D. Insurance

In this chapter, the "Solvency II" Law means the Law transposing into Belgian law the European Solvency II Directive as amended by the Omnibus II Directive. For simplicity, the term "Solvency II Law" is used even though, when this Report went to press, it was still a draft Law which has yet to be debated in Parliament. It is therefore possible that some of the provisions mentioned in this Report may yet be amended, especially as the implementing Decrees were still at the draft stage.

1. Introduction

The introduction of the new regulatory framework for insurers and reinsurers (Solvency II) on 1 January 2016 presents a major challenge for both the sector and the supervisory authority. The risk-based approach adopted in Solvency II could have a significant impact on the business model of insurance companies. For instance, additional capital could be stipulated in order to meet the new capital requirements. Another point for attention concerns the development and implementation of the processes and procedures necessary to meet the Solvency II requirements. The supervisory authority will also have to revise its practices to incorporate the risk-based approach in its routine supervision and to make full use of the new reporting.

The entry into force of Solvency II marks the end of a long legislative process. In 2014, a final agreement was reached on the revision of the Solvency II Directive [1] (by the Omnibus II Directive [2]), opening the way to the development of the Delegated Regulation by the European Commission and technical implementing standards and guidelines by the European Insurance and Occupational Pensions Authority (EIOPA). In 2015, the Solvency II Directive, as amended by the Omnibus II Directive, was transposed into Belgian law (the Solvency II Law). Following a "comply or explain" procedure, the great majority of the EIOPA guidelines were endorsed by the Bank before being transposed into circulars or internal procedures.

The preparatory work relating to Solvency II also led to thorough revision of the existing regulatory framework for the prudential supervision of insurers and reinsurers. The Royal Decree on the annual accounts of insurers and reinsurers refers to the provisions of Solvency I for the calculation of the technical reserves. As the Solvency I framework is being dropped, these provisions are incorporated in the Royal Decree itself. New provisions on the formation of an additional life insurance reserve (the flashing-light reserve) are also being introduced. The Royal Decree on life insurance activity was also aligned with the provisions of the Solvency II Law, and some sections on consumer protection were taken out. A new Royal Decree on profit-sharing has been drafted, which takes account of both the profitability and the solvency of the institution and gives the Bank the power to limit profit distribution in specific cases.

In view of the large volume of new regulations entering into force in 2016, both the insurance sector and the Bank face a considerable operational risk. Will all institutions meet the new legal requirements? Have adequate procedures been set up? Will the institutions be able to deliver qualitative and quantitative reporting? And will the quality of those reports be satisfactory? The first reports submitted

(1) Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency I Solvency II).

(2) Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No. 1060/2009, (EU) No. 1094/2010 and (EU) No. 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority).

during the preparatory phase showed that many institutions still needed to make considerable progress.

Section 2 of this chapter begins with an overview of the insurance institutions and groups operating in Belgium. Section 3 discusses the sector's qualitative and quantitative preparations for Solvency II. Section 4 deals with the monitoring of some priority risks and concludes with an account of the Bank's main regulatory initiatives.

2. Mapping of the sector

2.1 Insurers

At the end of 2015, the Bank exercised supervision over 91 insurers, reinsurers, surety companies and regional public transport companies which insure their fleet of vehicles themselves. The number of supervised undertakings has been falling slowly but steadily since the end of 2012, when the figure was still 113. This decline is due mainly to mergers and the cessation of business following the transfer of portfolios (about three-quarters of the decline). The expiry of insurance liabilities and the conversion of Belgian companies into branches of insurance companies of other EEA member countries account for about one-quarter of the reduction.

2.2 Insurance groups

At the end of 2015, 17 Belgian insurance groups were subject to the Bank's supervision. Eight of them only have holdings in Belgian insurance undertakings (national groups), while the other nine have holdings in at least one foreign insurance undertaking (international groups). Under Solvency II, the Bank is the group supervisory authority for each of those groups and, in that capacity, it receives specific reports which form the basis of prudential supervision at group level.

In order to facilitate group supervision, the supervisory authorities of cross-border groups work together in colleges of supervisors. These colleges ensure that the collaboration, exchange of information and mutual consultation between the supervisory authorities of the EEA member countries actually takes place in order to promote the convergence of supervisory decisions and activities. The establishment and operation of the colleges are based on coordination arrangements between the supervisory authorities concerned.

TABLE 4 NUMBER OF UNDERTAKINGS SUBJECT TO SUPERVISION (1)

	2012	2013	2014	2015
Active insurance undertakings	87	83	80	75
Insurance undertakings in run-off	9	8	4	3
Reinsurance undertakings	1	1	1	1
Other (2)	16	14	12	12
Total	**113**	**106**	**97**	**91**

Source: NBB.
(1) In addition, at the end of 2015, the Bank also exercised prudential supervision over ten branches of companies governed by the law of another EEA member country, although that was confined to checking compliance with the money-laundering regulations.
(2)) Surety companies and regional public transport companies.

TABLE 5 BELGIAN INSURANCE GROUPS SUBJECT TO THE BANK'S SUPERVISION

Belgian national groups	Belgian international groups
Alleasehold	Ageas SA/NV
AMMA Assurances	Argenta Assurances
Cigna Elmwood Holdings	Aviabel
Credimo Holding	Belfius Assurances
Fédérale Assurance	Credimundi
Fork Capital	Integrale
Securex	KBC Assurances
Vitrufin	PSH
	Trade Credit Re Insurance Company

Source: NBB.

In 2015, coordination arrangements were agreed for each Belgian international group with the supervisory authorities concerned. Coordination arrangements were also signed for insurance groups which have their head office in another EEA member country and a subsidiary in Belgium.

TABLE 6 COLLEGES FOR INSURANCE UNDERTAKINGS SUBJECT TO THE BANK'S SUPERVISION

The Bank is the group supervisory authority	The Bank is one of the supervisory authorities involved	
Ageas SA/NV	Allianz	Allianz Benelux
Argenta Assurances		Euler Hermes
Aviabel		
Belfius Assurances	AXA	AXA Belgium
Credimundi		Inter Partner Assistance
Integrale		Touring Insurance
KBC Assurances		
PSH	Assurances du Crédit Mutuel	Partners Assurances
Trade Credit Re Insurance Company		
	Delta Lloyd	Delta Lloyd Life
	Generali	Generali Belgium
		Europ Assistance Belgium
	Munich Re	D.A.S.
		Ergo Insurance
		DKV Belgium
	NN	NN Insurance Belgium
		NN Insurance Services Belgium
	Baloise Group [1]	Baloise Belgium
		Euromex

Source: NBB.
(1) The coordination arrangements will be signed during 2016.

3. Preparation for Solvency II

3.1 General framework

2015 was an important year in the preparation for entry into force of Solvency II. In September 2013, the uncertainty surrounding the adoption of the Solvency II Directive in Europe prompted EIOPA to publish guidelines in preparation for Solvency II. At the end of 2013, these guidelines were endorsed by the Bank and transposed into the following Circulars in preparation for Solvency II :

- The Circular on requirements concerning the prospective assessment of own risks ;
- The Circular on requirements for pre-applications for use of an internal model ;
- The Circular on requirements concerning the governance system ;
- The Circular on requirements concerning the communication of information to the Bank.

The undertakings implemented these Circulars in 2014, and the Bank monitored both the implementation and the progress of the preparations for Solvency II in 2015. Similarly, during 2015, after conducting a consultation on the subject, the Bank published a whole series of Circulars intended to help insurers to make the necessary preparations. Two additional Circulars were also published : one concerning the supplementary requirements on the communication of information to the Bank, and the other on the simplification of the Solvency I reporting during the preparatory stage.

3.2 Assessment of the qualitative preparations

The Bank's various contacts with the insurance sector showed that, up to mid-2014, the insurers' preparations focused mainly on the development of internal models and on other more financial and quantitative aspects of the Solvency II requirements. During the year under review, developments concerning the assessment of the solvency needs and governance were also closely monitored.

Pursuant to Solvency II, as an integral part of their business strategy, undertakings must regularly assess their own solvency needs in the light of their specific risk profile (Own Risk and Solvency Assessment, ORSA). In 2014, the Bank used a qualitative assessment model to examine, for a number of companies, the extent to which their internal processes were prepared for that. In 2015, the points for attention which emerged from that examination were monitored and the assessment was updated on the basis of new information obtained from the ORSA reports. During the year under review, the Bank also paid particular attention to the low yield environment. Thus, large insurance companies were also asked to assess their solvency situation in a scenario in which, after 20 years, the risk-free interest rate curve used to value the insurance portfolio does not converge on an interest rate of 4.2 %, but on a lower interest rate in line with market conditions.

Apart from monitoring the progress of the ORSAs, in 2014, the Bank also asked all insurers to test their governance system against the Solvency II requirements and to draw up an action plan to remedy any defects before entry into force of the new regulatory framework. In so doing, the Bank intended to draw insurers' attention to a number of points concerning governance under Solvency II. The results of this questionnaire were analysed in 2014, and in 2015 the findings were relayed to the insurance companies.

In general, it was found that insurers did not face any insurmountable problems preventing them from

complying with the Solvency II governance requirements. Nonetheless, some undertakings were asked to make more effort to ensure that compliance. Their lack of attention to the instructions on requirements relating to expertise and professional integrity was a recurrent failing. Insurers must attach more importance, among other things, to situations which could lead to a reappraisal, and to the procedures for the appraisal of other key staff. In many cases, insurers were also asked to make sure that the actuarial function is allocated sufficient resources so that it can perform its duties in an appropriate, totally independent way. Furthermore, the actuarial function must also be properly organised at group level. Another point for attention is the need to designate someone within the undertaking to take on full responsibility for key functions which are outsourced.

3.3 Assessment of the quantitative preparations

The Bank expects insurers and insurance groups to develop appropriate systems and procedures to supply high-quality information for the purposes of prudential supervision. The information submitted in that respect during the preparatory stage enables the Bank to examine and assess the progress made and the quality of the information provided.

The Bank decided that all Belgian insurers and insurance groups must submit annual and quarterly Quantitative Reporting Templates (QRTs) for 2014 and for the third quarter of 2015. However, in the case of small undertakings and small groups, the Bank limited the scale of the reporting. The final version of the reporting templates will form the basis of the Bank's periodic risk analyses and will provide a deeper insight into the solvency position and the financial situation under Solvency II. In analysing the QRTs, the Bank was also able to draw on the specific reports compiled by the approved auditors.

3.3.1 Quantitative reporting by insurers

The great majority of undertakings succeeded in submitting their QRT for 2014. For various reasons, six companies did not manage to do so. For instance, some of those undertakings were destined to exit the market before the entry into force of Solvency II, while others are subject to special provisions on account of their small size, so that there was no point in reporting during the preparatory stage. Some companies were in the process of a strategic reorientation during the preparatory stage and therefore did not submit reports. Insurers which did not report or which were very late in doing so were contacted on the subject and are being closely monitored.

At the end of November 2015, the Bank also received the QRTs relating to the third quarter of 2015. These figures indicate an improvement in the operational preparedness of the undertakings since the first wave of QRT reporting. In regard to the QRT reports relating to the third quarter of 2015, 79 % of undertakings fulfilled their obligations within a week of the final deadline, whereas only 50 % had achieved that in the first wave.

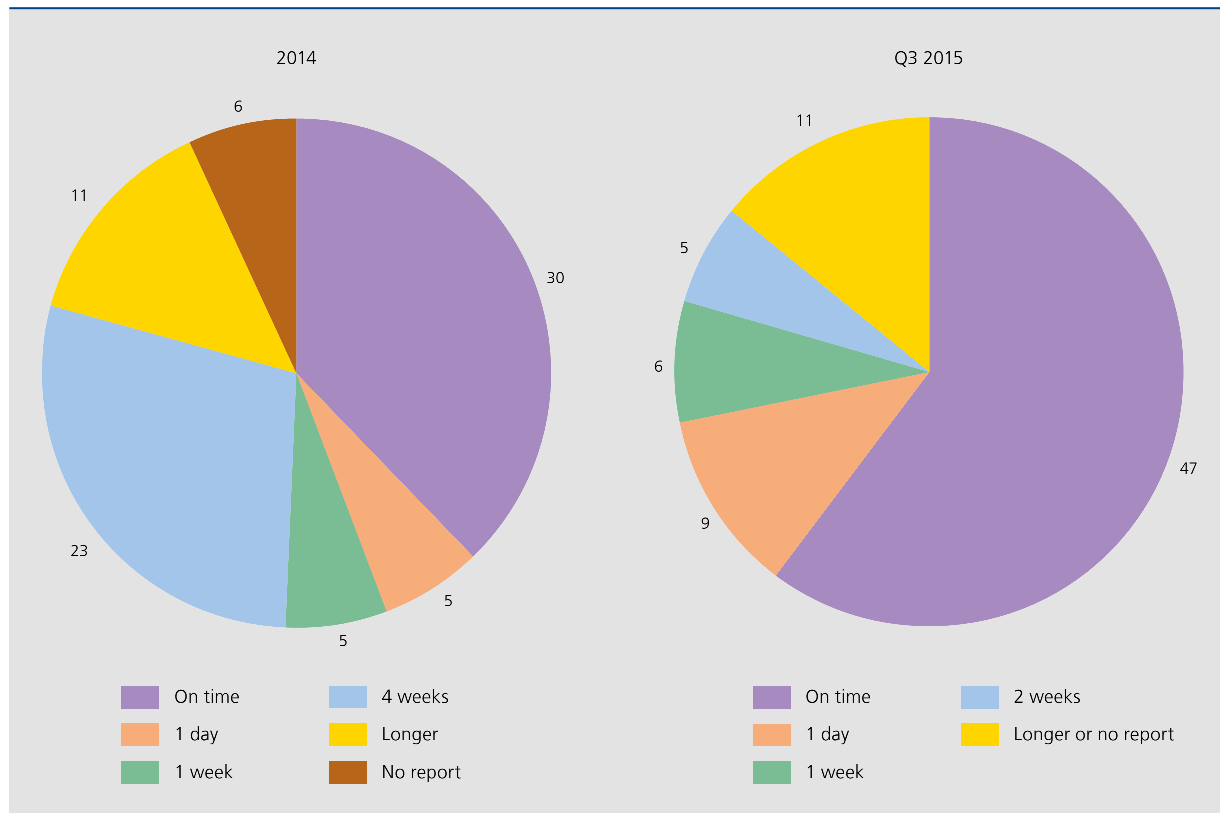
3.3.2 Quantitative reporting by insurance groups

The obligation to submit the annual and quarterly QRTs during the preparatory stage applied equally to all Belgian insurance groups. The deadline for group reporting relating to the 2014 financial year was set at 15 July 2015. Of the 17 insurance groups subject to the obligation, only 11 submitted their reports. One insurance group had planned to absorb its only insurance subsidiary before the entry into force of Solvency II, so that group reporting was irrelevant. Most of the groups that submitted reports did so on time. Only one group was more than a month behind the deadline.

In relative numbers, the insurance group reporting clearly fell short of the figures for insurers. The groups which did not report or which were late in doing so were contacted on the subject and are being closely monitored to check the continuing development of the underlying systems and procedures, as the Bank also expects insurance groups to submit accurate reports on time. At the beginning of 2016, the Bank received the group reports relating to the third quarter of 2015, and on that basis it reassessed the operational preparedness of the groups.

The Bank decided to extend the reporting obligation during the preparatory stage to the market as a whole, and not limit it to insurance undertakings and groups covered by the EIOPA guidelines on the submission of information to the competent national authorities. Taking account of that and in view of the scale and operational complexity of the reporting, the Bank is cautiously optimistic about the operational preparedness of Belgian insurers and insurance groups. Undertakings which did not manage to submit their reports or failed to do so on time are expected to do significantly better in future reporting cycles.

CHART 7 QRT REPORTING BY INSURERS
(number of undertakings)



Source: NBB.

3.3.3 Results of the analysis of the content of the quantitative reporting

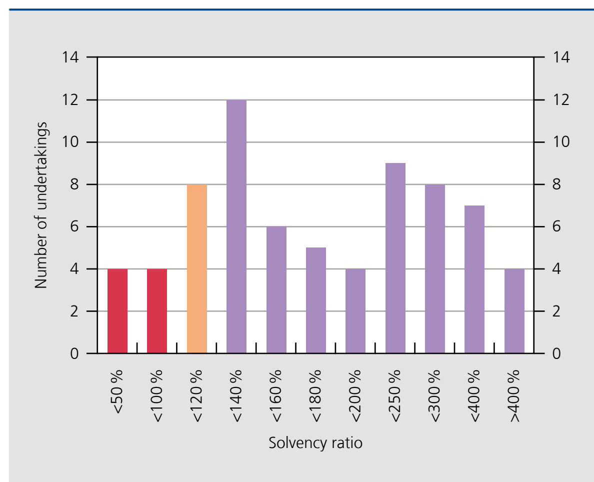
The preparatory stage was originally designed to put the emphasis on the operational aspect of the reporting, rather than on the quality of information supplied. However, the publication of the results of the EIOPA stress test at the end of November 2014 – using data relating to the end of 2013 – and the further deterioration in the macroeconomic environment for insurers since the end of 2013 prompted EIOPA and the national supervisory authorities to conduct a broader and more detailed analysis of the impact of the current economic environment and the degree to which the sector is prepared for Solvency II. The QRTs formed a key element of that analysis.

The Bank found that the quality of the data submitted during the preparatory stage was inadequate, and is continuing to monitor that aspect, in collaboration with the undertakings concerned. Overall, the quality of the reporting needs to improve considerably if it is to satisfy the legal requirements of Solvency II and be usable for prudential purposes.

The Bank launched a dialogue with insurers reporting a solvency ratio below the statutory minimum (100 %) during the preparatory stage. It reviewed the measures that those undertakings could adopt to restore their solvency position before the actual entry into force of Solvency II. Various types of prudential measures were taken, such as the option of using – subject to the Bank's approval – certain transitional provisions or certain parameters specific to the undertaking concerned, adjustment of the reinsurance structure, a reduction in the guaranteed interest rates, de-risking of the asset portfolio or an increase in the capital. In view of the poor quality of the information, that approach was also extended to all undertakings with a solvency ratio of less than 120 % or those confronted since the reporting by new events liable to jeopardise the solvency ratio.

The approach aimed mainly to set up an action plan for these undertakings which, if successfully implemented, would enable them to achieve sufficient solvency by the time the new rules took effect. Despite this proactive approach, it is still possible that some undertakings may still be insufficiently solvent, e.g. because the planned

CHART 8 SOLVENCY RATIOS REPORTED FOR THE YEAR 2014



Source: NBB.

measures have not yet been fully implemented or because a change in the macroeconomic circumstances has had a serious adverse effect on the solvency ratio.

Examination of the solvency ratios reported during the preparatory stage for 2014 reveals that the ratio is below 100 % for 8 undertakings. Another 8 undertakings reported a solvency ratio of between 100 % and 120 %. Although serious solvency deficits were identified for several individual undertakings, the deficit at market level is small. The solvency deficit for these 8 undertakings corresponds to 1.6 % of the solvency capital requirement for the market. The market solvency ratio stands at 190 %.

In October of the year under review, EIOPA presented a summary report on the monitoring of undertakings with a solvency deficit and the measures taken to address it, and on the impact of the current market conditions on their present and future solvency situation.

3.4 Specific points for the Bank's attention

3.4.1 Internal models

In 2015, the Bank analysed the applications from insurers wishing to use an internal model to calculate their regulatory capital under Solvency II.

As a result of the pre-application procedure conducted since 2010, the number of undertakings intending to use an internal model has fallen sharply, as the Bank's inspection reports demonstrated to five undertakings that they would find it difficult to meet the Bank's stipulations for internal models, based on the legal requirements. Those undertakings decided to end their pre-application procedure or postponed the planned date for submitting their application.

Seven applications were expected in 2015. After their latest contacts with the Bank, two undertakings opted to delay the date for submitting an application. One application for a (virtually) full internal model was rejected. That leaves four undertakings (two full internal models and two partial internal models) whose applications were accepted, but only after the imposition of additional capital requirements and conditions. In most cases – depending on the approach adopted by the colleges concerned – those points were inserted in a remedial plan that the undertakings added to their application. There were also two new applications submitted at the end of 2015 on which a decision will be taken in 2016.

In general, a key factor for success seems to consist in the undertakings being aware of the substantial resources needed to develop and validate the internal models, and planning accordingly at a sufficiently early stage. One of the most important points for attention identified by the analysis of the applications was that some subsidiaries of foreign insurance groups have inadequate knowledge of their internal model developed at group level, so that they cannot really take it on board; another important point is that various undertakings underestimated the role of the national supervisory authorities in the process of deciding on the approval of an internal model at group level. In addition, the independent internal validation is often insufficiently critical, so that too few questions are asked about the fundamental choices relating to the models. In regard to types of risk, the modelling of the life underwriting risk has not yet generally achieved the same quality standards as the modelling of other types of risk. Finally, it seems that, in some cases, the weaknesses detected in internal models for the calculation of the solvency capital requirement also have a significant impact on the calculation of the technical provisions under the new prudential rules (best estimate) and/or the solvency capital requirement determined by the standard formula (particularly in the case of life insurance activities).

3.4.2 Assessment of the best estimate

Assessment by the Bank

Last year, the assessment of the adequacy of the technical provisions applicable under the new prudential

rules took up most of the inspection team's resources. That was due partly to the size of the amounts forming the technical provisions on insurers' balance sheets – the best estimate represents the bulk of an insurer's liabilities and plays a crucial role in determining its solvency – and partly to the duration of these liabilities. In particular, this last factor leads to complex actuarial calculations based on a large number of assumptions, parameters and measures envisaged by the insurer's management bodies, and a degree of uncertainty which must be assessed with due caution.

The examinations carried out by the inspection teams led to a significant increase in the total amount of the technical provisions of the insurance companies considered. Furthermore, following various inspections conducted in 2015 on the calculation of the technical provisions, the Bank has identified several points to which it will pay particular attention during implementation of Solvency II to determine whether the undertakings have made the correct adjustments.

First, there was evidently a great disparity between life and non-life insurance activities, the latter generally presenting fewer problems owing to the relatively short duration of the liabilities and good overall control of the claims management process. The second point for attention is the often incorrect application of the prudential rules on contractual limits, concerning whether or not the results of future business are taken into account in the calculation of the technical provisions. It was also found that the financial projections do not take accurate account of the costs associated with insurance liabilities, and that the risk margin – i.e. the margin to be applied as a prudence factor in addition to the calculated best estimate – is not correctly estimated. The application of discounting curves other than the one published by EIOPA also gives rise to problems. The final point for attention is the inadequate estimate of future profit-sharing in view of the expected yields from the assets representing the technical provisions.

Development of the assessment instrument

In connection with checking the best estimate, the Bank has developed a special form of reporting on life insurance operations. For that purpose, insurers have to report all cash flows involved in determining the best estimate. Other data must also be reported, namely the cash flows used to rebuild the inventory reserves for the insurance policies concerned, and various general statistics relating to parameters such as average age, sums insured, average guaranteed interest rates, etc. The figures reported by the insurer will be processed in various ways to permit a breakdown of the best estimate into its constituent parts, a reconciliation of the best estimate with the inventory reserves, and a range of consistency tests.

The data reported by the undertakings will also be used to map the insurance portfolios on the basis of the said general statistics. These various points can then be examined to arrive at an initial assessment of the suitability and conformity of the best estimate calculation. The conclusions of that initial analysis will then be used to consider whether that best estimate – or some elements of it – should be examined in more detail.

In the year under review, these data were collected for the first time from 7 large Belgian insurers. In the case of those companies, the full report as at 31 December 2014 was expected by the end of 2015 at the latest.

Assessment by external experts

In connection with the measures in preparation for Solvency II, it was vital for the Bank to have sufficient confidence in the calculation of the best estimate by the undertakings. As well as carrying out its own inspections, the Bank also called in external actuarial experts to assess the quality and suitability of the best estimate of the seven largest Belgian insurers.

In their report, the external experts gave their opinion on such matters as the accuracy of the amount of the best estimate and on the correct use of the data, assumptions and models. Where possible, they also quantified the impact of the shortcomings identified. During June 2015, the provisional findings were presented to the management of the insurance undertakings concerned and to the Bank, after which the reports were finalised.

The analysis of these reports resulted in a number of findings for each undertaking. Those findings were notified to the individual undertakings with a request that they draw up an action plan, on the basis of which the Bank will be able to monitor their progress. Comparison of the individual findings revealed a number of divergent market practices and points for attention, which will be considered in greater depth via horizontal analyses in order to foster greater convergence and harmonisation.

The work of the external experts is regarded as a useful supervision instrument during the preparations for

Solvency II. It enabled the Bank to meet a specific need without entailing any structural increase in operating costs. This type of assignment will not be repeated in the immediate future, although the use of external experts remains an option which might be considered under specific circumstances.

4. Priority risks

4.1 Interest rate risk

The potential consequences of persistently low interest rates are the biggest financial risk facing insurers, and therefore remain a point for the Bank's attention. In view of the fragile macroeconomic situation, the boost provided by the interest rate rise since April 2015 could be short-lived. Moreover, the Belgian insurance sector still features high guaranteed yields on certain life insurance products.

In 2014, the Bank developed a new standard report to permit more detailed monitoring of the interest rate risk facing all insurers. That report consists of various components which are important for providing an accurate and complete picture of the interest rate risk situation in insurance undertakings. This concerns more particularly the following four aspects: the composition of the current outstanding guaranteed yields on insurance portfolio contracts, the duration of the technical provisions and their covering assets, detailed projections for cash flows from the technical provisions and their covering assets, and projections relating to yields on the assets and liabilities.

The results of the first round of reporting, based on the figures at year-end 2013, were submitted to the Bank at the end of the third quarter of 2014 and were still being analysed in 2015. On the basis of those data, the Bank developed a series of indicators providing a better insight into the interest rate risk facing both individual insurance companies and the market. Points considered include the level of the average guaranteed yields and their residual term, the proportion of the technical provisions with interest rate guarantees on future premiums, the various duration gaps and the matching of the underlying asset and liability cash flows.

On the basis of this assessment framework, undertakings can be given a score for each of these indicators and in some cases outliers can be identified. The undertakings concerned are subjected to more detailed examination, which may result in a request for an action plan or the imposition of mitigating measures, such as the purchase of derivatives.

The Bank found that some undertakings failed to submit these reports, and that the data quality was not always up to expectations. Thus, data from some undertakings were excluded from the dataset following an in-depth assessment. The comments submitted to the insurance companies during this first reporting cycle should ensure that the quality improves significantly in the years ahead. In addition, on the basis of the aforesaid analyses, the Bank also examined whether it was appropriate to impose risk mitigation measures on some of these undertakings.

4.2 Liquidity risk

Since 2011, the Bank has taken various initiatives to chart the liquidity risk facing the insurance sector in Belgium. For that purpose, a section on liquidity was first added to a more general report which aimed to reveal the vulnerabilities of the six largest Belgian insurance groups.

The figures reported showed that a number of Belgian insurers faced rising redemptions and falling premium income. The main factors here are a change in the tax treatment of life insurance products, as the tax on premiums was increased from 1.1 % to 2 % in 2013, the current low interest rates, and the fact that an ever-growing proportion of the class 21 portfolio is now eight years old, bringing exemption from the withholding tax for certain contracts (e.g. on redemption). Moreover, increasing numbers of insurers are deliberately turning away from offering certain class 21 products.

At the end of 2014, the Bank decided, on the basis of these initial results, to introduce separate quarterly liquidity reporting for all life insurance undertakings. Also, to permit integrated monitoring of the liquidity risk, the Bank developed a series of risk indicators. These can be divided into three groups. The first group of indicators focuses on the trend in incoming and outgoing cash flows and how they are interconnected. The second group examines the trend in liquid assets and liabilities and the ratio between them. The third group of indicators monitors the trend in exposures to instruments and derivatives presenting a potential liquidity risk. Each group of indicators is then linked to a range of risk limits so that the risk can be monitored systematically for each indicator.

On the basis of the initial results for the life insurance sector as a whole in Belgium, it emerged that, during the first half of 2015, around 48 % of Belgian life insurers had to contend with an outflow from the traditional life insurance portfolio that exceeded premium income for at least one of the two quarters. In the case of around 16 % of the undertakings, the total outgoing cash flow came to more than twice the premium income. If redemptions alone are considered, it can be said that for 16 % of undertakings (not necessarily the same ones as those mentioned above), the related cash flows exceeded their premium income. These are often undertakings which are actively trying to scale down their life insurance portfolio (or part of it). There has also been a downward trend in the proportion of the assets that can be considered liquid. It declined from around 61 % at the end of 2014 to 55 % as at 30 June 2015. Moreover, there are very marked differences between undertakings in the ratio of liquid assets to liabilities which could, in theory, be cancelled without (any major) penalty. For most undertakings the volume of the liquid assets is still more than sufficient to cover the most liquid liabilities. Finally, a small number of undertakings (13.5 %) hold, at face value, a quantity of derivatives accounting for more than 10 % of the total market value of their investment. A similar conclusion can be drawn for the same percentage of undertakings (not necessarily the same ones) in regard to their exposure to repo transactions, securities lending and other related activities.

The results of the liquidity reporting described above led to follow-up measures for a small group of undertakings. The Bank also decided to maintain the liquidity reporting under Solvency II.

5. Legislation

The introduction of a new regulatory framework for the prudential supervision of insurers and reinsurers led to the preparation of the Solvency II Law and a large number of implementing measures and Circulars. The abolition of the Solvency I framework and disappearance of the Law of 9 July 1975 provided an occasion for a thorough review of all the existing rules on the prudential supervision of insurers and reinsurers. Some Royal Decrees and Circulars have already been recast on account of Solvency II, but owing to the large volume of legislation that exercise will continue in 2016. As explained in Box 3, the disappearance of the medical index and the rising health care costs meant that particular attention must be paid to requests for an increase in health insurance tariffs.

5.1 The Solvency II Law

The Solvency II Law on the legal status and supervision of insurance and reinsurance undertakings transposes the Solvency II Directive. This Law replaces those governing the supervision of insurance undertakings (Law of 9 July 1975) and reinsurance undertakings (Law of 16 February 2009), and their implementing Decrees will also be rewritten.

The Solvency II Law represents a significant reform of the prudential supervision of insurers and reinsurers, focusing that supervision on the knowledge, control and attenuation of all types of risk associated with the pursuit of their activities. The approach is prospective, covering all elements of the balance sheet in assessing the real risks. For that purpose, the asset and liability items are stated at their market value. Like the Solvency II Directive, the Law is based on three pillars. The first pillar determines the quantitative requirements relating to capital and technical provisions, the second lays down qualitative rules on the monitoring of the risks by the undertakings, and the third determines the information that the undertakings must supply, either for supervision purposes or for the public. A number of points specific to Belgium merit particular attention.

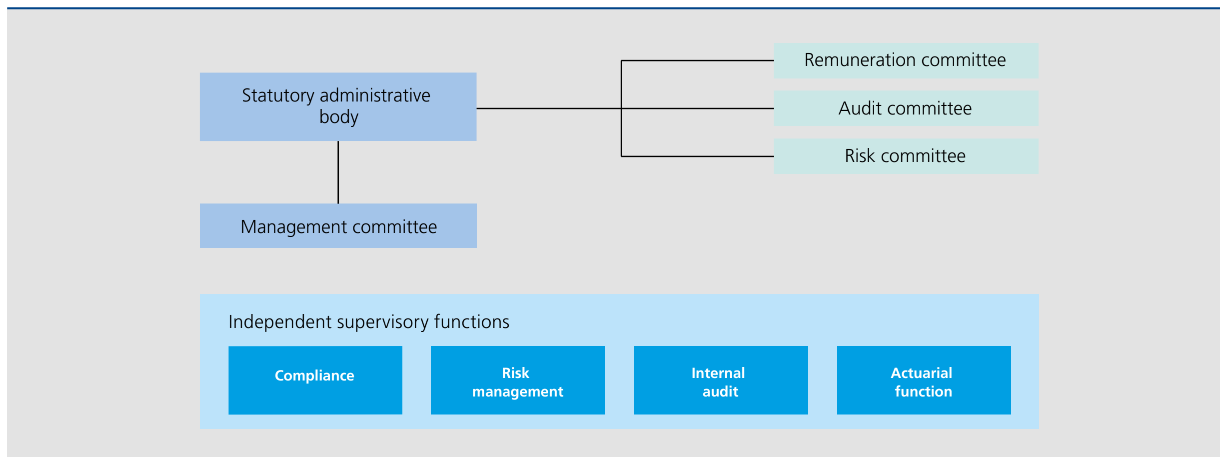
5.1.1 Governance

The Solvency II Directive leaves the national legislatures some latitude to supplement and specify the requirements to be met by insurers and reinsurers. The Solvency II Law used that option to establish a governance system which is based on the minimum requirements of the Directive but also takes account of the achievements of earlier legislation and equal treatment with the other financial sectors.

The governance structure of an insurer or reinsurer comprises a statutory administrative body, usually the board of directors, which carries ultimate responsibility for the undertaking and is in charge of the strategy and determination of the risk policy, a management committee which holds all the powers to manage the undertaking, three specialist committees within the board of directors (remuneration, audit and risk committee), and four independent supervisory functions or key functions (compliance, internal audit, risk management and actuarial function).

Taking account of the relative heterogeneity of the sector, the Solvency II Law provides for various exemptions from this standard structure to allow for the undertaking's specific situation. Thus, as regards the management committee, the new Law incorporates the principles included in insurance supervision law since 2014. In principle, it is obligatory to establish this committee but – depending on the undertaking's size and risk profile – the Bank may grant exemption *inter alia* in respect of the obligation to set up such a committee, its composition or the

CHART 9 GOVERNANCE STRUCTURE



Source : NBB.

prohibition on combining the chairmanship of the management committee with that of the statutory administrative body.

The new Law no longer requires the management committee to be composed entirely of members of the statutory administrative body, but stipulates only that three members of that committee – or even two if the risk management officer is not a member (see below) – must also be members of the statutory administrative body. Conversely, it maintains the obligation whereby non-executive members of the statutory administrative body must make up the majority of that committee.

In regard to the specialist committees, the Solvency II Law provides for two exemptions which do not require the approval of the supervisory authority. The first means that specialist committees are not obligatory in undertakings which meet at least two of the following criteria : average number of employees below 250 people, balance sheet total of € 43 million or less, and annual net turnover of € 50 million or less. In that case, the functions of the committees are performed by the statutory administrative body as a whole. Under the second exemption, in undertakings with a balance sheet total of less than € 3 billion, a single body may exercise the powers of the audit committee and the risk committee.

Two other exemptions are subject to the Bank's prior approval. The first waives the obligation to establish one or more of the three specialist committees if the insurer or reinsurer is part of a group and if such a committee has been set up in an undertaking controlled by the group (e.g. in a credit institution or insurance holding company). Obviously, the committee set up at group level must have powers which extend to the insurer or reinsurer. The second exemption only concerns the remuneration committee. That committee need not be formed if the company is organised in such a way that the statutory administrative body receives adequate support.

There is also provision for some flexibility in regard to the risk management function. In principle, a member of the management committee is in charge of that function. However, the same person may combine that post with responsibility for the compliance function and the duties of the actuarial function which do not generate risks (e.g. the preparation of certain reports), provided the actual performance of the three functions is kept separate and there are no conflicts of interest. In the case of undertakings with a balance sheet total of € 3 billion or less, there is no need to obtain the consent of the supervisory authorities in this respect.

The Bank may also allow the risk management function to be headed by someone who is not a member of the management committee if the undertaking's risk profile so permits and if there is no conflict of interests concerning that officer.

In comparison with other financial sectors, especially the credit institution sector, the requirements of the Solvency II Law are more flexible. They make allowance for more diverse situations, e.g. for medium-sized undertakings or those with a simpler structure, but this may also lead to an increase in the cases where an undertaking cannot adequately measure and control the risks associated with its activities. It must be

acknowledged that there is some contradiction between the requirements of the Directive, which regards risk management as a central feature in the organisation of insurance and reinsurance undertakings, and the exemptions possible under the Belgian law, some of which – as explained above – are not subject to any prior checks. In any case, the Bank will keep watch over the way in which the undertakings set up their governance system and the resources that they use to detect and control the risks inherent in their activities. From that point of view, it will also pay close attention to how the risk management function actually operates.

5.1.2 *Ex-ante* recovery plans

The Solvency II Law contains new provisions in relation to both the Directive and the earlier legislation regarding *ex-ante* recovery plans. The Bank may impose such a plan on certain undertakings on the basis of their size or their risk situation. The plan comprises measures that the undertaking is likely to implement if the risks foreseen in the plan actually materialise. However, pending European harmonisation on the subject, the Law does not lay down any general obligation requiring all insurers and reinsurers to draw up such a plan, not does it provide for the preparation of resolution plans by the Bank.

The recovery plan should be seen as preparation for the implementation of a consolidation programme or short-term financing plan that the undertaking may have to produce at relatively short notice if it fails to meet the solvency capital requirement (SCR) or the minimum capital requirement (MCR).

5.1.3 Preferential claims and separate management

The Solvency II Directive incorporates provisions from earlier Directives regarding preferential claims of insurance creditors. The EU legislation provides for two options which may be combined, namely an absolute preferential claim on the assets representing the technical provisions and a preferential claim on the whole of the assets. Exceptions to the latter preferential claim are claims by employees of the undertaking, the tax authorities and social security systems, and claims on assets subject to rights *in rem*.

The Solvency II Law uses both options offered by the Directive. Compared to the earlier situation, this places insurance creditors in a better position if the preferential claim on all the assets has to be exercised. Under the Law of 9 July 1975, that preferential claim ranked very low, making it virtually ineffective.

The claims accorded preference are assessed from the point of view of the liquidation of the insurance undertaking. In that situation, the contracts are terminated without being transferred to another undertaking which will take on the management of the existing portfolio or continue the business of the undertaking making the transfer. Since the policy-holders and insurance beneficiaries have to be paid out the amount of their claims, it is no longer possible to take account of future events such as contract redemptions or the discounting of compensation claims. The amount of these claims may therefore differ from that of the technical provisions shown in the Solvency II balance sheet.

On the other hand, the assets forming the basis of the preferential claims are stated at market value, as is normal under the other provisions of the Solvency II Law. To permit checking of the consistency of that basis, the Law obliges insurance undertakings to maintain a permanent register stating the assets which will thus be excluded from claims on the undertaking by other creditors.

The preferential claims are organised on the basis of each separate division, of which there are just two: life and non-life. It was considered that these were the only two divisions sufficiently consistent and stable to prevent manipulation of the basis of the preferential claims. Investment funds (mainly those in class 23) in which the policy-holder bears the investment risk form exceptions, as each one is a separate division in itself. The reason is that, for this type of contract, the claim is at all times equal to the assets forming the fund.

5.1.4 Small undertakings

The Solvency II Law contains a chapter devoted to undertakings excluded from the scope of the Directive (Article 4 of the Directive). This small number of undertakings, licensed pursuant to the Law of 9 July 1975, are subject to rules comparable to those under the aforesaid Law which permit account to be taken of their size and of the low risk inherent in their activities. For these undertakings, that is a practical application of the principle of proportionality.

So long as these undertakings have concluded an agreement providing for the reinsurance or total transfer of their liabilities, they qualify for almost total exemption from the provisions of the Solvency II Law.

Finally, for local insurance undertakings which confine their activities to covering simple risks in the municipality where they have their registered office or in neighbouring municipalities, it is proposed to revert – broadly speaking – to the rules in force up to 31 December 2009 ; that means virtually total exemption from supervision provided their activities remain limited and the undertakings take out reinsurance covering the major part of their risks.

5.1.5 Transitional provisions over 16 years

The Solvency II Law contains transitional measures taken over from the Directive. These allow insurers and reinsurers sufficient time to adapt to the new provisions, and to stagger the financial impact over time. Two of these measures concern the technical provisions over a 16-year period. One directly concerns the amount of the provisions (the transitional measure on technical provisions), while the other operates indirectly via the risk-free interest rate (transitional measure on the interest rate). The two measures are mutually exclusive, in that the use of one automatically rules out use of the other.

The amount of the transitional measure on technical provisions corresponds to the difference between the technical provisions under Solvency II and the technical provisions under Solvency I (including the additional provision and the provision for profit-sharing) on the portfolio of contracts in existence on 1 January 2016. This deduction is at its maximum in the first year and declines linearly at the end of each year, disappearing from 1 January 2032.

The transitional measure on the interest rate corresponds to the difference between the single discount rate for life insurance portfolio liabilities according to the Solvency I rules and the single discount rate according to Solvency II. This transitional measure decreases linearly over a 16-year period in the same way as the transitional measure on technical provisions. It can only apply to all the contracts in the life insurance portfolio concluded before the introduction of Solvency II. The extra workload that this measure entails, owing to its complexity, is such that few undertakings are likely to make use of it, either in Belgium or in the other Member States.

The application of the transitional measures is subject to the prior approval of the supervisory authorities. Since this transitional period is decidedly future-oriented, it is important for the Bank to have all the necessary information to assess the quality of this prospective valuation. Insurance undertakings seeking the Bank's approval will therefore have to compose a dossier for that purpose. The content of that dossier has been specified in a Circular.

5.2 Guidelines

5.2.1 Royal Decree on profit-sharing and the granting of rebates

The entry into force of the Solvency II Law made it necessary to adjust the rules on profit-sharing in line with the new prudential rules for insurance and reinsurance undertakings.

The prudential rules only concern profit-sharing applicable to all insurance contracts. The rules on the allocation of profits to specific contracts come under consumer protection and do not belong in a prudential Decree. Profit-sharing involves handing over all or part of the undertaking's profit to policy-holders and beneficiaries to offset the cautiousness priced into the tariffs. The amount is determined as a global figure for all the policy-holders concerned and incorporated in the insurer's technical provisions in the form of an allocation in the financial year to the provision for bonuses and rebates.

The main weakness of the old regulations was that the supervision of profit-sharing was based only on the annual accounting profitability of the insurance contracts, with no future-oriented view of the risks that the undertaking has to bear throughout the life of the contract. The Decree introduces a prospective approach via the criterion of the SCR coverage ratio.

The technical/financial profit, i.e. the net result of the actual insurance operations, plus the net financial result disregarding the allocation for the financial year to the provision for bonuses and rebates, is defined as the maximum amount that an undertaking may distribute in the form of profit-sharing.

On that basis, the Decree distinguishes between three situations. If the SCR coverage ratio is 100 % or more without the need to use the transitional measures provided for by the Solvency II Law (see 5.1.5 above), the undertaking may distribute the above amount without seeking the consent of the Bank. If that ratio is 100 % or more purely because the undertaking uses the transitional measures, the distribution is subject to the Bank's prior approval. Finally, if the ratio is below 100 % even with use of the transitional measures, no profit distribution is permitted. In this last case, however, the Bank may grant exceptional permission for the distribution of profits if the undertaking proves that there is no detrimental effect on its financial situation, e.g. because it has capital components which are not eligible for covering the SCR

and non-distribution would have adverse procyclical effects, such as mass contract redemptions.

The rules described above apply separately to life and non-life business.

5.2.2 Royal Decree on the annual accounts of insurance and reinsurance undertakings

The statutory annual accounts of Belgian insurance undertakings are currently governed by the Royal Decree of 17 November 1994 on the annual accounts of insurance and reinsurance undertakings, commonly known as BE GAAP for insurance. For the calculation of the technical provisions, that Decree is supplemented by the more detailed stipulations of the Solvency I framework. The entry into force of the Solvency II framework, replacing Solvency I, has severed that link between the accounting rules and the prudential rules. Furthermore, the Solvency II system does not contain any rules on accounting.

Considering these developments, the Bank consulted interested parties on a possible adjustment to the statutory accounting rules for the insurance sector. Those adjustments are not only in keeping with Solvency II, but also tie in with the revision of the rules on the calculation of profit-sharing, which mainly depends on the accounting result for the year.

The approach that the Bank proposes is to maintain the current philosophy of BE GAAP for insurance, which is based mainly on a symmetrical assessment of the insurance assets and liabilities according to historical cost and/or amortised cost. However, the Bank considered it advisable to propose tightening up these accounting rules by incorporating the prudential rules on calculation of the technical provisions under the Solvency I framework, those rules being more precise and cautious. This adjustment primarily concerns the supplementary (flashing-light) provisions which should continue to be included in the statutory accounts despite the switch to Solvency II. The statutory accounting standards for the insurance sector also need to be adjusted to take account of the power that the Solvency II Law conferred on the Bank to grant exemptions from the accounting rules.

5.2.3 Circulars relating to the EIOPA guidelines

The provisions of the Solvency II Directive, amended by the Omnibus II Directive, were supplemented by Delegated Regulation (EU) 2015/35 of 10 October 2014 and are subject to EC technical implementing standards (TIS) and EIOPA guidelines. The TIS and the guidelines were drawn up in two stages.

The stage 1 TIS and guidelines, which mainly concern the approval dossiers which undertakings have been able to submit since 1 April 2015, were published by EIOPA on 2 February 2015. The stage 2 guidelines and the guidelines on the governance system and those on the ORSA were published on 14 September 2015. The Bank prepared national Circulars to incorporate these guidelines into the Belgian legislation and submitted them to interested parties for consultation. In the case of certain guidelines, there is no specific Circular because those guidelines concern procedures to be included in the Bank's prudential supervision system.

The Bank will keep a close watch on the EIOPA guidelines. The Circulars were adapted on some points to take account of specific national characteristics, and additional clarification was provided in the Circulars on own funds. Also, to prevent distortion of competition between Belgian insurers, the Circular on contract limits includes an annex explaining how to apply those limits to certain specific products.

5.2.4 Circular on applications for approval and transitional measures

In the context of the gradual introduction of Solvency II (phasing-in), it is important to improve transparency and to provide further details on the information requirements and approval procedures relating to the various measures as laid down in Article 308a of the Solvency II Directive.

The use of some measures which come under the phased introduction of Solvency II requires the Bank's prior approval on the basis of a full application dossier. That approval will be granted on an individual basis, taking account of the specific requirements and additional factors relevant to the appraisal.

To improve transparency and provide further details on the specific requirements concerning the various approval procedures, the Bank sent out a Circular to the insurance companies.

Undertakings which intend to submit an application for approval for one or more of the transitional measures relating to the entry into force of Solvency II are required to provide the Bank with certain specific, relevant information. That concerns such matters as the use of the matching adjustment, the volatility adjustment, the transitional

measures on risk-free interest rates and technical provisions, ancillary own funds, company-specific parameters, and a full or partial internal model.

For the great majority of the measures, the Circular refers to the relevant EC implementing Regulations and the EIOPA guidelines. In the case of the transitional measure on technical provisions, the Bank imposes specific requirements for the content of the application dossier. This concerns the documentation of all relevant calculations, a standard reporting template showing the impact of the transitional measure, an assessment of conformity with the capital requirements with and without application of the measure, a capital management plan taking account of the application of the measure, and the results of standardised stress test scenarios entailing a balance sheet projection over 16 years. The Bank expects those projections to be sufficiently realistic and conservative.

5.2.5 Circular on reporting

The Circular on reporting for insurance undertakings sets out what the Bank expects in regard to the regular communication of information in the context of the implementation of the Solvency II Law. It essentially comprises a summary of all the provisions of the various regulatory texts on reporting under Solvency II.

In particular, it contains information on:
- the legal framework for reporting requirements,
- the exemption policy,
- the reporting structure,
- the content and date of the last report to be submitted under Solvency I,
- the content and submission date of the "Day-1" report and the first quarterly report under Solvency II in 2016,
- the content and submission dates of future quarterly reports,
- the content and submission dates of the annual quantitative reports.
- the content of the report on solvency and the financial position,
- the content of the information to be supplied regularly for supervision purposes,
- some practical guidance for reporting on financial stability and harmonisation with reports destined for the ECB, and
- the additional national requirements and means of communicating information to the Bank.

Box 14 – Adjustments to hospitalisation insurance tariffs

A health insurance policy is a contract which is, in principle, concluded for life and which cannot be cancelled by the insurer. Moreover, the law limits the scope for insurers to make changes to the technical basis of the premium and the conditions of cover under these contracts once they have been concluded.

However, health care costs are constantly rising and are difficult to predict at the time of conclusion of the contract. It is therefore inevitable that the premium has to be adjusted during the term of the contract (unless substantial margins are priced into the contract from the start).

There is also the problem of the ageing provision. This stems from the system of level premiums, which means that young policy-holders pay more than the premium needed to cover the risk. That surplus is set aside in the ageing provision to absorb the higher costs at a later stage in life. While the adjustment of the premiums via an index – which takes no account in the growth of the ageing provision – absorbs the increase in medical costs in the immediate future, it does not adjust the existing ageing provision in line with that increase.

In the case of non-occupation-related health insurance contracts, the insurers' options for adjusting the premiums and conditions of cover were originally restricted by law to the following three possibilities:
- by mutual agreement between the parties, at the request of principal policy-holder and solely in the interests of the persons insured,
- on the basis of the consumer price index,
- on the basis of one or more specific indices, known as the "medical indices".

Since the abolition of the third option in 2011, there are now only two alternatives for tariff adjustments by insurers, which implies that it is no longer permissible to increase a tariff by a percentage that exceeds the consumer price index. Without prejudice to these limited legal options for adjusting tariffs, under exceptional circumstances an undertaking may seek the Bank's consent to rebalancing its tariffs if it can show that the tariffs charged are – or risk becoming – loss-making. Since health care costs are rising faster than the consumer price index, and in view of the problem of the ageing provision, many insurers have been forced to do that.

Between 2013 and 2015, the Bank received nine applications for tariff increases from six different insurers. Of the nine applications, seven were approved either in whole or in part (the increase was permitted but only for part of the percentage originally requested) and two were refused.

The Bank examines these applications from a prudential angle. In contrast, consumer protection is an FSMA responsibility. This means that the Bank takes account of product profitability and decides on the basis of the factors generating that profitability. For that purpose, the undertaking has to supply, among other things, a short-term projection of its accounting results for the products in question, accompanied by the results of the portfolio over the entire period covered. An undertaking's cost structure is one of the objective data that determine profitability, but is not decisive. In 2016, the Bank will take steps to introduce a uniform, harmonised application dossier.

After obtaining the opinion of the FSMA, the Bank approves the increase if it considers that failure to adjust the tariff will lead to a situation which is loss-making, or likely to become so. In the case of some undertakings, the application submitted concerned a small or older health portfolio in run-off.