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Measures for adaptation of the solvency II reform to Moroccan insurance companies

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Abstract: *In a global context marked by the fluctuations of regulations and professional practices, the new IFRS standards, Solvency II, the generalization of internal control systems and the strong development of the Enterprise Risk Management function, the Moroccan insurance supervisory authority has just rethought the regulatory framework of the sector. The bill n ° 059-13 amending and supplementing the law n ° 17-99 on the insurance code provides for the introduction of the solvency regime based on risks. Our article aims to explain what is a solvency regime based on risks? What are the consequences for the sector? and what are the measures for adaptation of the Solvency II reform to Moroccan insurance companies?*
Keywords: *Solvency II, internal control, risks, Moroccan insurance company.*

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I. Introduction

Moroccan insurance companies have until now adopted a solvency regime modeled on the European Solvency I Directive. This system, which only takes into account the technical risk, has shown its limits. A European project called Solvency II which aims to integrate all the risks run by an insurance company is being prepared by the European Commission. The Moroccan supervisory authority is, however, adopting a wait-and-see attitude towards this new regime. While two circulars on internal control and market transparency have been circulated, they have not provided concrete measures for convergence towards Solvency II requirements.

II. Insurance between Solvency I limits and Solvency II requirements

II.1. the limits of Solvency I

The Solvency I regime consists of two elements, namely the Minimum Solvency Requirement (MSR) and the Minimum Solvency Capital (MSC)[1]. The Minimum Solvency Requirement is indexed to the pricing risk. The calculation is in fact proportional to premiums, claims and technical provisions. The amount thus calculated must be covered by the solvency margin established, determined from equity, quasi-equity and unrealized capital gains on investments. A company is considered to meet the requirements of the solvency margin if the MSC / MSR ratio is greater than zero[2].

This system contains, however, no lesser limits. The most widespread criticism is related to the lack of sensitivity to risk. Indeed, several types of risks among the fundamental risks for the insurers are judged as not being correctly taken into account. This is the risk borne by the assets, ie the market risk and the credit risk. Operational risk is only very little considered [1]. As the standard formula is based on unfavorable scenarios for the sector as a whole, it is also not able to allow a company to know and measure its own risk profile.

In the same vein, it should be noted that information on the solvency margin of the Moroccan sector is almost absent. The supervisory authority does not communicate on this aspect. None of the last ten reports of the Directorate of Insurance and Social Welfare (DAPS) referred to the solvency margin of Moroccan insurance companies.

II.2. Mixed convergence towards Solvency II

Conscious of Solvency I's inability to take all risks into account, the European Commission has put in place a project of integrated solvency of risks entitled solvency II[3]. It is based on a three pillar, similar to Basel II[4], including quantitative requirements (financial resource rules), qualitative requirements (internal control,

[1] C.f. http://docplayer.fr/20101319-Solvabilite-contexte-et-principes.html
[2] Solvency II technical reporting and disclosure requirements.
[3] Cf. https://en.wikipedia.org/wiki/Solvency_II_Directive_2009.
[4] Basel II is the second of the Basel Accords, (now extended and partially superseded by Basel III), which are recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision.

prudential supervision and risk management) and market discipline (financial communication). The originality of the Solvency II project is that it has foreseen the possibility for companies to set up internal models for calculating their capital requirements.

The program contract[5] signed in May 2011 by the Moroccan government and the insurance sector foresaw the convergence towards Solvency II. The Moroccan supervisory authority is, however, adopting a wait-and-see attitude towards this new regime. Admittedly, the circulation of two circulars on internal control (Pillar 1 of Solvency II) and market transparency (Pillar 2 of Solvency II) is an important step for the convergence of the market, but we believe that they are insufficient for a rapid convergence.

The first circular that was issued on August 26, 2008 has as its object the accountability of the management body in the establishment of an internal control system. In our opinion, this circular is of a general nature because it has not provided for concrete arrangements for setting up an explicit quantitative and qualitative risk management system like the ORSA system (Own Risk and Solvency Assessment) recommended by solvency II.

The second circular on market transparency issued on 31 October 2011 provides for the publication of purely accounting information. In insurance, unlike certain sectors, accounting information alone is not able to provide information on the company's ability to honor its commitments to policyholders. It must be, in our opinion, accompanied by detailed information on the technical and financial activity.

The wait-and-see behavior of the DAPS reveals to us an uncertainty of authority over the approach to be followed. It goes without saying that the adoption of Solvency II will require changes to the Insurance Code and the Insurance Accounting Plan, which could take several years of negotiations. We regret the fact that the supervisory authority did not take the initiative to adapt and submit Moroccan companies to different impact tests like the European sector to make the necessary adjustments when finalizing the project. This lack of responsiveness augurs a lengthy convergence process that could result in the obsolescence of Solvency II enforcement measures.

III. Regulatory Framework: A Risk-based Solvency Model

III.1. Solvency regime based on risks

A risk-based solvency regime is an important step forward for the insurance industry[6]. It is in fact a new strategy of management of companies based on a risk management integrating both quantitative and qualitative aspects. This new prudential framework makes it possible to position risk management at the heart of the concerns of insurance companies. The aim is to better tailor the capital requirements of an insurance company to the risks it incurs.

Although the guidelines of the new regime are not yet unveiled, the quantitative measures of such a system should normally be based on a modular approach to risk. It consists of the determination of the immobilized capital via a standard formula. In a simpler way, the objective is to evaluate the cost of an insurance product in relation to the risk incurred. The temporal and uncertain nature of insurance requires the intervention of actuarial models. Studies on Solvency II have indeed shown the importance of accompanying the standard formula with an internal model that alone can represent the interaction of risks.

The risk-based solvency regime could also be of great interest in terms of profitability. The time factor and uncertainty about the occurrence of a claim mean that profitability models developed in an industrial context are of no interest in insurance. In a risk-based solvency context, profitability per product is measured by adding the technical result and the financial result to the previously determined capital requirement. This ratio will allow management to act on its pricing policy to adjust the numerator, or its reinsurance policy to limit the denominator. Although the approach is theoretically sound, it would be difficult in a context marked by price controls and the narrowness of the financial market.

III.2. Consequences on the sector

Risk-based solvency is a prudential regime that will modify insurance activity. It will have a direct impact on capital requirements, investments and the structure of the insurance market[7].

Investment capital requirements may also require companies to be less risky than under the old system, moving more towards well-rated bonds at the expense of equities and real estate. Regarding the structure of the market, the requirements of the new regime will force companies to focus more on the trades and skills they master [2].

[5] Cf. http://fnacam.ma/files/publications/Contrat_Programme.pdf

[6] Cf. http://www.sgg.gov.ma/portals/0/AvantProjet/76/Avp_loi_059.13_Fr.pdf

[7] The study carried out by the Swiss insurance company "Swiss-Re" on the European market through the Swiss solvency model (Swiss solvency test) has shown that the transition to a risk-based solvency regime is going to be accompanied by a significant increase in capital requirements. The main reason is that this scheme takes into account all the risks incurred by an insurance company.

Some insurers will therefore decide to move away from the activities that consume the most resources, and turn to outsourcing or relocation of their back-office services. It is indeed conceivable that an insurer with excellent risk management skills, but a weak distribution network focuses on product design and disengages from the distribution of policies. For another with a strong sales network, it may be profitable for him to specialize in the distribution of policies by leaving the design and transfer of risk to other insurers.

The risk / return pair would be at the center of the strategies. With a risk-based solvency regime, companies that fail to generate economic value will become the subject of buyback transactions. The regime could accelerate the phenomenon of acquisition-merger.

In our opinion, a transitional period is necessary in order to mitigate the volatility that could result from the transition to a risk-based solvency regime. In addition, to ensure that Moroccan insurers are not at a disadvantage vis-à-vis European insurers, particularly in the context of the Aleca[8], the Moroccan solvency system must be compatible with Solvency II.

Finally, if the risk-based solvency regime is adopted, there is a strong demand for actuaries. Fortunately, it is not necessary to be the aggregated by math to be able to use the diet. Its models are normally designed to produce indicators understandable by all, whether at the level of the general management, or at the level of the other directions [3].

IV. Towards a new standard of evaluation of the solvency

The Insurance Authority is in favor of relaxing restrictions on investment policy. But companies wishing to move towards risky assets will have to strengthen their own funds [4].

Current ratios tighten significantly for the overall market. The very comfortable solvency ratios posted by the insurance companies do not reflect their real situation.

Until now, only the underwriting risk was taken into account. Within one year, the estimate of solvency margins will be based on risk.

The first simulations show that the margins are tightening very sharply.

The regulator reveals that one to two operators did not pass these tests. At the very least, these companies will have to increase their own funds and review their investment policy. But this is not yet the case as the risk-based solvency project is still in its infancy.

Regulation on investment should evolve. The exposure of insurance companies to the stock market is considered excessive, moreover in a stock market in crisis for a few years. The weight of equities listed in the companies' portfolio is between 40 and 45% currently.

The calculation of the solvency margin does not take account today of market risks in particular. But they are the most important threat to companies, at least in the current context.

While Morocco is very much inspired by European regulations, this reference system can not be transposed as it is in the context of Morocco.

The risks facing Moroccan insurers are significantly lower. Even in Europe, Solvency II, which should come into force in January 2016, is not unanimous. For the experts, this standard would be out of step with the current context, particularly with regard to long-term investment. By duplicating it as it is, it will penalize the market.

Last but not least, the insurer must be able to demonstrate each year its resilience to financial uncertainties in accordance with the content of Pillar 1 (Fig 1). The risk appetite philosophy in Solvency II requires additional equity counterparties when the strategic investment allocation of Solvency II equity securities exceeds a level deemed acceptable. When we know that the average strategic allocation of shares in the sector is approaching the 70% mark at the moment, the question that arises naturally is how the sector would manage the dilemma between financing the economy. and manage the equity risk exposure. This question arises with insistence and acuity when one knows that the second principle on which the program-contract is based is that of the collection of savings and the financing of the economy (Table 1).

The Moroccan authorities seem to advocate a smooth transition from Solvency I to Solvency II. The wishes for the years to come are that this passage is not impregnated with complexity, and operates under the best conditions for the operators and without causing an increase in the price of insurance.

[8] Accord de Libre-échange Complet et Approfondi (ALECA), Or Deep and Comprehensive Free Trade Agreement (DCFTA).

V. Figure and Table

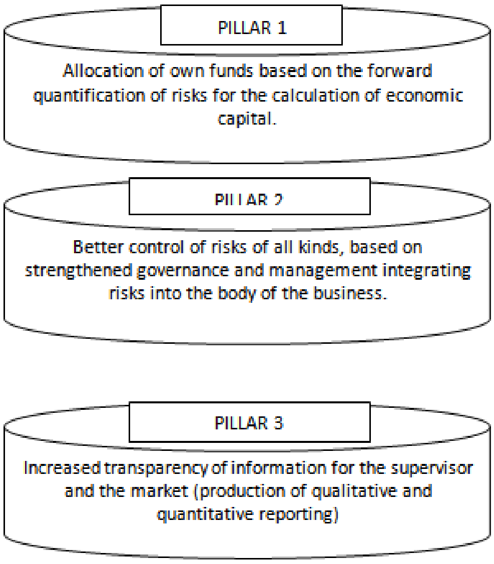

Fig 1. The three pillars of Solvency II

	Market average
Bonds	13%
Shares	68%
Real estate	7%
UCITS	10%
Others	2%

Table 1. Strategic allocation of investments by insurance companies

VI. Conclusion

Insurers thus admit that all of these pillars represent, beyond a regulatory constraint, a necessary evil, a windfall and a great opportunity for risk management. Better late than never, at a time when companies are struggling to offer increasingly attractive packages of guarantees to their private customers, small businesses, SMEs or even large companies, they will have to sift, and that of sustainable way, the operational risks of their management. The so-called ORSA (Own Risk and Solvency Assessment), as the Europeans call it, which consists of identifying and evaluating risks, will become a repetitive and unavoidable exercise. In addition, the quality of management data is a must to have, in that an insurer can not exempt or exempt. As a result, large investments within companies to revisit and rethink computer architectures can not be ruled out. These investments will achieve the desired granularity in business data. The supervisory authority will also have the power to impose an additional solvency margin (capital add-on), under certain conditions, in the event that it has been judged that the risks have been badly appreciated by the company.

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