

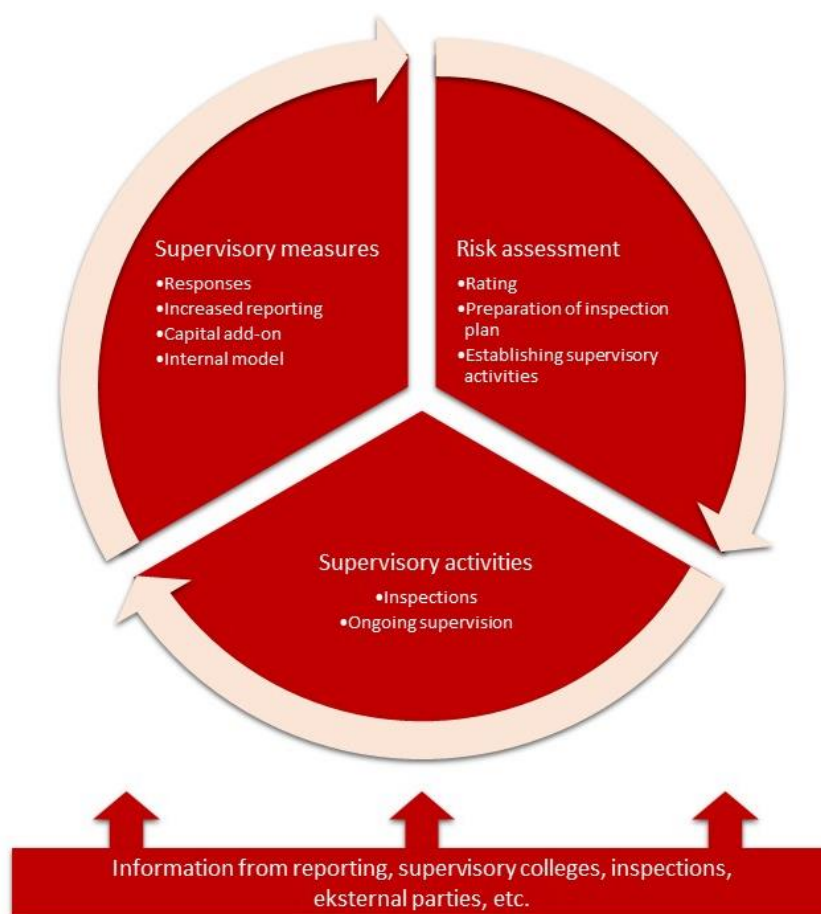
THE DANISH FSA'S SUPERVISORY REVIEW PROCESS

In the field of insurance, protection of policyholders is an essential part of the purpose of the Danish FSA's supervision. As a result, in its supervision the Danish FSA focuses on policyholders and beneficiaries being highly likely to receive the funds to which they are entitled. In regard to supervision, this means that the Danish FSA helps to ensure that the insurance undertakings are solvent, have adequate technical provisions, invest in suitable assets, comply with the principles regarding generally accepted business practice, and have an appropriate system of governance.

To ensure that these requirements are met on an ongoing basis, the Danish FSA's supervisory review process is forward-looking, risk-based and proportional, in accordance with The European Insurance and Occupational Pensions Authority's (EIOPA's) Guidelines on supervisory review process. The supervisory review process is forward-looking, since insurance undertakings are assessed not only in the context of current risks, but also in the context of risks that could arise in the future.

In general, the Danish FSA's supervisory review process consists of three components:

- 1) Risk assessment and inspection plan
- 2) Supervisory activities
- 3) Supervisory measures



Risk assessment and inspection plan

The Danish FSA performs an annual internal risk assessment which is used to evaluate the risk profiles of the individual insurance undertakings. If the Danish FSA receives new information that could affect the risk assessment, however, whether negatively or positively, a new risk assessment will be performed. For example, this could be in connection with the conclusion of an inspection, new knowledge about the asset quality, changes in the undertaking's business model, and so on.

In general, the risk assessment is an expression of two things: the risk that *customers will suffer losses* and the risk that the insurance undertaking will lose its licence as a result of *failure to comply with legislative requirements*. The risk assessment system classifies the insurance undertakings depending on the nature, scope and complexity of their business activities and associated risks. The risk assessment is determined in two steps. A model-based quantitative risk assessment is performed first, followed by a qualitative assessment, which may occasion an adjustment to the quantitative risk assessment. The risk assessment model is based on a set of selected risk indicators on which the insurance undertakings are scored. The risk indicators are adjusted according to the type of undertaking, and may include growth or risk concentrations of various natures. The overall score results in a risk assessment on a five-step scale from low-risk to high-risk. The risk assessment includes all available information about the insurance undertaking which the Danish FSA holds as a result of ongoing supervision.

Low risk	Below medium risk	Medium risk	Above medium risk	High risk
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The risk assessment forms the crux of the ongoing risk-based prioritisation of activity in the field of insurance, since the results of the risk assessments are used as a basis for planning the inspection plan for the following year and decisions regarding other supervisory activities, including requirements for further reporting, for example.

When planning the following year's inspection plan, the focus is on those insurance undertakings that are judged to be at greater risk of breaching the rules than other insurance undertakings of the same size, and on those insurance undertakings for which the consequences of severe breaches of the rules are likely to be most significant for customers and society at large. An undertaking's position in the inspection plan is therefore based on two dimensions:

- 1) The size of the insurance undertaking.
- 2) The insurance undertaking's risk assessment.

Supervisory activities

The Danish FSA's supervisory activities consist of the ongoing supervision along with inspections and investigations. The Danish FSA's supervision is arranged on the basis of a risk-based principle that the supervisory action should be proportional to the risk of the harmful effects of the offences.

As part of the ongoing supervision, information about the insurance undertakings and groups is obtained and evaluated. Information is obtained from sources such as the insurance undertakings and groups, the college of supervisors, other authorities and external parties (e.g. market or sector information, information from consumer or industry associations, research reports or the media).

Information from the insurance undertakings and groups derives among other things from the following reports:

- Quantitative reporting templates (QRTs) (quarterly and annually)
- Solvency and Financial Condition Reports (SFCR) (annually)
- Detailed reports on solvency and financial condition (Regular Supervisory Report, or RSR) (at least once every three years, although significant changes must be reported annually)
- Own Risk and Solvency Assessments (ORSA) (annually)
- Sensitivity analyses (quarterly)
- Alternative investments (quarterly)
- Generational distribution analysis (annually)
- Statistical analysis of portfolio compared with life expectancy benchmark (annually)
- Actuarial report and meeting with the responsible actuary (annually)
- Notifications of the technical basis (ongoing in the event of changes)
- Audit book (annually)
- Other information that is obtained upon request to the undertaking or group (ongoing as necessary)

In the ongoing supervision of an insurance undertaking or insurance group, the Danish FSA also looks at historical information, “early warning” indicators, risk indicators and earlier results from the supervision of the relevant insurance undertaking or group.

In addition to ongoing supervision, the Danish FSA performs inspections and investigations of the insurance undertakings. An inspection may be effected as a full inspection, in which a single insurance undertaking is investigated in detail, or as a themed investigation, in which a particular topic is investigated in detail in several different insurance undertakings.

The Danish FSA uses the information that is obtained via the ongoing supervision, inspections and investigations to assess whether the financial regulation is complied with in general. However, the Danish FSA especially assesses whether the regulation regarding the following topics is complied with:

- management and the system of governance, including the Own Risk and Solvency Assessment (ORSA),
- technical provisions,
- capital requirements,
- investment rules,
- quality and quantity of own funds, and
- complete or partial internal models when such models are used.

Tools developed in accordance with Article 34(4) of the Solvency II Directive

Under Article 34(4) of the Solvency II Directive, Member States must ensure that, as part of the supervisory review process, the national supervisory authorities have the power to develop quantitative tools to

assess the ability of the insurance undertakings to cope with possible events or future changes in economic conditions that could have unfavourable effects on their overall financial standing, and to require that corresponding tests are performed by the insurance undertakings.

When the Solvency II Directive was transposed into Danish law, section 126g was added to the Danish Financial Business Act. According to this provision, group 1 insurance undertakings, i.e. insurance undertakings covered by the Solvency II regulations, must analyse which changes in significant risks affect the own funds, the Solvency Capital Requirement and the Minimum Capital Requirement calculated by the undertaking. The analyses are intended to ensure that risk is managed effectively within the undertaking. The results of the analyses must be reported to the Danish FSA no later than 20 business days after the end of each quarter. Reporting of the results enables the Danish FSA to track the financial situation of insurance undertakings on an ongoing basis, and thus to take the requisite measures if the Danish FSA judges that an insurance undertaking's financial position has deteriorated, thus posing a risk that the interests of the policyholders may not be satisfied.

The specific requirements for the analyses will be laid down in an *executive order on sensitivity analyses*, which is expected to be issued in 2018.

Supervisory measures

Based on the ongoing supervision and inspections, the Danish FSA is required to identify any weaknesses, actual or potential deficiencies and failure to comply with requirements, which may result in supervisory measures being imposed on an insurance undertaking. In order to decide whether measures should be taken, the Danish FSA is required to assess the significance of these weaknesses, actual or potential deficiencies and failure to comply with requirements. Based on this, the Danish FSA must choose appropriate measures in order to rectify the situation.

Examples of measures that may be adopted by the Danish FSA:

- Order to use an internal model to calculate the Solvency Capital Requirement if the group 1 insurance undertaking's risk profile deviates significantly from the assumptions on which the standard formula is based, cf. section 126c(4) of the Danish Financial Business Act.
- Order regarding a capital add-on for the Solvency Capital Requirement for a group 1 insurance undertaking, cf. section 350b of the Danish Financial Business Act.

The Danish FSA may only issue responses regarding compliance with financial legislation. The Danish FSA has the following response options:

- Orders
- Reprimands
- Immediate rectifications
- Risk information
- Penalty payments
- Police reports or administrative fixed penalty notices

The Danish FSA discloses basic and/or further rulings as well as decisions to pass on cases for police investigation on its website¹ in accordance with section 354a of the Danish Financial Business Act. In addition to this, the Danish FSA discloses orders, reprimands or penalty payments regarding breaches

¹ For more information, go here: <https://www.finanstilsynet.dk/Tilsyn/Tilsynsreaktioner>

of specific rules in accordance with section 354e of the Danish Financial Business Act. Disclosure of these supervisory measures is intended to help prevent breaches by informing the public and the undertakings of behaviour that the Danish FSA considers as being in breach of financial regulation.

Orders

If the Danish FSA determines that an insurance undertaking is behaving illegally or omitting to act when an action is required by law, the Danish FSA may issue an order, thus demanding a particular action or behaviour in future. An order is issued with a reasonable time limit for compliance. No later than the end of the time limit, the insurance undertaking must prove to the Danish FSA that the situation has been rectified. In some cases, the undertaking will not be required to submit documentation, since the Danish FSA is able to check whether the situation has been rectified. Orders cannot be used for a breach of the regulation that no longer exists.

Reprimands

If the Danish FSA identifies a breach of the financial legislation which no longer exists, the Danish FSA may issue a reprimand regarding the breach. This may be when an irregularity concerns a situation of a temporary nature which is over at the time when the Danish FSA identifies it, or where the insurance undertaking has already rectified the situation on its own initiative.

Depending on the situation, the nature of a particular reprimand may mean that the insurance undertaking should instead be reported to the police. For example, this could be in connection with an inspection that gives rise to a range of reprimands. The number of projected reprimands may mean that overall there is a case of wilful or repeated violation of the financial legislation.

Immediate rectifications

In the case of uncomplicated breaches of formalities which are not significant, as an alternative to an order, the Danish FSA may elect to issue the insurance undertaking with an immediate rectification. An immediate rectification is used when it is judged that an order would be unnecessarily formal. The situations that may give rise to an agreement regarding immediate rectification are commensurate with the situations that may give rise to a (less serious) order, and the deciding point is the specific situation, including whether the undertaking acknowledges the error and agrees to rectify it immediately, and whether the Danish FSA otherwise finds it reasonable in the specific situation.

Risk information

Risk information is used when the Danish FSA judges that there is a need to draw an insurance undertaking's attention to the fact that the undertaking has a significantly increased risk in an area or non-viable elements in its business model, without any irregularities being committed.

There is no explicit legal basis in the financial legislation for issuing risk information. However, the objective of the Danish FSA is to help maintain trust in the financial sector and ensure financial stability. The ability to point out conditions in which an insurance undertaking is exposing itself to elevated risk may therefore be regarded as inherent to the Danish FSA's activity.

Penalty payments

Penalty payments are applied in situations where the Danish FSA wishes to force the relevant undertaking to meet its obligations pursuant to financial legislation, for example, when the Danish FSA wishes to ensure a particular behaviour right here and now. Penalty payments can be classed as a type of order

with a financial penalty that applies until the order is complied with. For example, penalty payments may apply in a situation in which an insurance undertaking has not submitted its annual report on time.

In the financial legislation generally, the Danish FSA has legal backing to impose daily or weekly fines on a specific set of undertakings; for example, see section 374(2) of the Danish Financial Business Act. The remarks on the provision in the Danish Financial Business Act also state that the Danish FSA can only apply penalty payments *“if the purpose is to obtain information that is necessary to the supervisor’s assessment of the financial undertaking’s financial position”*. The remarks thus limit the use of penalty payments to financial factors.

Police reports and administrative fixed penalty notices

The Danish FSA is not obliged to report all violations of financial legislation to the police. This depends on a specific assessment in each individual case. The Danish FSA may elect to give the insurance undertaking a reprimand instead of reporting it to the police. These two response options may not be used simultaneously, however. On the other hand, the Danish FSA can certainly report an insurance undertaking to the police and simultaneously order the undertaking to cease its unlawful behaviour.

In the following situations, the Danish FSA will always consider a police report:

- Wilful violation of the financial legislation.
- Multiple violations of the legislation which would not individually result in a police report, but must, when taken together, be regarded as wilful or repeated violation of the legislation, and therefore result in a police report for the overall situation.
- Operation of a financial undertaking without the authorisation of the Danish FSA. This also applies in cases where an insurance undertaking that is authorised to carry out insurance activity exceeds the remit of the authorisation, thus carrying out unauthorised activity. In each individual case, there may obviously be factors to support no report being made to the police. If the violation is a minor one and unintentional, an order will suffice initially.

In some cases of violation of the Danish Financial Business Act, which are not deemed to entail higher penalty than a fine, in notifications of fines the Danish FSA may tell the insurance undertaking that the case may be decided without court proceedings, if the offending undertaking admits it is guilty of the offence and agrees to pay a fine within a specified time limit as stated in the notification of fines.