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Review of the Bulgarian Insurance and Pensions Sector

Frequently Questions and Answers

Why did the Bulgarian Financial Supervision Commission (FSC) organise a comprehensive balance sheet review (BSR) and stress test of the insurance and sector and an asset review of the pension funds' sector?

On 26 February 2016, the European Commission (EC) published its Country Report for Bulgaria for 2016. The report assesses the progress in the execution of Bulgaria-specific recommendations approved by the Council on 14 July 2015. The report also includes results from the in-depth review under Article 5 of Regulation (EU) No. 1176/2011 on the prevention and correction of macroeconomic imbalances. The analysis of the EC gives grounds to conclude that there are excessive macroeconomic imbalances in Bulgaria. A part of country specific recommendation requires performing a portfolio screening for the pension funds and insurance sector.

For the insurance sector, the Balance Sheet Review (BSR) and stress test constitutes an important tool for assessing the capacity of insurance undertakings to fulfil their obligations towards policyholders and to withstand stress conditions. This exercise is expected to enhance policyholder protection and to strengthen market discipline. The BSR and stress test led to the production of granular entity-by-entity data illustrating the manner in which the balance sheets of the participating insurance undertakings are impacted by a comprehensive review of both their assets and liabilities and by common shocks (i.e. financial markets and insurance specific shocks).

For the pension funds sector, the asset review constitutes an important tool for assessing the accuracy of the value of the assets in the pension funds following the applicable local framework and the main risks not captured or fully captured by that framework. The latter assessment will further allow evaluating whether additional changes in the legal framework are necessary.

Which were the main components of the exercises?

For the insurance sector this exercise included two main components, namely a balance sheet review (BSR) and a stress test. The BSR aimed to assess the accuracy of the balance sheets of the participating insurance undertakings based on data as of June 30, 2016, including the adequacy of technical provisions and the re-calculation of prudential indicators of these undertakings following the adjustments applied by the external auditors to the pre-BSR balance sheets. The stress test provided a forward-looking examination of the resilience of the solvency of insurance undertakings to both financial market and insurance specific scenarios.

For the pension funds sector this exercise included a review of the accuracy of assets based on data as of June 30, 2016 in two perspectives, namely under the applicable local framework and in regards to the risks not captured or not fully captured by that framework. For the latter international common standards (IFRS) including the definition of related parties were used.

What was the scope of the exercises in terms of market coverage?

The exercises covered the whole insurance market (individual and group level) and all universal, professional and voluntary pension funds in Bulgaria.

Which parties were involved in the exercises?

In order to increase the credibility of the exercise and allow for an independent assessment, the comprehensive exercises and stress test were performed with the support of independent external reviewers (IERs), an independent external stress test consultant and an independent external Project Manager. The IERs were selected and appointed by a Steering Committee (SC) – composed by two members (FSC and EIOPA) and four observers (European Commission (EC), European Securities and Markets Authority (ESMA), Bulgarian Ministry of Finance and Bulgarian National Bank – based on the compliance with predefined strict qualifications and selection criteria. The stress test consultant and Project Manager were selected by the FSC following a transparent public procurement process.

Which methodology was used for the exercises?

The exercises were based on a common methodological guidance developed by the Project Manager following the steer of the Steering Committee, which coordinated and monitored the entire exercise. The methodological guidance took into account for the insurance sector the most advanced knowledge on the Solvency II framework. For the pension funds sector the methodological guidance took into account the current requirements as laid down in the FSC norms and regulations as all as other applicable common international standards namely IFRS for assessing risks not captured or fully captured by the applicable local framework. The harmonised application of the methodological guidance was ensured by a project management team.

Are the reviews of insurance undertakings (or pension funds) fully comparable?

Both Solvency II and IFRS are principle-based standards and involve the use of judgement. Under these frameworks mechanical rules replacing these principles cannot be imposed as that would contradict the referred frameworks jeopardising enforcement. Complete comparability will never be possible in practice. On the other hand, judgement has to be supported by sufficient evidence and be reasonable given the circumstances at the time the judgement is made. Having this in mind the Steering Committee asked the project management team to make an assessment of the situations where economic reality of similar transactions and events was not understood in a similar way. This consistency assessment will be taken into consideration when the follow-up measures are enforced.

Why were the exercises delayed until end January 2017?

There were two main events that delayed the exercise. There was a three-months postponement at the beginning of the exercise as communicated by FSC on March 2016 due to the unavailability of IERs at that time occupied with the statutory auditing and the review in the banking sector. And another 1-month extension as communicated by FSC on December 2016 to finalise the group level reviews as those included indicators from related insurance undertakings from another countries. It is further clarified that these group level reviews were previously assigned to RSM Bulgaria that was expelled on 15 September 2016 when it was discovered that the appointments had been done based on substantial incorrect information, which led to the need to make new appointments on that date.

What are the consequences of the exercises?

The exercises revealed several shortcomings, ranging from valuation errors, capital shortfalls to deficiencies in the areas of corporate governance, internal control or IT systems which need to be addressed by the respective insurance undertakings and pension insurance companies in the upcoming months. Based on the magnitude of the identified deficiencies, the participating insurance undertakings and pension insurance companies will have to implement follow-up actions including measures aimed to correct the shortcomings under the close oversight of the FSC and within the deadlines communicated in the follow-up actions published by the FSC on 15 February 2016.