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# AUSTRIA

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## FINANCIAL SECTOR ASSESSMENT PROGRAM

## TECHNICAL NOTE

## INSURANCE SECTOR

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.

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**TABLES**

# Glossary

| | |
|---|---|
| AML/CFT | Anti-Money Laundering and Combatting the Financing of Terrorism |
| CESEE | Central, Eastern, and South-Eastern Europe |
| EIOPA | European Insurance and Occupational Pensions Authority |
| EU | European Union |
| FMA | Financial Market Authority |
| FMABG | Financial Market Authority Act (Finanzmarktaufsichtsbehördengesetz) |
| FSAP | Financial Sector Assessment Program |
| GAAP | Generally Accepted Accounting Principles |
| IAIS | International Association of Insurance Supervisors |
| IFRS | International Financial Reporting Standards |
| ICPs | Insurance Core Principles |
| IOPS | International Organization of Pension Supervisors |
| MoU | Memorandum of Understanding |
| OECD | Organization for Economic Cooperation and Development |
| OeNB | Austrian National Bank (Oesterreichische Nationalbank) |
| PKG | Pension Funds Act (Pensionskassengesetz) |
| UGB | Company Code (Unternehmensgesetzbuch) |
| VAG | Insurance Supervision Act (Versicherungsaufsichtsgesetz) |
| VSE | Vienna Stock Exchange |

# INTRODUCTION

1. **As part of Austria's Financial Sector Assessment Program (FSAP), the insurance industry has been reviewed every 5 years since 2003.** A detailed assessment of observance of the Insurance Core Principles (ICPs) of the International Association of Insurance Supervisors (IAIS) was undertaken in October 2003 and updated in December 2007.[1] Both the detailed assessment and the update found that the regulatory framework and its implementation were generally of high standard and effective. Challenges related mainly to the expansion of Austrian insurers into the Central, Eastern, and South-Eastern European (CESEE[2]) region, and the prospective introduction of Solvency II requirements. The update concluded that further strengthening was needed to: enhance the size and relevant expertise of the Financial Market Authority (FMA) in order to cope with these challenges; extend the scope of suitability requirements; strengthen the role of the actuarial profession; enhance stress testing; investigate the use of market-based solvency indicators; conduct more on-site inspections; work closely with the Austrian National Bank (OeNB) in supervising financial groups; achieve a smooth transition by insurers to a prudent-person investment approach; increase maximum fines; and remain vigilant for attempts to circumvent requirements for disclosures to consumers.

2. **This note provides an update on the Austrian insurance industry and an analysis of its regulatory and supervisory regime.[3]** It focuses on developments since the December 2007 update reviewing economic risks as well as legal, regulatory and supervisory developments. Benchmarks for insurance regulation and supervision are the ICPs, as adopted by the IAIS in October 2011 and amended in October 2012. Primary sources of information included the Insurance Supervision Act (VAG), as amended, and other legislation; material provided by the FMA; and discussions during the FSAP Update mission in February 2013 with FMA staff, insurers, and industry and professional associations.[4]

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[1] The update was published as a Technical Note in July 2008; see IMF Country Report No. 08/207.

[2] The acronym CESEE stands for Central Europe and South Eastern Europe but is typically more broadly applied in Austria and in this paper. It includes new EU member states in 2004: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia; new EU member states in 2007: Bulgaria, Romania; countries in South-Eastern Europe: Albania, Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Montenegro, Serbia, Turkey; and Commonwealth of Independent States: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.

[3] Prepared by Michael Hafeman and Mustafa Saiyid.

[4] The IMF Austria FSAP team would like to express its appreciation for extensive collaboration with the authorities and especially the FMA Insurance Department.

# OVERVIEW OF THE AUSTRIAN INSURANCE SECTOR

**3. The structure of the domestic insurance sector has remained largely stable since the last update.** At Q3-2012 there were 50 insurance companies with assets of €108 billion, making up nearly 40 percent of GDP. Total premiums were €16 billion at end-2012. There were three companies engaged solely in life insurance, 15 solely in non-life insurance, 29 in both, and three reinsurers. Assets of life insurers dominate non-life and comprise about 70 percent of that of the industry.

**4. The insurance market is concentrated**. The two largest groups account for almost half of the €16.5 billion of premiums written in Austria in 2011, and the five largest groups with operations in Austria account for nearly three-quarters of the total.[5] Many individual insurers are members of groups associated with Austrian banks or major insurers from other European countries, including Italy, Germany and Switzerland. There has been significant consolidation in the industry with 14 mergers over the past 15 years resulting in a 20 percent decline in the number of firms.

**5. Slow domestic growth has encouraged Austrian insurers to expand into the CESEE region, where they now have a prominent presence.** More than 40 percent of the total premiums and nearly one-third of their total profits of the five internationally-active Austrian groups come from their foreign operations—mostly in the CESEE countries. Austrian insurers' main CESEE markets are the Czech Republic, Poland, Slovakia and Romania, which account for nearly two-thirds of total CESEE premiums.

**6. While insurance portfolios are largely concentrated in high-quality bonds, they have significant exposure to European banks.** About 20 percent of insurance assets, nearly €20 billion, are exposed to European banks—largely through the holdings of bank debt. Of this total banking exposure, insurance companies hold nearly half, or about €10 billion in Austrian bank bonds. Bond holdings of banks in Euro area countries under market pressure, including Italy, Spain and Ireland, amount to about €1.2 billion. One large insurer took significant write-downs on Greek exposure, which forced it post an operating loss in 2011. A relatively small proportion, less than 10 percent, of asset portfolios is allocated to real estate or equities.

**7. Most insurance companies appear well-capitalized under the Solvency I regime.** Although solvency ratios are generally above 200 percent (as of end-2011), they may not fully reflect the potential effects of future low interest rates in the valuation of liabilities. Life insurers were at about 180 percent; and non-life close to 590 percent. Earned premiums in 2012 were only slightly less than 1 percent below 2011 results. For the industry as a whole, declining premiums on the life insurance sector were mostly covered by rising premiums on non-life business. In general, internationally-active insurance companies with diversified product lines have been better insulated

[5] The two largest groups are Vienna Insurance Group and UNIQA, both Austrian. The groups with the next three largest shares of the Austrian market are Generali (based in Italy), Allianz, and Ergo (the latter two based in Germany).

from the low rate, low growth environment, as they have benefited from their expansion in the CESEE region, where premium income has grown rapidly.

**8. The industry remains profitable though margins have come under some pressure recently.** Nevertheless, the insurance industry posted a profit of nearly €1 billion, an after-tax ROA of nearly one percent during 2011. Nevertheless, profits fell by 5 percent in 2011 versus 2010 because of write-downs on peripheral euro-area sovereign exposure, a low interest rate environment and relatively high claims from natural catastrophes. 2012 is looking better although full-year results are not yet available (as of May 2013).

**9. The FMA is largely responsible for regulation and supervision of insurers.** The FMA supervises the distribution of insurance directly by insurers or banks, while the Federal Ministry of Economy, Family, and Youth has general authority over insurance agents and brokers.

# RISKS FACED BY THE INSURANCE SECTOR

**10. Although insurers face elevated credit risks generally, the sustained low interest rate environment poses a serious challenge for some types of Austrian insurers.** Life insurance companies, in particular, face a situation in which they have large legacy liabilities contracted at rates well above those available in the domestic sovereign bond market at present. This means that any rollover of maturing bonds on the asset side leads to lower yields on the asset portfolio relative to guaranteed liabilities.

**11. Some legacy liabilities of life insurers are contracted at rates more than 200 bps above the current yield on government bonds.** Life insurance products guarantee a minimum rate of return set by the FMA annually, which corresponds to the average yield on 10-year government bonds. This procedure adjusts the rate applicable to new liabilities (the flow), but on the existing stock, there are legacy liabilities carrying rates of up to 4 percent compared with a current yield on comparable duration government bonds of 1.75 percent. Also, a maturity gap between assets and liabilities, which have average maturities of 7 and 9 years respectively, implies that some bonds are going to mature too early and will have to be rolled over most likely at lower rates. Based on a recent FMA study (April 2013), assets of over €12 billion are subject to rollover risk during a 10-year period ahead.

**12. Additionally, insurers are exposed to banking sector risks that go beyond direct holdings of bank debt.** Banks provide guarantees on some insurance products, which could become less effective or worthless in case of pressures on some institutions.[6] The FMA estimates

[6] For example, some savings-oriented life insurance products provide for a guaranteed maturity value where the guarantee is contingent on the counterparty of the underlying investment meeting its repayment obligation. To back the guarantee, the insurer would invest in a security issued by a bank, such as a senior zero-coupon bond with the same tenor as the insurance policy. If the policyholder keeps the product until maturity and the bank meets its obligation, the full maturity value is paid. If the bank fails to do so, the maturity value depends on how much could be recovered from bank liquidation.

that technical provisions for products with external guarantors were slightly more than €6 billion at end-2011.

**13. On the regulatory side, insurers face some uncertainty regarding timing and content of the Solvency II initiative but this has been reduced by recent draft European guidelines.** Since March 2013, the European Insurance and Occupational Pensions Authority (EIOPA) has started public consultation on interim guidelines for Solvency II, which cover the system of governance, risk management, internal models, and reporting to supervisors. Although the FMA has been working with the industry to enhance its readiness, more work is needed in areas such as risk management, financial measurement and reporting, capital planning, product management, and investment policy.

# IMPLEMENTATION OF IAIS INSURANCE CORE PRINCIPLES

**14. The FMA continues to perform well but some challenges identified in the 2007 assessment remain relevant.** These are set out in Table 1.

**Table 1. Progress on Key 2007 Recommendations**

| Recommendation | Priority | Current Status |
|---|---|---|
| Ensure that tax and regulatory policies are neutral across otherwise comparable savings vehicles to support competition. | Medium | Changes were made to the taxation of single premium life insurance, but tax neutrality remains a concern. The FMA department supervising pensions (pension companies and corporate pension funds) cooperate with one another, but regulatory neutrality has yet to be achieved. A review of the European Directive on Institutions for Occupational Retirement Provision that is currently underway is considering the extent to which Solvency II would be relevant. |
| Support the expansion of the supply of well-trained actuaries. | Medium | The FMA has been supportive, but this issue remains a concern. |
| Extend stress testing of insurance companies' liabilities and investigate the use of market-based soundness indicators. | Medium | The FMA requires insurers companies to prepare standardized stress tests. Insurers have also performed stress testing in connection with the Solvency II quantitative impact studies. Further refinement of the standardized stress tests, together with more extensive company-specific stress testing, is recommended. The FMA investigated the use of market-based soundness indicators, but concluded that the small number of listed insurers makes this impractical. |

## A. Conditions for Effective Insurance Supervision[7]

**15. The availability of well-trained actuaries in sufficient numbers remains a concern.** Although the number of ordinary members of the Actuarial Association of Austria has increased recently (from 430 in June 2012 to 462 in January 2013), the number of full members has not kept pace (declining slightly, from 274 to 268, during the same period). The prospective introduction of Solvency II requirements will increase the incentive for insurers to use more sophisticated techniques of risk assessment, and therefore increase demand for actuaries.

**16. The accounting and auditing professions appear to have coped successfully with the transition to IFRS.** The prospective adoption of market-consistent reporting for solvency purposes under Solvency II will increase the demand for accountants and auditors with specialized knowledge.

## B. The Supervisory System[8]

**17. The FMA has a wide range of powers to conduct supervision, including the power to issue and enforce rules by administrative means.** The FMA issues regulations, circulars (non-binding interpretations of legislation), and minimum standards ("soft law," called guidelines in many jurisdictions). Although the FMA explains the nature of minimum standards on its website, indicating clearly that these are merely recommendations, there is, nevertheless, confusion among some industry participants, who interpret these minimum standards as regulations. This would suggest the need for further dialogue with industry participants.

**18. The number of insurance and pension supervisors has been significantly increased.** At the time of writing there were about 59 people working in the Insurance and Pensions Supervision Department, compared to 40 in 2007 and 35 in 2003. Many other people in the FMA also devote at least part of their time to the supervision of these sectors, such as those dealing with AML/CFT, enforcement, and the supervision of corporate provision funds. There is an active training program and the FMA benchmarks its salaries against those of the Oesterreichische Nationalbank (OeNB). Nonetheless, human resources for supervision are strained by the need to prepare for the introduction of Solvency II, which has also made the expertise of FMA staff increasingly sought by the industry.

**19. The FMA actively participates in the work of EIOPA.** In addition to developmental initiatives, it cooperates in the implementation of various supervisory protocols, such as the supervision of international insurance groups. As regards EEA authorities there is no impediment to exchange of information, but the FMA faces challenges in collaborating with other country supervisors in the absence of a memorandum of understanding (MoU). Austria is a signatory of the IAIS Multilateral MoU and has bilateral MoUs with insurance supervisors in several other relevant

[7] Formerly ICP 1, but now dealt with in the Introduction to the ICPs.

[8] Formerly ICPs 2-5; new ICPs 1-3.

jurisdictions, but not all jurisdictions in which Austrian insurance groups have operations are covered by these MoUs. The FMA does cooperate and exchange more limited information with the supervisors in those jurisdictions.

## C. The Supervised Entity[9]

**20. Suitability requirements for some board members were strengthened.** From January 1, 2008, the chairperson of a supervisory board of an insurer with a gross written premium volume over € 500 million is subject to a fit and proper test, which covers both probity and professional experience, including relevant sectoral expertise. Such persons, along with all new appointees to the executive boards of insurers, are subject to an oral examination by the FMA on the basics of the VAG and Solvency II. Those who fail are only allowed to retake the examination once. Suitability requirements also apply to other members of the supervisory board and significant owner; but they are implicit rather than explicit for key persons in some control functions. For example, while there are detailed legal requirements for the actuary and minimum standards for members of internal audit, there are no explicit rules for the risk manager.

**21. Each insurer that underwrites life insurance or long-term health insurance is required to appoint a responsible actuary.** It is expected that Solvency II will also require non-life insurers to establish an actuarial function, but not necessarily to appoint a responsible actuary. The responsible actuary has to report to the executive board within five months of the end of the financial year, or if a serious deficiency is detected, and the report is passed to the FMA. However, legislation does not require reporting or guarantee access to the supervisory board of an insurer by either the responsible actuary or internal audit.

**22. Under present regulation, an insurance company may not have an opportunity to react to an auditor's concern before the regulator is notified.** Under this regulation (VAG), an external auditor has to report significant concerns to the FMA, with copies of the report to the management and supervisory boards. This appears to be in conflict with the requirement under the Company Code (UGB), in which an external auditor is required to report significant concerns to company management and supervisory boards (first). The FMA does not see an issue since the requirement relates to significant infringements.

## D. Ongoing Supervision[10]

**23. The FMA collects extensive quantitative and qualitative information from insurers.** It has various systems and processes for collecting, analyzing, and storing this information, which are enhanced on an ongoing basis. Financial soundness and performance indicators are regularly compiled, and serve as input to the risk ratings assigned to the entities. The results are used to help

[9] Formerly ICPs 6-10; new ICPs 4-8.

[10] Formerly ICPs 11-17; new ICPs 9-12 and 23-26.

determine priorities for on-site supervision and intensified monitoring. The risk rating systems differ among the various types of entities, in part reflecting differences in the nature of their businesses. Insurers are required to notify the FMA of all facts that put continued compliance with insurance obligations at risk.

**24. The FMA continues to require various stress tests of insurers.** Both prescribed stress scenarios and those developed by the entities are tested, however, there is scope for strengthening these tests. Insurers have also performed stress tests as part of the Solvency II quantitative impact studies, but additional stress testing undertaken for risk management purposes does not appear to be common practice in the insurance sector. This situation is expected to change with the implementation of Solvency II, which would require insurers to perform internal risk and solvency assessments.

**25. The FMA conducts some supervisory activities on-site.** These include planned and ad hoc formal inspections, thematic inspections for gathering information on a particular subject from a range of entities, company visits, and regular meetings with boards and senior managers. Its formal inspections are focused rather than full-scope, so the first-hand look at all aspects of an entity's operations develops over a period of years. During the period 2008–12, the FMA carried out 133 formal inspections of insurers. Besides the number of on-site inspections, the intensity of inspections has been strengthened. Most but not all entities were inspected at least once during that period, with the largest insurers having been inspected numerous times.

**26. The FMA has a wide range of preventive and corrective measures and sanctions at its disposal.** Such measures include the power to impose fines for various administrative offences. The maximum fines were recently increased, to as much as €150,000 for the most serious offences. It should be noted however that under Austrian law only natural persons may be fined and not corporations.

**27. The FMA follows a well-structured methodology for supervising insurance groups and conglomerates**. These involve various departments internally, as well as supervisors in other jurisdictions. It has established supervisory colleges for each of the five internationally-active Austrian insurance groups and participates in the supervisory colleges for foreign groups that have a significant presence in Austria. Presently, supervisors from all significant markets participate in the colleges (96.5 percent of foreign business based on premium 2011). The FMA undertakes both group-related and jurisdiction-related analyses of the risks. For example, it explicitly considers not only the share of a group's business that arises from each jurisdiction, but also the combined market share of Austrian groups in the various jurisdictions. It has developed a CESEE strategy and risk map. The FMA has participated in some joint on-site inspections of the operations of its groups in other jurisdictions.

**28. The FMA prepares regular analyses of trends and risks that might affect insurers.** In doing so, it draws upon a wide range of information, including the findings of its supervisory analyses of individual entities and groups, the results of stress tests, consultations within the FMA and with the OeNB, and international sources, such as EIOPA. The Financial Market Committee, which is comprised of senior representatives of the FMA, the OeNB, and the Ministry of Finance, also serves as a platform for cooperation and the exchange of information. However, the authorities have not yet assigned responsibilities for macroprudential supervision or established a process for assessing the potential systemic importance of insurers.

**29. The FMA has prepared a Crisis Management Handbook**. It defines what would be considered a supervisory crisis situation and sets out processes to be followed in dealing with them, include communication. Two actual problem situations involving groups have been dealt with successfully, with the involvement of the respective supervisory colleges. Also, in 2011 a multilateral emergency test was conducted through EIOPA. However, insurers are not required to maintain contingency plans and procedures based on their specific risk for use in a going- and gone-concern situation.

## E. Prudential Requirements[11]

**30. The FMA assesses the reinsurance programs of insurers through both off-site analysis and on-site inspections.** Reinsurance documentation is among the many things reviewed during on-site inspections. Although there are no explicit requirements regarding the timeliness and completeness of such documentation, the FMA regards timely finalization of binding contracts to be part of the requirement for proper administration and moreover notes that it has never had issues concerning incomplete or delayed written reinsurance contracts. About **91 percent** of reinsurance ceded goes to reinsurers of EEA countries or equivalent non-EEA countries.

**31. Austrian GAAP requirements for the valuation of assets and liabilities fall short of the standards set out in the revised ICPs.** While the FMA receives fair values of assets along with local GAAP figures, and detailed information on liability calculations from actuarial reports, an asset-liability valuation consistent with standards will only be implemented under Solvency II. At present, an insurer is required to establish additional provisions if its investment returns fall short of interest rate guarantees to policyholders, but the methods and assumptions used to calculate such provisions are left to the judgment of the responsible actuary of the insurer. The FMA is currently working on a circular concerning the calculation of additional provisions for guaranteed life insurance products.

**32. Insurers continue to invest under a traditional limit-based system.** There is no formal requirement that they invest in a manner that is appropriate to the nature of their liabilities. A "prudent person" investment regime, along with capital adequacy requirements that take account of the nature of an insurer's investments, is expected to be part of Solvency II.

**33. The FMA has not issued a regulation or minimum standard on risk management, which is dealt with extensively in the proposed Solvency II.** However, both in meetings with the

[11] Formerly ICPs 18-23; new ICPs 13-17.

insurance industry and through on-site discussions, it has expressed the expectation that insurers should establish risk management functions. This expectation is reinforced by the non-binding guidance on risk management issued by the industry association. Nevertheless, the current risk management practices of many insurers reportedly fall well short of those contemplated by the ICPs—and which will be expected under Solvency II, in areas such as risk quantification, asset-liability management, and the preparation of own risk and solvency assessments.

**34. Capital adequacy requirements in Austria continue to be based on Solvency I.** Insurers are legally required to meet the solvency margin requirements continuously, although they only routinely report their solvency margins to the FMA on an annual basis. Both the FMA and the insurance industry acknowledge that Solvency I does not appropriately recognize the risks faced by insurers. Although the proposed Solvency II requirements would be much more risk sensitive, industry representatives have expressed concerns about the complexity of the calculations, the calibration of risk factors, the potential volatility of the results, the ability of management to understand the results, and its effects on the viability of some traditional insurance products.

## F. Markets and Consumers[12]

**35. The FMA supervises the distribution of insurance directly by insurers or through banks.** The Federal Ministry of Economy, Family, and Youth has general authority over insurance agents and brokers, for which it seeks help from local administrative authorities. The Trade Act includes, for brokers, all provisions of the EU Insurance Mediation Directive. The complaints-handling body for agents and brokers is the Ministry of Economy, Families, and Youth; for bancassurance and direct distribution it is the FMA. The maximum fine in case of illicit activity by an intermediary remains quite low, at only €3,600. The FMA and the Ministry of Economy, Families, and Youth communicate frequently with one another on matters such as complaints, the interpretation of legislation, and international developments (for example, Ministry representatives participate in EIOPA meetings regarding intermediaries). A review of the Insurance Mediation Directive is currently taking place.

**36. Provisions on consumer protection are covered in the Trade Act**. Disclosure requirements are set out in the EU Insurance Mediation Directive. There has been some improvement in disclosures associated with savings products since the last FSAP update. For example, an amendment to minimum standards for the life insurance sector in 2008 indicates the need to disclose information about the amount of the invested premium and/or the amount of the overall costs. Separately, tied selling, such as the bundling of loan and insurance coverage, is not prohibited in Austria. This issue is currently being considered in connection with the revision of the Insurance Mediation Directive.

[12] Formerly ICPs 24-27; new ICPs 18-21.

**37. The FMA inspects how insurers handle customers' claims.** It has published the EIOPA Guidelines on Complaints-Handling by Insurance Undertakings as part of the regulatory framework. EIOPA is currently working on comparable Guidelines on Complaints-Handling by Insurance Intermediaries.

**38. Public disclosure by insurers is covered under UGB and VAG.** All commercial insurers are subject to the disclosure requirements applicable to large companies.[13] The same information must be disclosed by both listed and non-listed companies, although listed companies must disclose quarterly. Those reporting on IFRS or US GAAP are subject to additional disclosure requirements. The FMA annually reviews the consistency and quality of the disclosures of each insurer. The current disclosure requirements are not as extensive as those contemplated by the ICPs, although it is expected that Solvency II will close remaining gaps.

### G. Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT)[14]

**39. The FMA has consolidated compliance with AML/CFT legislation in a single division.** The division currently has a staff of eight full time employees, and is budgeted to grow to 12 in 2013. In addition, one person in the International Affairs and European Integration division has AML/CFT responsibilities. The AML/CFT division communicates with the insurance supervision divisions about its inspection plans and findings, in addition to regular semi-annual meetings. It expects to cover about 10 percent of the life insurers annually, through either on-site inspections or company visits. Also, the insurance supervision staff are expected to notify the AML/CFT division of relevant control weaknesses detected during their on-site activities. To this end, supervisors receive training on AML/CFT issues through the FMA Academy training program and ad hoc seminars.

## CONCLUSIONS

**40. The FMA is making progress in addressing vulnerabilities of life insurance companies to the low-rate environment.** The recent FMA study was a first step in analyzing the situation. At this stage, the FMA is appropriately engaging the insurance industry in discussion, while monitoring the situation closely and encouraging higher provisions. The industry would benefit from further consolidation, particularly of the remaining companies focused solely on life insurance as a diversified product line would help offset weakness in that sector.

**41. On the regulatory side, the FMA and the government will need to remain consistent and convergent with the overall European approach for a solvency framework.** The FMA has been actively involved in the development of the Solvency II framework, and both the FMA and the

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[13] Small mutual insurers are subject to different requirements, which include the disclosure of financial statements to their members.

[14] Formerly ICP 28; new ICP 22.

insurers it supervises have been working hard to prepare for its eventual adoption and implementation.

**42. The specific recommendations that follow are set out largely in the order in which the respective issues are dealt with in the ICPs.**

- The FMA should continue to prepare itself—and take steps to ensure that the industry is prepared—to effectively implement Solvency II.
- The FMA will have to update its entire risk assessment process under Solvency II, adopt a structured system for the internal review of risk assessments, and increase the use of risk ratings in planning supervisory activities.[15]
- Legislation should be revised to reinforce the operational independence of the FMA by requiring that the reasons for the dismissal of any member of its boards be publicly disclosed.
- Legislation should be revised to include explicit suitability requirements for key persons in control functions, as consistent with EIOPA guidelines.
- Legislation should be revised to require non-life insurers to establish an actuarial function and to appoint a responsible actuary.
- Legislation should be revised to require that the responsible actuary and the head of internal audit either report directly to the supervisory board or guarantee their access to it.
- The FMA should require all insurers to report solvency margins at a frequency consistent with EIOPA guidelines.
- Legislation should be revised to require insurers to promptly report any material changes or incidents that could affect their condition or customers.
- The FMA should enhance the value of its standard stress tests by widening the range of risks tested, including more refined stress scenarios (such as a shift in the yield curve, rather than just a percentage decline in asset values), and encouraging the use of internal models to carry out the testing.
- The FMA should increase the frequency of on-site inspections, to ensure that the significant activities and control functions of each entity are inspected within a period of time that is reasonable in relation to its risk profile and supervisory risk rating.

[15] FMA is elaborating new relevant KPI's and also setting up a project for a new risk assessment software to support the review process under Solvency II.

- The FMA should continue to strengthen training on AML/CFT issues for supervisors of life insurance companies, in order to enhance their ability to identify potential weaknesses in the course of other on-site inspections.

- The Ministry of Finance should enter into additional MoUs, as necessary, to facilitate the participation of the insurance supervisors in all jurisdictions in which Austrian insurance groups have significant operations in the relevant supervisory colleges.

- The FMA should provide input on the establishment of cross-sector macroprudential supervision responsibilities and participate on an ongoing basis, including through establishing a process for assessing the potential systemic importance of insurers.

- The FMA should require insurers to maintain contingency plans and procedures based on their specific risk for use in a going- and gone-concern situation.

- Legislation should be revised to strengthen prudential requirements in a manner that will enhance observance of the ICPs, consistent with EIOPA guidelines. Such steps might include:

    - enacting revisions to the VAG;

    - revising the liability valuation approach to take fuller account of emerging experience and anticipated future experience;

    - requiring consistent provisioning for guarantees, both those provided by the originating insurer or pension company and those backed by a third party; and

    - issuing a minimum standard on enterprise risk management, and developing a methodology for assessing capital adequacy that considers a wider range of risks than Solvency I (such as a factor-based system or a stress testing-based approach).

- Legislation should be revised to increase the fines imposed in case of illicit activity by an intermediary.

**Table 2. Financial Soundness Indicators for the Insurance Industry**

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| **Life insurance** | | | | | | |
| Total premimums (euro millions) | 7,136 | 7,157 | 7,317 | 7,356 | 7,467 | 6,928 |
| Pre-tax earnings/net premium | 4.7 | 3.4 | -1.7 | 2.3 | 4.2 | 3.0 |
| Loss ratio | 105.9 | 103.4 | 79.6 | 117.3 | 115.9 | 96.6 |
| Expense ratio | 15.1 | 14.7 | 14.2 | 13.3 | 14.1 | 15.6 |
| Combined ratio | … | … | … | … | … | … |
| Investment income/investment assets | 4.7 | 4.1 | 2.6 | 3.0 | 3.4 | 2.8 |
| Equity/total assets | 8.4 | 8.1 | 4.3 | 4.8 | 4.2 | 4.1 |
| Equity and related assets/total assets | 11.2 | 10.9 | 9.7 | 9.0 | 8.6 | 7.3 |
| Fixed income securities/math Reserves | 54.5 | 55.9 | 58.6 | 59.3 | 60.9 | 60.3 |
| Equity/math Reserves | 9.2 | 8.9 | 4.8 | 5.2 | 4.6 | 4.4 |
| Alternative investments/math Reserves | 0 | 2.1 | 1.8 | 1.3 | 1.1 | 0.8 |
| Solvency ratio | 160.1 | 163.9 | 206.8 | 211.6 | 210.1 | 178.1 |
| **Health insurance** | | | | | | |
| Total premimums (euro millions) | 1,445 | 1,491 | 1,543 | 1,598 | 1,645 | 1,704 |
| Pre-tax earnings/net premium | 5.0 | 2.7 | 3.9 | 5.3 | 7.3 | 4.9 |
| Loss ratio | 72.1 | 71.5 | 71.0 | 69.7 | 68.5 | 67.6 |
| Expense ratio | 14.4 | 14.2 | 14.5 | 13.2 | 14.2 | 15.1 |
| Combined ratio | … | … | … | … | … | … |
| Investment income/investment assets | 4.1 | 3.0 | 2.3 | 2.9 | 3.7 | 3.0 |
| Solvency ratio | 396.6 | 380.0 | 354.8 | 389.7 | 400.3 | 430.4 |
| **Non-life insurance** | | | | | | |
| Total premimums (euro millions) | 8,912 | 9,220 | 9,200 | 9,102 | 9,685 | 10,387 |
| Pre-tax earnings/net premium | 11.0 | 11.6 | 7.1 | 7.9 | 10.3 | 11.0 |
| Loss ratio | 67.6 | 67.1 | 68.7 | 73.2 | 65.2 | 63.9 |
| Expense ratio | 27.4 | 27.9 | 27.8 | 27.4 | 27.4 | 27.9 |
| Combined ratio | 95.0 | 94.9 | 96.5 | 100.6 | 92.7 | 91.8 |
| Investment income/investment assets | 7.1 | 6.2 | 3.7 | 3.8 | 3.9 | 4.1 |
| Solvency ratio | 361.2 | 438.6 | 551.7 | 578.4 | 619.2 | 592.5 |