
**MANUAL ON PERFORMANCE OF
SUPERVISION ON INSURANCE COMPANIES AND INSURANCE
MARKET SUBJECTS IN
MACEDONIA**

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A. INTRODUCTION

The primary objective of the insurance supervision is protection of the insured people's rights and provision of long-term stability of the insurance system. The following starting points shall be taken into consideration during the preparation of the Manual on performance of supervision on insurance companies and other subjects of insurance supervision:

1. The objective of the insurance and re-insurance supervision aims to strengthen the stability, transparency and efficiency of the insurance market in order to protect the interests of the contracting parties in the insurance contract and the parties that have certain interest from such contract. In order to meet this objective, the supervisory authorities prepare supervisory methods and assume that there is a regulatory and institutional preparedness and will to perform on-site supervisions.

2. The on-site supervisions whether performed by the supervisory authorities or people authorized by the authorities are of crucial importance for the entire supervision process and they are closely related to the constant monitoring of the work of the subjects under supervision. On one hand, such supervisions provide information that will contribute to the analyses conducted on the bases of financial and statistical information submitted by the insurance and re-insurance companies. On the other hand, on-site supervisions need support from the market through gathering of information and data and statistical reports arising from the analyses of the annual accounts, reports and other additional information and reports on the activities of the subjects under supervision.

3. Reliable information and data can be verified or provided through the performance of on-site supervisions that can be used in order to assess the current or future solvency of the insurance company, by measuring the development and the reasons for such development of the company.

4. Through the performance of on-site supervisions the supervisor can obtain information and data and discover problems that could not be discovered or obtained through the regular monitoring. So:

a. in cases when the insurance companies have problems with the management of the assets; irregularities in management with accounting-information system; proper application of the technical insurance bases (tariffs and insurance terms, calculation of the premium rate on the basis of application of actuary methods, for the life insurance – application of established tables of mortality etc.); management problems; on-site supervision enables the supervisor to identify the irregularities and the illegal issues intentionally ignored or concealed by the companies.

b. the on-site supervision enables the supervisors to make direct, personal contact with the directors, which is very useful for the conduct of proper analyses of their conformity in terms of meeting the criteria for management by performing insurance and reinsurance activities (fitness and properness). Management body members of the insurance company should possess capability, will and consistency in order to establish and maintain system of policies and insurance implementation procedures in context of consistent application of calculated and established technical basis of the insurance.

c. on-site supervision enables the supervisors to assess the management policies and internal controls and audits in the insurance companies;

d. during the on-site supervision the subjects can be directly influenced to give up performing certain activities that are contrary to the law and regulations of the insurance industry;

e. the on-site supervision enables the supervisors to conduct analyses on the influence of certain regulation and, in general, to collect information necessary for meeting the criteria at insurance industry level.

5. The on-site supervisions are useful for problem management in the companies. For example, the supervisors:

a. can influence and persuade (**oblige**) the management structures in the companies through dialogue during the on-site supervision to undertake measures for avoiding current or future problems, which might be more efficient than the drafting and adoption of regulations;

My remark: I believe that the on-site supervision does not have such power so as to bring decisions. The management body of the supervisory institution has that power. In the case of Macedonia that body should be the Council of experts within the Agency). Thus, I believe that the same formulation should remain – they can influence and persuade the management structures.

b. can use the on-site supervision as a tool to transfer information to the company management in relation to new regulation that requires explanation in order to avoid misinterpretation and misapplication.

6. The objective of this manual is to strengthen the supervisory function on the insurance market through implementation of generally accepted supervision standards. The manual includes the following main areas:

a. regulation in Macedonia referring to the insurance supervision (on-site and off-site supervision)

b. the objective of the on-site supervisions;

c. off-site monitoring of the operations

d. description of the procedures in on-site supervisions;

e. organization of the procedure in on-site supervision.

B. LEGAL GROUNDS IN MACEDONIA

1. If a simpler analysis is conducted on the regulation of OECD member states, it can be easily concluded that the performance of insurance activities all around the world, in all jurisdictions with different systems of rule of law is strictly regulated activity which is under constant supervision, i.e. control of the competent state bodies. This is result of the fact that the insurance market as part of the financial market in the legal system of the country enables mobilization of free funds through payment of insurance premiums from subjects, legal and physical persons that according to the solidarity and reciprocity principles unite their funds in risk communities, or insurers, which according to the insurance terms in case of occurrence of the insured case

undertake the responsibility to pay indemnity or provide other type of compensation according to the insurance contract.

2. If we take into consideration the source structure of insurers' funds (insurance companies) it can be noticed that the potential liabilities of the insurer towards the insured persons, based on insurance contracts, are bigger than the share of own sources – the capital, i.e. the available solvency margin. This, including the importance of the insurance in economical, financial and social context for an economy, is sufficient explanation why these institutions are strictly regulated all around the world. A failure of an insurance company rapidly spreads on the insurance market and on the financial market of a country, and the process of regaining the confidence is long and causes damages on the economy

3. In Macedonia, the institutions whose primary activity is performing insurance operations are founded as shareholding insurance companies in private ownership that have obtained license for insurance operations in accordance with the legal criteria for founding and operating of such companies. The fundamental law that regulates performance of insurance operations and insurance supervision in Macedonia is the Law on Insurance Supervision, adopted in April 2002, and the Law on Amending the Law on Insurance Supervision adopted in June 2007. According to Article 159 from the Law on Insurance Supervision (“Official Journal of RM” no. 27/02, 84/02, 98/02 and 33/04) and Article 91 paragraph 8 from the Law on Amending the Law on Insurance Supervision (“Official Journal of RM” no. 79/07), the Ministry of Finances conducts supervision on the insurance companies in order to establish whether the performance of insurance operations is in accordance with the risk management rules, the other provisions from this law, or other laws that regulate the operation of insurance companies. According to the Law on Prevention of Money Laundering and other proceeds from crime (“Official Journal of RM” no. 4/08) the insurance supervisor shall be obliged to conduct supervision on the application of measures and activities arising from this law, in the subjects under supervision.

4. According to the law, besides performing supervision on the operations of insurance companies, the Ministry of Finances shall conduct supervision on other subjects, such as insurance brokerage companies, insurance representatives, actuaries and the National Insurance Bureau.

5. The minister of finances can appoint an auditor or other qualified person for the performance of certain parts of supervision. In the part for which they are authorized to conduct supervision, the authorized persons shall have the same authorizations as the supervisors.

6. According to the law, the supervision on insurance company shall be conducted through:

- permanent off-site supervision on the operations of insurance companies through collection, analysis and verification of the reports and information submitted by the insurance companies or other persons in accordance with the provisions from this law;



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- on-site (partial or full) supervision on the operations of insurance company (control), as well as additional supervision which shall always be considered to be in the benefit and protection of the insured persons' rights; and
 - defining supervision measures

7. Party in a supervision procedure shall be legal or physical person upon who the Ministry of Finances performs supervision (subject of supervision). In supervision procedure over an insurance company, a party shall also be the management body of the insurance company.

8. The subject of supervision shall be obliged to enable the supervisors to perform on-site supervision on the operations in the head office of the subject of supervision as well as on other places where the subject of supervision or other person authorized by the subject of supervision performs activities on which the Ministry of Finances conducts the supervision. The supervisors can also conduct on-site supervision on legal persons connected to the subject of supervision if that is necessary for the completion of the supervision. The subject of supervision shall be obliged to enable the supervisors to investigate the complete accounting documentation, business documents, administrative and other business records. The subject of supervision shall be obliged to provide copies of the above mentioned documents to the supervisors.

9. During the supervision, the supervisors can ask from the subject of supervision reports and information regarding all matters relevant for the assessment whether the operations of the subject of supervision are in accordance with the law provisions. The supervisors can ask for the information and reports from the members of the management body, as well as from the employees. The supervisors can ask the persons within the subject of supervision to provide written report no later than three (3) days on the operations of the company subject to supervision.

10. The Ministry of Finances shall closely prescribe the basic procedures and rules for performance of on-site supervision.

C. OBJECTIVES OF ON-SITE SUPERVISIONS

1. In general, the key objective of an on-site supervision is evaluation of safety, stability, risks and harmonization of the operations of the insurance companies. Actually, the objective is to perform comparison of the risk profile of the company with its capacity to undertake risks and discover any problem that might influence its ability to fulfill future liabilities arising from insurance contracts.

2. However, the on-site supervisions must not be limited solely to the detection of problems in the company. The monitoring of the company's operations is actually a system of procedures and processes based on regular monitoring of the operations of the supervision subject through analyses of the reports and data that the subject must deliver to the supervisory body pursuant to the Law on Insurance Supervision, by-laws arising from it and other regulations. During the supervision process according to the Law, the authorized persons can ask for additional reports, data and statements from the employees as well as from the members of the management body.

3. These objectives can be divided into indirect objectives, as follows:

a. to evaluate the assets and liabilities (including the potential liabilities in the off-balance filing) and to analyze the adequacy of the tariffs and the balance of operations;

b. to assess the management technique by performing insurance operations (it refers above all to actuary methods used in calculations, business policy, reinsurance policy).

c. to assess the behavior of the clients and to establish whether illegal or irregular activities are used to the detriment of the insured persons and the public interest;

d. to assess the accounting and internal control systems, and to built an opinion regarding the corporative management;

e. to discover the problems that might occur as a result of the organizational structure of the insurance company or the company's participation in a group.

D. OBJECTIVES OF OFF-SITE MONITORING OF THE ACTIVITIES

The subjects of the insurance supervision are obliged regularly to inform the supervisory body on certain aspects of the operations in order to:

a) be established whether the reports and data are submitted on time and in the prescribed form;

b) be established whether the amounts presented in the reports are true and in accordance with the presented financial condition of the subject under supervision;

c) conduct analyses on submitted reports and information and prepare special risk profiles of the insurance companies;

d) analyze the trends of the operations of the insurance companies and to make an assessment of the stability, safety and future development trends;

e) draft quarterly and annual reports for the operations of the subjects under supervision, as well as additional reports when necessary.

E. ON-SITE SUPERVISION PROCEDURE

Planning and preparation

1. As a result of the conducted analyses of the financial and statistical information submitted by the subjects of supervision, the supervisor must draft a plan and programme based on systematic analyses of the data and information for the on-site supervisions that will be conducted in the coming period.

2. This plan shall take into consideration the frequency of the on-site supervisions and the risky profile of the subject of supervision. The on-site supervisions are more thorough and frequent when referring to subjects that are in difficult economic and financial condition. Big change in the structure of the top management, as well as in

the objectives and business policy of the subject could be sufficient reason for on-site supervision.

3. Besides the above mentioned, the plan for on-site supervision must remain indicative because the priorities might change in the course of the year. On the other hand, the duration of the supervision is unpredictable because it can last one day or even few months depending on the work scope of the subject, the size and the problems it is facing with.

4. In each respect, any on-site supervision must start with general review of the subject of supervision so that the on-site work could be properly planned and directed. This review should be conducted in cooperation with the management structure and result with program for field work.

On-site monitoring of the activities of insurance company

1. The regular off-site monitoring of the subject can be systematical and to a certain extent standardized (analyses of the consistency of the financial reports, the condition of the subject regarding the market average), whereas the on-site supervision is determined and adapted according to the subject characteristics, as well as the identified problems on field. So, it is difficult to define the duration and exact outcome of the on-site supervisions in advance. The on-site supervision can be full or partial, or additional if such supervision is in the interest and protection of insured persons' rights.

2. If the supervisors conduct full supervision it should include at least the below mentioned activities, whereas when the supervision refers to a certain area the supervisor can take into consideration only the relevant activities. Some of the activities can be conducted through off-site supervision.

a. Evaluation of the management structure and internal controls system

- reading of the minutes from the meetings of the management body and the competent body, the reports of the auditors, and the audit of the actuary and electronic analyses of the data if such thing has been established;
- analyses of the ownership structure and sources of capital funds;
- evaluation of the capacity of the management, its efficiency and willingness to accept and correct its mistakes (especially following the changes of the board composition);
- assessment of all current internal procedures of the subject and risk control system in order to evaluate the relevance of these internal controls and the approach of the subject to risk management;
- evaluation of the accounting procedures in order to check whether the financial and statistical information, which are periodically sent to the supervisory body, are true or not, and whether they are in accordance with the regulation.

b. Analyses of the subject's activities

- analyses of the main business categories, the clients and the geographical range thereof;
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- evaluation of the business plans and holding meetings with the management in order to provide information on the plans for future operations;
 - analyses of contracts.

c. Evaluation of the management technique for performing insurance activities

- evaluation of the organization and management of the subject under supervision;
- analysis of the company's business policy; particularly the insurance terms and the paid commissions to the intermediaries. The commissions must not be allocated from the so-called technical premium i.e. functional premium, but solely from the part of the premium for financing of the insurance function i.e. from the overhead allowance used for financing the insurance.
- evaluation of the reinsurance cover and its safety. particularly from the aspect whether it is in accordance with the shareholders' capital, security reserves, statutory reserves and anticipated premium in the coming period as well as the profile of the risks included in the insurance portfolio of the insurance company.
- control of the way the risks are managed (check whether the insurance company has at its disposal a margin of solvency (capital) which is at least at the required level of the margin of solvency, whether the insurance company has sufficient liquid assets that would cover the guarantee fund of the company, whether it calculates security reserves from the realized positive financial result, whether it carefully forms technical reserves by taking into consideration the liabilities assumed under concluded insurance contracts and whether it has sufficient assets that would cover the technical reserves, whether the assets that cover the technical reserves are invested in forms allowed under the regulations in force, whether it values the assets and liabilities in proper and careful manner and according to the allowed value methods in accordance with the valid regulations, which mortality tables it applies, how does it calculate the premium rates and whether it conducts audit on the calculation of the premium rates in accordance with changed conditions on the insurance market).

d. Analysis of the relations with external subjects

- analysis of the organizational schemes, grouping structure and the internal relations within the group. Namely, this refers to a case when the majority shares with management right in the insurance company are obtained by a foreign insurance company and in this context the analyses should include the relations between the insurance company and the majority owner (foreign insurance company), especially in the part for calculation and payment of services for expert and technical consulting aid, as well as in the field of reinsurance contracts realized within the grouping. Besides this, when it comes to such insurance companies thorough and detailed analyses is required in the part for insurance classes that need to be reinsured, which are usually presented in reinsurance, and the classes of insurance that can be protected with insurance funds set aside by the domestic insurance company for any assumed risk;
 - analyses of the relations with the branch offices abroad and the transactions within the group;
 - analyses of the agreements with external service providers;
 - identification of any financial problems arising from any subject within the group of the company.
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- e. Evaluation of the financial power of the company
- analyses of the process for liquidation of damages and the calculation of the technical reserves according to the current regulation;
 - analyses of the adequacy of the tariffs and their adequate application
 - analyses of the investment policy (including the management policy for derivatives), the assets kept as cover for the technical reserves;
 - verification of the property and evaluation of the company's investments;
 - analyses of the active and passive court proceedings of the company and off-balance items;
 - analyses of the projections of the balance sheet and profit and loss account for the following two or three years, on the bases of the last results and the future plans of the management.
4. The supervisors shall be entitled to analyze the relations of the company with its insured persons (clients), in other words they can conduct check and evaluation of:
- a. the data and the information presented to the clients and whether they are sufficient and adequate;
 - b. the time framework of damage payment, the number and the type of the court disputes and the transactions with the insured persons;
 - c. the harmonization with the regulation for consumer protection.

Evaluation and report

1. In the course or at least at the end of the supervision, the supervisor should discuss the conclusions with the subject of supervision and he/she must pay special attention on the hospitality of the subject.
2. Should any irregularities be established, the supervisors must conduct additional check whether the subject has acted upon elimination of the irregularities and, if necessary, the supervisors should continue monitoring the subject.

F. ORGANIZATION OF THE PROCEDURE IN ON-SITE SUPERVISION

1. The on-site supervisions should have legal bases in order to maintain the right of the supervisor to request and obtain any information. The insurance regulation should provide the supervisory body with large authorizations so that it can conduct full investigation of the insurance, reinsurance companies and other subjects under supervision and obtain any information.
 2. Besides this, if there is such need, the supervisor should have competence to expand the on-site supervision on subjects connected by capital or on subjects that cover certain activities delegated by the subject under supervision.
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3. The supervisory body should organize the process of on-site supervision in order to achieve better efficiency. If the supervisor acts in such manner she/he should consider, for instance, allocating the supervisory assignments among few supervisors or the ministry of finances can authorize an auditor or other qualified person to perform certain parts of supervision.

4. Some forms of organizational structure of the supervisory body group the competences for the off-site monitoring as well as for the on-site supervisions for group of insurance companies. Closer relations are established between off-site and on-site supervisions in this type of organizations. This type of organization is considered to be more efficient manner for monitoring the companies for a longer period of time. However, executive officers are undisputedly required that will work on all aspects of the supervision (for example, accounting, actuary methods, finances, data processing) as well on all types of insurances (for example, health insurance, insurance for motor vehicles, responsibility).

5. Some supervisory organizations can have experts on certain concrete assignments or for some classes of insurance and these experts can be included in the on-site supervisions in large number of insurance companies. This type of organizations is considered as flexible and efficient in handling the problems on the market. However, good cooperation is required as well as exchange of information between the executive officers competent for off-site monitoring and the officers responsible for on-site supervisions. In accordance with this, the results of the analyses must be documented and available to both of the groups.

6. Regardless of the internal organization of the supervisory services, the supervisors can provide aid from external auditors or actuaries to whom they would delegate complete or partial tasks to conduct on-site supervisions. By using services from experts, the supervisory bodies will be more flexible and they will strengthen their capabilities.

7. However, since the supervisors are the ones responsible for supervision, before using services from external supervisors or actuaries, they should take into consideration the following matters:

a. are there adequate controls over their competence and the need for monitoring their performance (for example, through check of their working documents);

b. their independency regarding the subjects (especially, when they are paid from the Board of directors) as well as their understanding for the protection of insured persons' interests.

8. Besides the fact that it is legally desirable to have the right to delegate these competences to external persons, the supervisors must have competence and be prepared to undertake legal measures against these auditors and actuaries, should such thing be necessary.

G. COOPERATION AND EXCHANGE OF INFORMATION AND DATA WITH OTHER SUPERVISORY BODIES IN MACEDONIA

1. In Macedonia, according to the Law on Insurance Supervision, the Ministry of Finances and other bodies competent for supervision of other financial organizations shall be obliged, upon request of supervisory body, to submit all data regarding any insurance company of other financial organization necessary for conduct of supervision over a financial organization, issuance of permits and adoption of decision on other matters.

2. The supervisory bodies shall be obliged to inform each other on the irregularities discovered during the supervision, should the irregularities refer to the work of other supervisory bodies.

3. The data obtained for the purposes listed in the previous two points, as well as the data obtained from supervisory bodies of a member state or a foreign country, shall be treated as confidential and can be used solely for the purposes they have been obtained for.

4. The Ministry of Finances collects and processes the data relevant for performance of supervision according to law.

The data refer to the following:

- license for insurance operations and other licenses issued by the Ministry of Finances according to the law;
- members of the management body and the supervisory body of the insurance companies, as well as organization and work of the internal audit;
- branch offices and direct insurance activities in member states, as well as branch offices and direct insurance activities by insurance companies of the member states in Macedonia;
- branch offices for performing insurance activities in foreign countries and branch offices of foreign insurance companies in Macedonia;
- compliance of the insurance companies' activities with the rules on risk management according to the law and the regulations arising thereof;
- reports that the insurance companies are obliged to submit on quarterly bases;
- holders of qualified shares in the insurance companies;
- audit on annual reports conducted according to law;
- supervision measures implemented according to law;
- data that the Ministry of Finances has collected from the competent supervisory bodies of the member states.

5. The Ministry of Finance can submit the above-mentioned data to:

- 1) national competent supervisory bodies, within the established cooperation according to law;
 - 2) competent supervisory bodies of the member states, should this be necessary for performing a supervision on the insurance company and should the bodies be legally obliged to keep confidential data, according to law;
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- 3) competent supervisory bodies of foreign countries, should this be necessary for performing a supervision on insurance companies and should the bodies be legally obliged to keep confidential data, according to law;
 - 4) judicial bodies, should this be necessary for conducting bankruptcy procedure.

