longest end-maturity from the base line risk-free term structure. The capital charge is based on the worse scenario between the two scenarios. However, the current standardized approach does not capture interest rate risk well under current low and negative interest rate.

35. Strategic investments to related parties (including banks) are subject to equity capital charges. Some Austrian insurers (such as VIG and UNIQA groups) have strategic relationships with banks for distribution purposes and have minority investments in the related banking groups (in some cases, mutually). Solvency II requires capital deduction if the insurer's holding of a bank's shares exceeds 10 percent of insurer's own funds. Otherwise, the exposure is treated as an ordinary asset. According to the FMA, most of those equity investments are recognized as "strategic investments" and, thus, are subject to a reduced capital charge of 22 percent from standard equity charges (39 percent for listed equities and 49 percent for unlisted equities).

36. Insurers using LTG and transitional measures are subject to more intensive supervision. To soften the impact of Solvency II, LTG and transitional measures are allowed to a small number of insurers, subject to FMA approval. The insurers with significant reliance on those measures are subject to more intense monitoring and frequent onsite examinations to ensure the continuous improvement of their capital position. The FMA is closely monitoring SCR coverage ratio without LTG and transitional measures. In fact, the risk score is assigned based on the SCR coverage ratio without transitional measures.

Capital Resources

37. The own funds of Austrian insurers also include some relatively lower quality capital. The inclusion is in conformity with Solvency II framework. Subordinated debt and other lower quality capital instruments were issued before the introduction of Solvency II, and some insurers (mainly large groups) are using the 10-year transitional arrangement provided in Solvency II to an immaterial extent. Depending on the timing of the rollover, there is uncertainty of the availability of the market and financing cost of the new instruments. The FMA is monitoring the potential refinancing of such instruments and associated funding cost. The FMA has observed no difficulties in the issuance of new instruments that comply with the full Solvency II requirements, and the amount of refinanced needs have been negligible.

Internal Model Validation

38. The FMA, often in close coordination with OeNB, conducts onsite inspections for internal model validations. While the FMA is responsible for the internal model validation and approval, the FMA obtains an expert opinion by the OeNB when the models to be approved comprise the market risk module, or parts of it. In such cases, the OeNB must assess whether the market risk module or, where applicable, parts of it comply with the applicable specifications (Art. 182 VAG); related onsite inspections are therefore conducted in close coordination with the OeNB. The FMA conducted 11 onsite inspections to validate internal model applications before the Solvency II implementation date. In the subsequent three years, the FMA continued to receive applications of internal models (such as expansion of coverage of partial internal models). As of June 2019, 20 onsite inspections were conducted and an additional 6 inspections were planned for 2019. The modeling techniques are becoming complex, thus workload and needed expertise for the validation exercise are also continuously increasing.

Box 2. FMA Stress Tests

The FMA conducted annual Solvency II based stress tests on the entire insurance sector since 2014. The first stress test based on Solvency II was rolled out two years before the implementation, focusing on the impact of continued low interest rates on the insurance sector. EIOPA has also conducted biannual stress tests, to which the FMA actively contributed. Since the implementation of Solvency II (January 2016), the national stress tests have been conducted annually.

The FMA is also conducting stress tests based on national GAAP measurements. Life insurers are subject to additional interest rate reserves. National GAAP results in lower levels of equity, therefore potentially providing a trigger for insolvency when the Solvency II balance sheet would still be in a solvent position. As the insolvency triggers are largely based on national GAAP values, FMA observes and analyses the balance sheet values according to national GAAP.

The 2017 national stress test covered all insurance solo entities with a Solvency II balance sheet of more than EUR1 billion. It covered 17 out of 37 solo entities. The scenarios included two situations with rising interest rates (with and without credit spread increase) and one with continued low interest rate. The low interest rate scenario was subdivided into three sub scenarios, focusing on the dependence on new business lines and on the reinvestment yield. In the first rising interest scenario, where the risk in the risk-free yield curve is associated with an expansion of the credit spread, some insurance companies would lose relatively large amounts of own funds.

2018 EIOPA stress testing took place at the group level and the only Austrian participant was the VIG group. The VIG group accounts for about 55 percent of total technical provision in Austria based on solo reporting. The group is also one of the largest listed international insurance groups in Central and Eastern Europe (CEESE). The test was conducted under three scenarios: (i) yield curve up; (ii) yield curve down; and (iii) natural catastrophe scenario. The VIG group met the SCR coverage ratio without relying on LTG or transitional measures in all scenarios. The largest impact was observed in interest rate "up" scenario. Similarly, the natural catastrophe scenario showed little impact on the group. The scenario included (i) four windstorms in north-western Europe; (ii) two CEE floods (Danube and Elbe); and (iii) two earthquakes in Italy and Monaco/France. Those events would not have a meaningful impact, as they are not the most material exposures of the group.

The 2019 national stress test is focusing on life insurance solo entities and will include a multi-year shock. All of the previous tests, including EIOPA stress tests, have been conducted using single and instant shocks. Multi-year scenarios allow the monitoring of effects caused by prolonged low interest rates. Only limited management actions are recognized, such as change of asset allocation after the stress period, but not during the stress period. The test includes two scenarios; constant low interest rate and sudden increase of interest rate. New business and its positive impact are not incorporated, but the tests are being conducted under going-concern assumptions. A mass lapse event is incorporated into the high interest rate scenario, which will allow the FMA to identify sales and transactions of assets.

While stress tests have become a core tool for the FMA to assess risks and vulnerabilities in the insurance market, the FMA is encouraged to focus on fewer scenarios and conduct more targeted analysis on the assumptions that have a larger impact. Over the process of a number of regular stress test exercises, the FMA has developed common methodologies for assessing the effect of adverse scenarios on the Austrian insurance sector. Stress test results have been comprehensively validated with available data. However, validation of a large volume of data might make it difficult for the FMA staff to focus on the analysis of material and critical assumptions. For example, focused validation on the assumptions behind lapse risk, loss-absorption capacity of technical provisions, loss-absorption capacity of deferred tax assets, and impact of mass lapse could be useful to identify different practices among insurance companies.

Recommendations

39. Focusing stress tests more intensely on insurers' identified vulnerabilities would provide additional value to the FMA's supervisory work and stress test exercises. The FMA has been conducting stress tests for a while and has now the benefit of having identified insurers' individual risks and vulnerabilities. In the future, it could leverage on this information and focus on particular entities/groups and scenarios tailored to the business models of the insurer.

40. The FMA should conduct stress tests on the segments where future profitability is a material contributor of the own funds of the service providers. It is recommended that the FMA conducts stress tests focusing on the segments where future profitability is a material contributor of the own funds, with scenarios tailored to key uncertainties, given the long-term engagement business model. Such scenarios should include, for example, that insurers may not be able to increase premiums in line with increasing costs, such as healthcare prices, in the medium term—under current law, such increases are possible.

41. The FMA should take more concrete enforcement or supervisory action, such as imposing capital add-on to address the medium-term uncertainty. Some segments, such as health insurance business, are growing faster recently in Austria, which could be driven partly by Solvency II capital eligibility from the future profit of the business line. To prevent the over-reliance of own funds on future profit from particular segments, tangible supervisory actions are recommended, such as imposition of capital add-on.

C. Supervisory Reporting, Monitoring, and Onsite Inspection

42. The supervisory review process of the FMA is well organized and increasingly analytically efficient, benefiting from a committed bottom-up analysis. The FMA has built several databases and inhouse IT systems in parallel to Solvency II implementation, where financial information of both local GAAP and Solvency II basis is stored. The system allows automatic validation of Solvency II data and, currently, the FMA is working to expand validation function to local GAAP figures. The key system is built on Excel and provides several analysis templates and flexible ad hoc analysis tools, which allow the supervisors to easily obtain different views of the insurer's positioning (within the industry, line of business, and appropriate peer groups).

43. A risk scoring is assigned to all solo and group entities; it is this score that determines the supervisory intensity. A risk score ranges from 1–1.9 (low), 2-2.9 (normal), 3–3.9 (high), to 4 (very high) and is determined with the combination of Financial Soundness Indicators (FSIs) with qualitative expert judgments by the line supervisors. FSIs include indicators of: (i) balance sheet risk, such as ALM, SCR, etc.; (ii) profitability, such as financial result, nonlife, health, and life technical results; and (iii) governance and operational risk. Expert judgment in the form of reasoned adjustments, is combined to derive the final score of an insurance company. Risk scoring is assigned to all solo and group entities and adjusted at least every year. In practice, FMA supervisors claim to be working based on continuously updated scores. The intensity of offsite monitoring critically depends on the risk score; for example, a full analysis of Solvency and Financial Condition Report (one of the key Solvency II disclosure reports) takes place when an insurer has a high or very high-risk score.

44. Risk scoring is also used to determine the frequency and scope of onsite inspections. Each insurance company (except small mutual insurance companies) must be examined at least every five years. If the company score is high or very high, the frequency of the required onsite examinations increases to once every three years. In addition, and in accordance with an FMA internal policy, onsite inspections of the two largest groups must be conducted at least once a year. The FMA conducted inspections on 20 insurance entities in 2018. The area of supervisory attention was the consistency of internal models, as well as the conclusion of the work launched in previous years in relation to the best estimate calculations. Moreover, management and internal governance were also the focus of a few onsite missions. The length of the mission and the sizing of the team clearly depend on the scope of the onsite examination; a typical inspection is 2–4 weeks long, with a team of 2–3 experts. Inspection results are communicated to the Management Board of the company about four weeks after the conclusion of the onsite inspection.

45. Recently, the FMA decided to communicate the risk score to the insurers in the high or very high-risk category. In the first quarter of 2019, the FMA engaged in a formal communication of individual risk scores to all insurers in the high or very high-risk category. The FMA informed that the letter used for this communication covers the following contents: (i) a description of rating approach; (ii) a composition of the final score to the submodules behind it; and (iii) internal guidelines regarding this communication. Discussions have also been held before and after this formal communication of the risk rating.

Recommendations

46. The FMA should improve the targeting of entity-specific communication from senior FMA officials on strategic and implementation concerns, with clear timeframes and commitments for the resolution of identified issues. While communicating individual risk scores to the individual entity is a welcome step forward, the overall communication should be enhanced to cover major strategic issues, such as business model shift, as well as key concerns behind high or very high-risk ratings. It would be also more effective for the FMA to communicate such concerns at a high level, with clear indication of the timeframe, requiring commitments from the insurers for the resolution of identified issues.

D. Group Supervision and International Cooperation

47. The Austrian insurance sector has an extensive cross-border footprint with presence in a total of 29 markets that differ in terms of size, concentration, and level of maturity. The five internationally active insurers in Austria (VIG, UNIQA, Grawe, Merkur, and Wüstenrot) are focused on growth in markets that are situated in Central, South-Eastern, and Eastern Europe, and where these Austrian insurers typically hold a significant or dominant position in life, non-life, or both. The foreign business contribution to the five groups' overall profitability is significant; in three of these five groups, the profit premium margin[15] of foreign business is higher than the domestic one (2017 data, FMA calculations).

48. The FMA has established comprehensive tools and processes for group risk assessment. Group risk assessment is conducted with consideration of risk analysis at three levels: (i) market level; (ii) solo level; and (iii) group level. Internal database ("Cube") is available at the group level, which enables supervisors to conduct various analyses (including peer comparison) of number of risk indicators effectively and efficiently.

49. Market-level analysis covers various aspects to analyze major risks of the key foreign insurance market. Group risk at market level may evolve due to number of factors, such as (i) macroeconomic development; (ii) political situation and independence of state institutions; (iii) changes in the legal, tax, and regulatory framework; (iv) insurance market development; (v) climate change and natural catastrophe events; and (vi) consumers' behavior. The FMA analyzed those factors with statistical data, inputs from host supervisors obtained through supervisory cooperation framework, and discussions with group management of internationally active insurance groups. Risk rating is assigned to the major markets where Austrian insurers are active in order to allow for a risk-based focus in supervisory cooperation.

50. Solo-level analysis is also conducted with respect to foreign subsidiaries of groups with the information obtained from supervisory cooperation. The FMA is collecting solo risk assessment and supervisory review processes from host supervisors. The FMA also uses its own solo risk assessment for domestic insurance entities. The results of analysis at the solo level are also considered for the group risk assessment and incorporated into the group risk report.

51. Group-level analysis covers a wide range of risks and is documented in the group Financial and Risk Analysis and Group Risk Report. The FMA analyzes a number of risks, including (i) strategic risk (new market entries); (ii) transformation risk from M&A activities; (iii) financial risks (such as increasing cost ratios); (iv) operational risks from IT integration or introduction of new IT systems; and (v) human resources risks (such as availability of appropriate key personnel) and governance risks (such as deficiencies in group risk management). The results of the assessments are documented in the group Financial and Risk Analysis and Group Risk Report, which are shared with the relevant host supervisors of Austrian insurance groups.

52. Group solvency is calculated with the consolidation method and some adjustments. The group solvency requirement is based on the consolidated balance sheet of the group. However, if the group SCR becomes lower than the sum of solo SCRs of the groups due to diversification effect, the group SCR is adjusted to be equal to the sum of solo SCRs of the group. Some own funds (such as surplus funds and some DTAs) may be available only to the loss of particular entity(ies), and such funds are deducted from the group capital calculation. If an insurance group has banking and other regulated subsidiaries within the group, and capital requirements of such regulated entities are incorporated based on the relevant sector's capital requirements.

[15] The PPM (profit-premium margin) is defined as: PPM = (total performance/written premiums).

53. The FMA is cooperating with foreign supervisors through various channels and occasions. Those include bilateral meetings, active engagement with the EIOPA and IAIS, and supervisory colleges. The FMA has developed close cooperation relationships with a number of foreign authorities and is one of the first signatories to the IAIS Multilateral Memorandum of Understanding (MMoU), which has been signed by 70 insurance supervisory authorities. In addition, the FMA has bilateral MoUs with 12 jurisdictions that cover key markets where Austrian groups are actively operating.

54. Supervisory colleges have been established for the five internationally active Austrian insurance groups. Annual face-to-face meetings, or at least conference calls for small groups, have been organized with both college members from European Economic Area (EEA) jurisdictions and participants from non-EEA jurisdictions. Information exchange templates have been set up by the FMA since 2014 (and subsequently updated) to facilitate data and information sharing. They contain key performance indicators (KPIs), supervisory assessments, and activities of National Competent Authorities (NCAs).

55. In 2018, the FMA implemented an updated college approach with stronger focus on coordinated supervisory work. In 2018 the FMA started sharing the Group Risk Report with the supervisory college participants. Additionally, it has been bringing the group work plan for discussion, with a view to achieving more coordination in the areas of supervisory priorities and (joint) onsite inspections with host supervisors.

Recommendations

56. The FMA should enhance information sharing with the host supervisors; in particular, with those jurisdictions where Austrian insurers have a systemically significant market share. These efforts should be firmly grounded in the FMA's annual program. Supervisory college structures have often broad-based membership; this should not have an impact on the flow of information necessary for the joint assessment performed within a college.

E. Market Conduct

57. The FMA has implemented new EU-wide new regulations to enhance information provided to the policyholders. EU regulation introduced new information requirements to producers (insurers and asset managers) of Packaged Retail and Insurance-based Investment Products (PRIIPs) and, more generally, other insurance products through Insurance Distribution Directive (IDD). To facilitate the implementation of PRIIPs, the FMA issued a circular on Key Information Documents for PRIIPs. The PRIIPs Regulation entered into force in January 2018, and the circular on Key Information Documents for PRIIPs in February 2018. To facilitate the implementation of IDD, the FMA issued the Life Insurance Information Requirements Regulation 2018. This regulation stipulates the minimum content of information to be provided by insurers to policyholders before and after the conclusion of an insurance contract. In connection with the implementation of the IDD, the Information Requirements Regulation for Health Insurance was amended. The Information Requirements Regulation for Occupational Group Insurance, which entered into force in January 2016, and minimum standards for information requirements in occupational pension group insurance, which entered into force in July 2015, were both introduced before and independently of the IDD Directive and PRIIPs Regulation. The Information Requirements Regulation for Occupational Group Insurance stipulates the minimum content of information to be provided by insurers to beneficiaries (entitled and recipients), as well as the content of the information to be provided by insurance companies to insured persons. These minimum standards cover information to be provided to beneficiaries upon their inclusion in occupational pension group insurance, as well as the information to be provided should they leave the company prior to the occurrence of a benefit event.

58. In terms of conduct of business, the FMA supervises the distribution of insurance directly by insurers or banks, while the Federal Ministry of Digital and Economic Affairs has general authority over insurance agents. Indeed, the oversight of the distribution network of insurance products appears fragmented, as does the escalation mechanism of a dispute, should there be one. Supervision of insurance brokers and agents is conducted by 106 local supervisors at the district level. Mediation would be conducted by the ministry, and the cases would be shared with the FMA for information and to facilitate its work toward meeting its overall supervisory objectives. The Arbitration Board for consumer business (Verbraucherschlichtung Austria) is an independent, non-profit and state-approved association. The Arbitration Board offers voluntary mediation free of charge. Austrian Insurance Association (VVO) is also receiving and handling complaints at their Information and Complaints Office.

59. The FMA's conduct of business supervision relies on the analysis of complaints, market monitoring activities, thematic desktop reviews, and the integration of the findings in its risk assessment of insurance entities. Complaints are an important source of information for the FMA's conduct supervision and risk analysis. Insurers continue to rely on and often grow their agent network in order to increase their business as the effectiveness of alternative distribution platforms, especially internet, is reported as being quite limited for a number of reasons: structure of the market with regional insurers keeping in close contact with the policyholders (which are also members, in case of mutual); effectiveness of decentralized claims management; loyalty to the agent handling the relationship, etc. Insurers are required to submit reports in relation to the complaints that they receive. In the case of internationally active groups, conduct of business may be part of the Supervisory College agenda or tour-de-table discussion.

60. The FMA may also receive complaints directly from the public, **although it does not have legal functions of mediation and resolution of individual cases.** The FMA forwards these complaints to the insurers if they were not addressed to them as well. In 2018, the FMA received approximately 1,700 complaints, 300 of which were against insurance companies.

61. There are several public and industry institutions dealing with complaints from insurers. The Federal Minister of Labor Social Affairs, Health and Consumer Protection is in charge of addressing complaints from consumers, including those of the insurance sector.

62. In Austria, the number of complaints that responsible institutions are receiving is on an increasing trend over the last three years; the 2018 data point to a further material increase. For example, the Arbitration Board for consumer business and the industry association (VVO) have respectively received 75 percent and 65 percent more complains in 2018 than in 2017. The majority of the complaints were related to auto insurance (about 40 percent), followed by life insurance (about 10 percent).

63. Industry participants suggest recent court decisions as a potentially important legal risk to the life insurance sector. In 2014, the European Court of Justice (ECJ) ruled in the case of Walter Endress versus Allianz (German entity) that a national provision that restricted the exercise of the cancellation rights granted, where that policyholder had not been provided with information required, was not justified. Taking into account the ECJ decision, the Austrian Supreme Court (OGH) ruled that in the case of a life insurance contract, the policyholder or beneficiary is entitled to an unlimited right of cancellation due to the communication of incorrect information about the duration of the period of cancellation at the time of origination.[16] According to recent court rulings, the policyholder is therefore entitled to premium payments as well as 4 percent interest. Interest coverage and other issues are currently under the OGH for its ruling. Moreover, there is now legislative work to clarify the law in relation to the cancellation of a policy: after five years from contract origination, cancellation is possible at surrender value.

64. The FMA has conducted data-collection exercises on the potential impacts of mass cancelations since 2016. Data collection exercises have been conducted four times (in April and September 2016, June 2017, and April 2018). The FMA is also intensively discussing with individual entities to ensure the compliance of pre-contractual information requirements, improvement of the governance of product designs, and level of provisioning for the potential future cancellation in case of in favor court decisions in the future.

Recommendations

65. The government should initiate studies on conduct risks of insurance brokers and agents. The current institutional framework, where the FMA and 106 local supervisors at the district level share the responsibility of insurance intermediaries, could pose significant challenges for the supervisors to identify increasing market conduct risks. The relevant ministries should conduct comprehensive data collection and risk analysis of conduct risks in insurance brokers and agents.

66. The FMA should develop a coordinated strategy with current supervisory bodies of insurance brokers and agents at the district level to improve risk-based supervision of market conduct. Recent increasing number of complaints would warrant enhanced monitoring by the existing supervisory bodies. While the FMA has already decided to conduct market -focused inspections in 2019, such initiatives should be conducted in a coordinated manner with local

[16] In the past, changes in the duration of policy cancellation were the principal reason behind the widespread industry practice of using outdated information in relation to cancellation rights.

supervisors at the district level, ideally with joint inspections. If the FMA identifies material risks in upcoming onsite inspections, those could be usefully shared with the Federal Ministry of Digital and Economic Affairs and local supervisors at the district level, and vice versa. A coordinated strategy could also include appropriate information sharing system and agreements. Information sharing should not be limited to those related to enforcement actions but also to a wider range of data and information for effective risk-based supervision.

F. Enforcement

67. The FMA has several enforcement tools, including orders and administrative fines to both individuals as well as legal entities. Those tools are available to ensure that insurers comply with information requirements and conduct of business rules. The maximum amount of a fine was increased significantly to EUR 700,000, or double the amount of the benefit derived from the breach to an individual, or EUR 5 million, 5 percent of total annual turnover, or up to double the amount of the benefit derived from the breach for a legal entity. In terms of disclosure, the FMA is required to publish all fines and legally take measures for breaches against the obligations pursuant to provisions for insurance distribution and internal policies for the distribution.

68. On the other hand, the FMA does not have any authority or power over independent brokers and agents. The Federal Ministry of Digital and Economic Affairs is responsible for the policy making of independent brokers and agents. At a local district level, there are 106 local supervisors at district level who are responsible for certification, training, supervision, and enforcement of intermediaries.

G. Safety Net and Crisis Management: Current Situation and Potential Changes

69. The safety net in the insurance sector is the Deckungsstocksystem, a pool of special funds—the so-called "Deckungsstock"—that insurers need to establish for life assurance as well as health and accident insurance.[17] The Deckungsstock constitutes a special internal (i.e., within the companies) fund in case of bankruptcy/insolvency of an insurance company. Assets that are held for this purpose are registered in a specific register that is monitored by a trustee (Treuhänder) appointed by the FMA. The Deckungsstock trustee informs the FMA via quarterly and annual reports and is mandated with the task to bring immediately to the authority's attention any circumstances that may raise concerns regarding the compliance with the cover requirement (Art. 305 para 1 no. 3 VAG 2016).

[17] According to Chapter 12 VAG 2016 companies performing (1) life assurance, as far as it does not fall under nos. 2 to 6; (2) occupational pension group insurance; (3) unit-linked life insurance; (4) index-linked life insurance; (5) investment-oriented life assurance, where the policyholder is at least entitled to the invested premiums guaranteed by the insurance undertaking; (6) state-sponsored retirement provision pursuant to Articles 108g to 108i EStG 1988, unless allocated to a different *Deckungsstock* group; (7) health insurance, as far as this is operated in a manner similar to life assurance; and (8) accident insurance, as far as this is operated in a manner similar to life assurance.

70. The Deckungsstock actuary is responsible for the adequacy of the amount of technical provisions that each insurer needs to maintain at all times, to ensure the continuous fulfillment of the commitments arising from contracted insurance policies; the role can be entrusted to the actuary employed by the insurance entity, The insurance law (Art. 116, para 6 VAG 2016) foresees an annual report on the required amount of technical provisions from the responsible actuary to the MB of the insurer, and an escalation to the authority in case of disagreement, or divergence of views within the insurance company.

71. The assets dedicated to the Deckungsstock may only be subject to execution for the benefit of policyholders and beneficiaries in bankruptcy or runoff. The legal disposal of assets dedicated to this pool of funds requires the trustee's written consent. In the event that the FMA files a petition of bankruptcy in case of insolvency or over-indebtedness of an insurer, from that point on the settlement of insurance contracts falls within the responsibility of the bankruptcy court and—importantly, for long-term (life and health) policyholders—contracts are terminated. The register of assets dedicated to the Deckungsstock is immediately submitted to the bankruptcy court, which would initiate the proceedings. On the other hand, in the event of a run-off (Article 286 VAG 2016), it is the supervisory authority that assumes the responsibility of the insurance entity in this process.

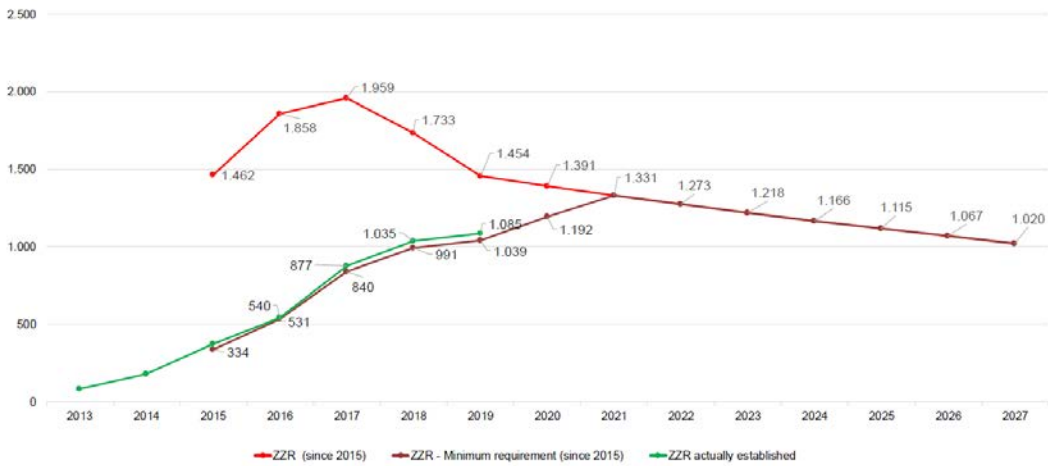
72. In the life business, for the benefit of insurers and policyholders alike, the FMA has taken measures to increase the resilience of the entities that have been facing a "low for long" interest rate environment, as well as other challenges. The life insurance sector will have to accumulate, in total, about EUR 1.5 billion of additional regulatory provisions (interest rate reserves), known as Zinszusatzrueckstellung (ZZR) by end-2021. At end-2018, life insurers had accrued EUR 1035 million on the back of ZZR contributions of about EUR 158 million in 2018, a material amount in light of the low profitability of the life segment.

73. In 2013, when the additional interest rate reserve (ZZR) for life insurers was introduced by the FMA, it had to be funded by ordinary profits; in 2016, ZZR was adjusted to allow the reserve to be co-financed by available surpluses from the sharing system. When the requirement was first introduced, affected insurers were given 10 years to meet the target-level of reserves; however, when the Maximum Interest Rate regulation was amended, the minimum amount of the interest rate provision was doubled, and the transitional period was shortened to seven years; hence, the 2021 deadline. The additional interest reserve is derived by the simple formula, with the following parameters; (i) life insurance provision; (ii) the average guaranteed rate of an insurance company; and (iii) the annual average Austrian government bond yield. Insurers have built up EUR 1 billion and would have to set aside additionally EUR 0.3 billion by 2021 (see Figure 11). As Solvency II figures rely heavily on modeling assumptions for both valuations and capital requirements, statutory accounting with additional interest rate reserve is providing some reasonable safeguard.

74. The national implementation of Solvency II is providing the FMA with many tools to deal with entities facing challenges that could be critical to their solvency and survival, especially in the context of life assurance. These measures are broad-based, providing a legal basis for intense and intrusive oversight of insurance companies and distribution networks. VAG 2016, which implemented the Solvency II framework in Austria, also preserved features of the previous regime that were deemed prudent, successful, and well understood (such as the Deckungsstock). VAG 2016 enables the FMA to take a large number of supervisory measures vis-à-vis the insurers (from capital add-ons to convening a general meeting, requiring the submission of a solvency plan and finance scheme, restrictions/prohibitions in business activities with a view to de-risking the balance-sheet, request of a portfolio transfer, dismissal of Board members and/or senior managers of the company, appointment of a commissioner), but also to investigate and take measures on the conduct of business related matters.[18]

Figure 9. Austria: Trend of Zinszusatzrueckstellung

Insurers have built up EUR1 billion and would have to set aside EUR additionally 0.3 billion by 2021.



Source: FMA.

75. The VAG allows the FMA to take extraordinary measures in the interest of policyholders and beneficiaries. The FMA can temporarily prohibit payments of insurance benefits, and in the case of life assurance, prohibit also surrenders and advance payments on policies, as well as reduce the obligations of the insurer arising from life assurance, in accordance with the existing assets. The safeguard provided by the law (Article 316 VAG) is that such extraordinary measures as the temporary prohibition of payments, are revoked when the financial situation of the insurer permits it.

76. In light of domestic[19] and international developments pointing to the possible creation of a minimum harmonization framework in the EU, the FMA is discussing to enhance, on the one hand, the completeness and legal certainty of the insurance framework and, on the other, the effectiveness of the supervisory toolkit in crisis preparedness. The discussions within the first

[18] Article 275 of VAG 2016 invites the FMA to give any orders would be necessary to ensure compliance of the business activities with EU implementing and delegated regulation as well as technical standards.

[19] The FMA internal analysis discusses amendments and changes to the insurance law (VAG 2016) are motivated by the implications of the 2016 STs.

category are quite broad in scope: they range from clarifications of existing provisions to the introduction of a requirement for the drawing of pre-emptive recovery plans from insurers (only those that are offering interest-sensitive products). They also include a limitation of the distribution of dividends on the basis of a broader assessment than the imminent breach of the SCR[20] and the definition, in law, of a framework for a new generation of insurance guarantee products. The measures discussed aim at reinforcing the Austrian PPS (Deckungsstock) primarily through the focus on clarifying the prudent person principle[21] in order to provide legal certainty on this far-reaching concept (insurance companies, policyholders, Management Board, auditors, and responsible actuaries). One additional objective is to strengthen the position and independence of the actuary within the insurer, as this role has the important responsibility of confirming that the uninterrupted fulfilment of commitments arising from contracted insurance policies is possible. Finally, within this first category of proposals, the discussion is suggesting the introduction of expert qualification requirements for the statutory auditors, to ensure adequate insurance knowledge.

77. Ongoing discussions suggest that the FMA's powers need to be substantially reinforced through a number of enhancements to the supervisory regime. They include the extension of existing restructuring powers to all kinds of insurance and all types of creditors, and the ability to mandate a portfolio transfer. Importantly, the analysis suggests to formally adopt in the insurance sector the overarching principle adopted early on after the GFC: losses must be borne first by shareholders and other creditors before they affect policyholders' and beneficiaries' claims. As discussed above, in the context of life assurance, the FMA has currently the power to suspend payments and restructure policyholders' claims provided that it is in their interest and that of the beneficiaries (Art. 316 VAG); this power has not been exercised to-date. Ongoing discussions aim at extending these powers to impose losses to all creditors of the entity (e.g., shareholders, bondholders, agents, and reinsurers), while also clarifying the order and extent of commitment to the absorption of losses, and for all kinds of insurance activity. Additionally, in the current context, the FMA is able to invite an insurer to transfer portfolios when it deems that the uninterrupted continuation of these policies (typically life and health) are of fundamental importance. However, it cannot force the portfolio transfer to one or more insurers, possibly with the financial support of an internal guarantee fund (to be established).

[20] Dividend distribution restrictions or an overall prohibition at higher levels than SCR is seen as a required forward-looking measure. Its aim would be to ascertain that the insurer's financial resources are preserved in situations where the insurer may be solvent however the policyholder's' benefits are not yet fully protected (because, for instance, the additional interest reserve on the life portfolios has not been fully built).

[21] Solvency II requires that investments be managed in line with the prudent person principle. In practical terms this means that there are no longer external quantitative restrictions but rather an expectation that insurers will only invest in assets and instruments whose risks the company concerned can properly identify, measure, monitor, manage, control and report and appropriately consider in the assessment of its overall solvency needs. All assets are to be invested in a manner that ensures the security, quality, liquidity and profitability of the portfolio as a whole.

78. The FMA discussions in the direction of crisis preparedness are a welcome step which, in compliance with global guidance, should be firmly grounded and secured in the context of an introduction of a comprehensive recovery and resolution framework (RR). The adoption of the overarching principle that losses must be borne first by shareholders and other creditors before they affect policyholders' and beneficiaries' claims would be a fundamental building-block[22] in that direction. In proposing intervention powers, the FMA is clearly taking additional steps toward a national, in absence of a European, framework that could increase the resilience of firms through crisis, improve the effectiveness of recovery measures, and deliver a structured (and with several options according to the circumstances) path to resolution and market exit.

79. The introduction of an RR framework would provide an opportunity to review the scope and respective responsibilities of competent authorities; introduce a broad set of resolution tools, which would include the power to transfer assets and liabilities to bridge institutions; and secure the support of resolution funding arrangements, while introducing appropriate safeguards and legal protection. Such a framework should clearly establish the scope and responsibilities of the resolution authority (FMA), its interaction with other relevant policy-making entities and, importantly, all relevant decision-making processes under the RR framework. The separation between supervisory and resolution responsibilities and decision making in the planning and execution phase should be clear, well understood, and adequately communicated to avoid the perception of risks derived from possible overlaps and potential conflicts of interest.

80. The introduction of an effective resolution framework should be well supported with a combination of different funding arrangements, starting with private funding arrangements that provide adequate ex ante resources for purposes of resolution, and benefiting from the credible support of specific provisions for public funding. At present, the Deckungsstock is the internal (i.e., within the companies) pool of funds that is only subject to execution for the benefit of insurance claims. Only the FMA may file a petition in case of bankruptcy/insolvency of an insurance company. This special fund could participate in the context of forced portfolio transfers and provide funding in the context of liquidation, should its mandate be redesigned to provide resolution funding. The present lack of private funding arrangements and ex ante resources dedicated to resolution funding would make the capitalization and liquidity of a bridge institution a challenge; careful consideration is therefore warranted before a proposal of a comprehensive RR framework proceeds.

81. In addition, an effective RR framework should strongly encourage and critically depend on cross-border cooperation; the FMA's experience and positive track-record in the supervision context should be an important enabler going forward. In the context of its supervisory oversight of the insurance sector, the FMA is reaching out to competent authorities of EEA and non-EEA European countries through a range of activities within the Supervisory College

[22] In developing an effective RR framework for insurers, the KAs identify four requirements, necessary and enabling conditions: (i) a well-established financial stability framework; (ii) an effective system of supervision, regulation and oversight of insurers; (iii) effective protection schemes for insurance policyholders; (iv) a well-grounded liquidation framework**.** These preconditions appear to be broadly there in Austria, especially as far as the foundation work is concerned**.**

platform of year-long engagement, and with bilateral as well as ad hoc initiatives. The recovery and resolution planning effort will therefore benefit from a well-engaged effort that would gradually translate into a trusted and effective cross-border crisis management cooperation, including, when necessary, to effectively bring a failing insurer into resolution. This coordination should be timely, with information preceding actions, and apply to resolution cases initiated domestically or in a foreign jurisdiction. Additionally, adequate mechanisms should be ensured for the resolution authority to coordinate with foreign judicial proceedings.

82. Work in the direction of requesting pre-emptive and proportional recovery plans from insurers selected based on microprudential and macroprudential considerations is strongly supported. The FMA considers requiring pre-emptive recovery plans from life insurers that have interest-sensitive products. Pre-emptive recovery plans are a valuable tool for insurers and supervisors, especially when properly integrated into their risk management framework; work on the appropriate selection of eligible insurers for this requirement should be grounded in microprudential and macroprudential considerations.[23] Relevant considerations beyond size are the entity's risk profile, nature or structure of business, scope and complexity of activities, interconnectedness to other financial institutions, to the financial system and economy more broadly, cross-border operations and systemicity, and possible impact on host jurisdictions. Finally, proportionality is an important consideration that goes beyond the scope of application, as it can, among other things: (i) shape the content and granularity of the plan; (ii) inform the required timeframe to draft, consult internally, obtain sign-off from the Board and submit to the FMA; and (iii) determine the policy with respect to the updating of the pre-emptive recovery plans.

83. Austria has not dealt with systemic insurance failures in the past or even had an insolvency case since before WWII, and the FMA reports no cases of near-failures of non-systemic insurers; it appears that challenges in the sector have been successfully dealt with through mergers and other market solutions. Hence, one of the main challenges of the current framework and any forthcoming interventions or broad-based framework changes, comes from the operationalization and testing of the crisis management regime and the institutional arrangements to ensure its overall effectiveness. This should include the preparation of operational manuals, procedural steps, alerts and triggers, escalation process, and simulation exercises (internal, with the authority, domestic, and with different configurations of cross-border competent authorities), beyond what exists today (FMA internal-crisis manual).

84. The implementation of the framework will require the FMA improve staff's range of expertise and probably increase its total number of FTEs. The going-concerns tasks are dealt with efficiently by the current staff of the FMA's Insurance Division. However, existing resources and skills should be carefully re-assessed against new tasks and responsibilities from the development and implementation of the RR framework. Resource limitations could become important obstacles in the operationalization of resolution preparedness, when, for instance, the FMA would need to start

[23] The IAIS has recently consulted on an "Application Paper on Recovery Planning" and should be finalizing its views in the following weeks or months.

assessing recovery plans to be able to subsequently prepare resolution plans and develop framework-related policies.

Recommendations

85. Enhance crisis management preparedness by including pre-emptive recovery planning for a group of insurers, adequately selected based on microprudential and macroprudential considerations, with due consideration to the proportionality principle.

86. Introduce the formal adoption of the overarching principle that losses must be borne first by shareholders and other creditors before they affect policyholders' and beneficiaries' claims as a fundamental building-block toward a formal recovery and resolution framework. When further developing and modernizing the FMA's supervisory toolkit on the basis of the existing Deckungsstocksystem,[24] standards and principles forming the basis for future EU legislation should be taken into account. It should introduce new powers, with appropriate safeguards and legal protection, as well as a clear delineation of the scope and respective responsibilities of authorities (supervisory and resolution), to avoid overlaps and potential conflicts of interest.

Box 3. Overview of Recovery and Resolution Frameworks for Insurers in Europe

France is one of the first jurisdictions of global systemic importance to establish a comprehensive resolution framework for insurers. On the basis of legislation enacted in December 2016 and November 2017 (Sapin II and Ordinance 1608 respectively), the legal framework was amended to increase ACPR's (Autorité de Contrôle Prudentiel et de Résolution; the supervisory and resolution authority for banks and, until that time, insurance supervisory authority) toolkit and scope for insurers' recovery and resolution.

The new legal framework introduces resolution tools, such as transfers of assets and liabilities and bridge institutions, however it does not provide the ACPR with the power to restructure the liabilities of the failing insurer (bail-in tool). It is designed to apply to insurers that breach the SCR and the MCR coverage ratio while remaining balance-sheet solvent in a Solvency II sense (i.e., assets still cover liabilities). When the insurer becomes balance-sheet insolvent, the framework leads to liquidation, as resolution would no longer be possible. Consistently with the above features, private funding arrangements or specific provisions for public funding, and NCWO safeguards are not part of the RR framework.

Two criteria have been identified as fundamental to determining whether a group or an insurance company is subject to the new framework's requirements, that is to recovery and resolution planning. These criteria are: (1) a balance-sheet size (total assets) threshold, which was set by the MoF (Trésor) to EUR50 billion (and can be reviewed and revised); and (2) the existence of critical functions or specific risks. Criticality is defined in a broad sense, giving consideration to financial stability (as per the usual definition) and also to the real economy, with the aim to avoid or minimize disruptions to the economic activity. In its current implementation, the only operational criterion is the balance-sheet size threshold: a double-digit number (14) of insurers are required to submit recovery plans to ACPR in 2019.

In the Netherlands, the framework draws its inspiration from the KAs for insurers and the BRRD framework for banks; it does not introduce an Insurance Guarantee Scheme for the protection of policyholders. The framework was approved in late November 2018 and entered into effect on January 1, 2019.

[24] Such a framework would add to the existing supervisory toolkit, introducing new powers, with appropriate safeguards and legal protection, as well as a clear delineation of the scope and respective responsibilities of authorities (supervisory and resolution), to avoid overlaps and potential conflicts of interest.

Box 3. Overview of Recovery and Resolution Frameworks for Insurers in Europe (continued)

It sets resolution objectives (protecting policyholders, avoiding unnecessary value destruction and minimizing the overall costs of resolution), and provides the resolution authority (DNB) with a resolution toolkit. The toolkit includes: (i) bail-in, i.e., the power to write down or convert equity or debt, or restructure insurance policies; (ii) sale of business: sell the shares of an insurance group or troubled company within the group; (iii) bridge institution: temporarily transfer the insurer's shares and/or (part) of its assets and liabilities to a bridge institution, to the extent that a market solution cannot be found; and (iv) asset separation: ability to transfer assets and liabilities to an asset management vehicle (AMV). This measure can only be used in combination with one of the other measures.

The framework also adopts a public interest test to assess whether resolution is warranted, as the default option is that a failing insurer would go to insolvency. In doing so, the resolution authority assesses whether the resolution actions are necessary and proportional, having regard to the objectives of resolution, and whether a normal bankruptcy procedure would not lead to the same results. The public interest test relies on the evaluation of the following criteria: (a) is resolution is in the interest of policyholders; (b) does it avoid a disruption to the society, i.e., does it minimize the social cost; (c) does it prevent a severe impact to the financial system and real economy; and (d) are public funds better protected, i.e., is the cost of failure minimized?

The protection of policyholders is not however of paramount importance; the prevention of major social consequences or significant adverse consequences for the financial markets or the economy on the other hand is. So, resolution may impose losses on policyholders under the NCWO safeguard. The Act provides general guidance as to the factors that could proxy the impact on society from the activities of the failing insurer: how many policyholders are affected, the type of insurance, and the replaceability of the insurance contract in the market. The thresholds adopted are 1 million policyholders and 1 billion of technical provisions; however, the public interest test is conducted at the time of failure and is a case-by-case assessment.

All insurers will have to participate in crisis preparedness through the drawing up of preventive recovery plans. In preparing these plans, which are coined "preventive crisis plans" in the Netherlands, the proportionality principle will be taken into consideration in terms of the depth and detail of the plan. The resolution authority will be drafting resolution plans for the insurers captured by the above thresholds, with the preventive recovery plans as important input and starting point for its work.

Romania was the first European country with an RR framework for insurers. The framework draws heavily on the BRRD with a notable exception, the inclusion of the bail-in tool in the resolution toolkit. The framework provides the competent authority (Financial Supervisory Authority; FSA) with early intervention powers that could be taken in the event that an insurer is not meeting, or is likely not to meet capital requirements, as a result of the rapid deterioration of the financial situation, which includes a deterioration of the solvency capital and of the own funds that cover solvency capital requirements. These measures include the appointment of a temporary Director for a maximum of one year to replace or cooperate with the insurer's existing management.

Resolution can be imposed by the FSA if an insurer enters or is likely to enter into a state of major difficulty and the measure is necessary from a public interest perspective. The FSA appoints a Resolution Director, who carries out all of the responsibilities of the insurer's shareholders and management. The resolution measures may include share capital increases, shareholding changes or takeover of the control of the insurer by other insurers with adequate financial soundness. Before ordering a resolution measure, the FSA will require a financial auditor to perform a valuation of the assets, liabilities and equity of the insurer in question.

The framework provides resolution tools to the resolution authority's (FSA), which is not however provided with bail-in powers. The three tools of the resolution toolkit are: (i) Sale of activity and portfolio: In this case, the FSA can transfer an insurer's shares to a buyer, as well as any category of insurer assets, rights or obligations; (ii) bridge-institution: The bridge-institution is an entity controlled by the FSA, to which the FSA can

Box 3. Overview of Recovery and Resolution Frameworks for Insurers in Europe (concluded)

transfer the shares, assets, rights, and obligations of the insurer, with or without the consent of failing insurer's shareholders. The assets, rights, and obligations can subsequently be transferred either to third parties or back to the insurer, as per FSA decision; (iii) separation of assets: In the case of separation of assets, the FSA has the authority to transfer the assets, rights, and obligations of an insurer or of a bridge-institution to an AMV, without having to obtain the approval of the insurer's shareholders. Such AMVs are controlled and managed by the FSA for the purpose of the sale of assets and/or portfolios, or for liquidation.

This regime has safeguards and introduces resolution financing. More precisely, the FSA needs to ensure that, in the event of resolution, the shareholders and creditors are not treated worse, i.e., suffer more losses, than they would in the event of an insolvency procedure (NCWO principle). Should this be the case, shareholders and/or creditors will be entitled to a compensation in the amount of the difference, paid from the resolution financing mechanism. The resolution financing mechanism consists of the Insurers Resolution Fund set-up and managed by the Insured Guarantee Fund. The fund is established with the insurers' contributions, up to a maximum of 1 percent of the gross premiums collected.

In the context of recovery and resolution preparedness, each insurer must develop and regularly update a recovery plan. The recovery plan is submitted to the FSA for its assessment. The FSA establishes a resolution plan for Romanian insurers that are likely to be of systemic importance.

H. Macroprudential Surveillance

87. **The FMA has conducted a number of horizontal reviews and ad hoc industry-wide surveys.** Thematical reviews have been conducted within the broader activities of stress testing, benchmarking exercises, and other industry/thematic reviews. In addition, the FMA collects information from the industry when risks are identified or more information is needed to inform risk assessments. The analysis has identified outliers, which are excessively exposed to those risks. Recent examples are summarized in Box 4.

Box 4. FMA's Thematic Reviews

The FMA has performed number of thematic and focused reviews in the recent years. The FMA has actively conducted reviews of emerging issues, such as profitability of foreign insurance business, impact of LTG measures, technical provisions in health insurance, liquidity test, real estate valuation, IT and Operational Risks, digitalization on the insurance market. The reviews identify industry wide practices and/or outliers, which are subject to supervisory reviews and inspections to improve firms' practices and risk profiles. The following are some examples of reviews that the FMA has conducted recently.

In 2016, the FMA performed a detailed survey on direct and indirect property investment of the insurance companies. The scope of the survey included basic information on valuation methods, valuation parameters (e.g., location, type of property, rental income, economic lifetime, discounting yield, vacancies, local gap accounting information, and market value). The analysis identified overall prudence of the current industry valuations, such as assumed rental income, etc. However, the analysis identified several issues, including (i) significant concentrations of their location (in Vienna); (ii) a large share (39 percent) of the properties are valued using internal valuation reports; and (iii) some portion (9 percent) of the market values of the properties are valued using valuation reports older than three years. Based on the thematical analysis, a more detailed analysis of the property portfolio of 10 insurers was performed. Based on the deep analysis, one onsite inspection is taking place and additional review of two insurers will be taking place in 2019.

Box 4. FMA's Thematic Reviews (concluded)

The FMA identified potential needs for considerable premium adjustments in health insurance. While shares of premium or assets of health insurance are still small, the sector is growing more than other subsectors. In Austria, insurers are required to provide lifetime policies to all policyholders and thus duration of liabilities are quite long. Low interest rate environment has some impact on the technical provision to meet the future obligations. Therefore, FMA has carried out an analysis of the sufficiency of the level of technical provisions. The analysis identified that insurers are using mainly deterministic approaches rather than stochastic modeling of their best estimate calculation. They also assume that premium could be adjusted in line with inflation of health care services. In fact, premium is allowed to be adjusted according to contract law (cf. Art 178 f Insurance Contract Act).

FMA conducted analysis of surrender behaviors in life insurance and liquidity test for insurers. In 2016, the Insurance Distribution Directive (IDD) was introduced to ensure the level of protection of policyholders, regardless of distribution channels. In preparation of the national implementation of the IDD, FMA conducted a data collection on the surrender behavior of life insurance products, in cooperation with the Austrian Ministry of Economy. Approximately 11 million contracts covering from 2012 to 2016 were analyzed. The analysis showed that bank distribution channels had the highest lapse rate, and approximately 47 percent of contracts have been canceled due to lapsing.

I. Digitalization

88. **The FMA has recently conducted surveys and analyses on digitalization and is therefore aware of potential benefits and risks for the insurance market.** More precisely, information on potential impact of digitalization and industry strategies, processes, cyber risks, and IT landscape was collected from all Austrian insurers, and the input received was subsequently analyzed. The FMA also assessed IT and operational risks in the Own Risk and Solvency Assessment (ORSA) and conducted a survey concerning the main IT systems. Industry is also investing to improve its IT system to meet higher customer needs and demands that would help it to prepare for increasing competitive pressures from existing companies and potential entrants. The FMA is encouraged to continue to monitor the developments and take supervisory actions if needed.

89. **The FMA's analysis of the use and implications of big data analytics (BDA) revealed that 23 percent of insurers are actively using the BDA.** The current main-use cases are customer relationship management (CRM), sales, risk management, and fraud detection. Some insurers have also introduced products connected with telematics and other Internet of Things (IoT) devices. The FMA expects that the technology will be used in the field of pricing and product development. While the BDA is able to provide some benefits for insurers and policyholders, the FMA also identified several risks. For example: shortfalls in data quality and erroneous models might lead to flawed results and high complexity; individual pricing can lead to a lack of transparency and undue discrimination. Importantly, increased collection of sensitive data can substantially increase legal risk and expose vulnerabilities to more incentivized and motivated cyberattacks. The FMA is encouraged to continue to monitor the use of BDA and analyze both benefits and risks.