Insurance/Reinsurance - Sweden

Traffic-Light Model Will Soon Apply to Non-life Insurance Companies

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At the beginning of 2006 the Financial Supervisory Authority launched a new supervisory system in order to control the financial risks of life assurance companies. As of 2007, the system will also measure risks in non-life insurance companies. In addition to financial risks, insurance risks will also be measured for both life and non-life insurance.

Traffic-Light Model

In January 2006 the authority implemented the traffic-light model to supervise the risk exposure of life assurance companies. The model is designed to work as a signal system to identify companies whose risk exposure is such that they might be unable to fulfil their commitments to policyholders if asset values fall or liabilities increase. Companies can receive a green or red light from the authority, depending on how much their assets and liabilities are affected.(1)

Financial Risks of Non-life Insurance Companies

In order to evaluate their financial risks, insurance companies must estimate their insurance liabilities(2) at realistic values and calculate a sufficient capital buffer. Roughly, the capital buffer consists of the part of the company's surplus that can be used to cover losses before undertakings towards policyholders are affected. The capital buffer is then put to a 'stress test', where the size of the buffer is compared with the hypothetical net value of the assets and liabilities under a worst-case scenario. Depending on the result, the company may get a red light.

Insurance Risks of Non-life Insurance Companies

The authority is developing an experimental model to measure insurance risks which has already been tested on certain life insurance companies. According to the authority's schedule, it is expected that the experimental model will be presented in the near future and the final model will be introduced in December 2006. The model is expected to be applied to non-life insurance companies as of 2007.

The model measures whether an insurance company has underestimated the possible cost of future claims and the cost of claims incurred. The objective is to measure the estimated maximum loss that the insurance company could suffer with a 99.5% probability. This method is in line with the preparatory works to the forthcoming EU Solvency II Framework Directive, which will be implemented in the near future. However, the authority's traffic-light model will probably not be as detailed as the solutions tested by the European Union.

Introduction of 'Prudent Person' Principle for Insurance Risks

The 'prudent person' principle (already applicable to risks in most life assurance companies) will affect the measuring of insurance risks in a number of ways. Pursuant to the principle, technical reserves should be calculated based on reasonable 'prudent' assumptions of the insurance commitments (in contrast to today's safeguard assumptions). A prudent capital buffer should be used for technical provisions, in accordance with the provisions drafted by the authority. Moreover, the principle affects the investment guidelines and other principles relating to the discount rate.

Comment

According to the government, a modernized solvency system is currently being prepared. Consequently, Sweden will not await the completion of the Solvency II project; the traffic-light model is an indication of what is coming next.

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Endnotes

(1) The authority refers only to red light. However, it is reported that the absence of a red light will be considered as a green light.

(2) Technical provisions, Sw FTA.