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SLOVENIA

Pilot Diagnostic Review of Governance of the Insurance Sector

May 2007

THE WORLD BANK
Private and Financial Sector Development Department
Europe and Central Asia Region
Washington, DC

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This Diagnostic Review is a product of the staff of the International Bank for Reconstruction and Development/ The World Bank. The findings, interpretations, and conclusions expressed herein do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent.

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Abbreviations

AA	Appointed Actuary
ALM	Asset Liability Management
CA	Companies Act
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CEA	Comité Européen des Assurances (European Insurance Committee)
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
COSO	Committee of Sponsoring Organizations of the Treadway Commission
D&O	Directors and Officers (liability insurance)
EC	European Commission
EU	European Union
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
IAIS	International Association of Insurance Supervisors
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
ISA	Insurance Supervisory Agency
KAD	*Kapitalska Druzba*, state pension fund
MAS	Managers' Association of Slovenia
MB	Management Board
MOF	Ministry of Finance
OECD	Organisation for Economic Cooperation and Development
PAYGO	Pay As You Go
RBS	Risk-Based Supervision
ROSC	Report on Observance of Standards and Codes
RS	Republic of Slovenia
SAS	Slovenian Accounting Standards
SIT	Local Currency, the Tolar (1 USD = 185 SIT)
SOD	*Slovenska Odskodninska Druzba*, state restitution fund
SB	Supervisory Board
USD	United States Dollars
VAR	Value at Risk

Foreword

As financial sector markets become more sophisticated, the burden of supervision also increases. The increase in the burden not only implies higher regulation costs but also challenges in effective supervision. Corporate governance has been an important element to balance the additional burden by creating stronger and more transparent internal control structures. The insurance sector has been the first among financial services to promote better corporate governance and there, by better risk management to ultimately reduce supervisory burden.

This review looks at the governance of the insurance sector in Slovenia, analyzing the legal framework and its enforcement and the adoption of corporate governance principles by firms. It is part of a series of pilot reviews undertaken by the Financial and Private Sector Development Unit of the Europe and Central Region of the World Bank and is the second review of the governance of the insurance sector following a similar review in the Czech Republic. The review is one of three reviews conducted in Slovenia together with reviews of the Banking and Collective Investment Funds sectors.

The report is intended to provide policy makers and insurers in Slovenia and other countries with insight into existing corporate practices, and to offer a framework of good practices that can assist lawmakers in their efforts to strengthen governance in the insurance sector. We hope the report will also contribute to the ongoing international debate on good corporate governance practices in insurance sector companies worldwide.

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Executive Summary

This diagnostic review covers governance of the insurance sector in Slovenia and was prepared at the request of the Ministry of Finance of Slovenia. The review has three objectives: (1) improve the description of good practices related to governance of insurance sectors, (2) conduct a diagnostic review of Slovenian insurance governance against these benchmarks, and (3) provide recommendations on ways of further improving the corporate governance of the Slovenian insurance sector.

The most important element of governance is the active role performed by management and supervisory boards to enforce the adoption and constant adherence to good principles of corporate governance within the company itself. Other key elements include the regulatory approach, the strength and approach of the supervisor, the role of the professions (actuaries and auditors), the legal structures and financing of institutions, and the quality of information presented to the public. A strong system would be characterized by: (1) appropriate risk management and risk-based capital requirements, (2) effective supervisory boards, (3) appropriate regulation including accounting standards, (4) corporate structures that inhibit the easy and non-transparent transfer of assets, (5) a consolidated risk-based supervisory approach, and (6) strong protection of policyholders, creditors and minorities in the event of corporate stress or insolvency.

The corporate governance of insurers also concerns the management of risk. Risk management requires that: (1) sufficient technical provisions and capital be retained by the business given the insurer's risk, and (2) the governance structure takes into account the rights and interest of all stakeholders within the framework of a country's institutions and financial infrastructure.

Corporate governance of the Slovenian insurance sector has improved in recent years, particularly in transparency and disclosure of financial information, and most of the elements of a strong corporate governance framework are in place. However weaknesses remain in: (1) outdated risk management processes of insurance companies, (2) insufficiently effective supervisory boards in the companies, and (3) a supervisory approach that relies on inspection cycles rather than risk-based supervision and fails to adequately supervise financial conglomerates on a consolidated basis. The weaknesses are exacerbated by Government ownership control of almost 60 percent of the sector, including three of the five largest insurance companies. While the weaknesses may have been acceptable in the past, they now leave the sector vulnerable. The adoption of single passport rules for EU member states will likely increase competition for financial services, including insurance products. At the same time, the introduction of Solvency II for the EU insurance sector (and probably in much of the rest of the world) will oblige the Slovenian Insurance Supervisory Agency to employ consolidated and risk-based supervision and rely heavily on the corporate governance arrangements for insurance companies. Slovenia would be well-served by strengthening of the corporate governance of the sector before EU-wide competition and regulatory requirements impose the same.

To improve governance of the sector, five key measures are recommended:

1) For Government-controlled companies such as Triglav, the Government could consider the sale of its holding, issuing an IPO for 10 to 25 percent of the shares, and obtaining international credit ratings;
2) Supervisory boards of insurance companies should be strengthened with increased accountability and be compelled to create internal committees such as audit committees, thereby invoking the authority provided under the new Companies Act;

3) Insurance companies--both large and small--should be required to establish risk management functions responsible for periodic reporting on the company's measures for risk monitoring, management and mitigation and develop contingency plans;
4) To prepare for the introduction of Solvency II, the Insurance Supervisory Agency should start to introduce consolidated risk-based methods of supervision; and
5) The financial regulators could review measures to ensure consistent supervision of the financial sector and avoid opportunities for "regulatory arbitrage" by market participants.

Background

In recent years the World Bank has reviewed the corporate governance of banks and insurance sectors in many countries as part of the joint IMF-World Bank Financial Sector Assessment Program (FSAP.) Throughout the emerging markets, but particularly in the transition and post-transition countries of the Europe and Central Asia Region, governance has consistently proved to be one of the weakest elements identified in the financial sector. Looking to take a more detailed and structured approach, the World Bank recently started a pilot program to develop templates containing sets of good practices that would assist in a diagnostic review of corporate governance of key parts of the financial sector--banks, insurance companies, collective investment funds and private pension funds. All four diagnostic reviews were prepared for the Czech Republic as the first country in the pilot program.[1] The insurance governance diagnostic review for Slovenia is one of two pilot financial sector governance reviews prepared by the World Bank at the request of the Slovenian Government. The other diagnostic review involves collective investment funds.

This diagnostic review has three objectives to: (1) improve the description of good practices related to governance of insurance sectors, (2) conduct an diagnostic review of Slovenian insurance governance against these benchmarks, and (3) provide recommendations on ways of further improving the corporate governance of the Slovenian insurance sector. A summary of recommendations is presented in Annex I and the good practices and detailed review in Annex II.

The report is based on a visit by a World Bank team to Slovenia from May 10 to May 24, 2006. The Bank team met with officials from the Ministry of Finance (MOF), the Insurance Supervisory Agency (ISA), the Slovenian Insurers Association, the Slovenian Consumer Protection Office, SOD (Slovenian restitution fund) and KAD (Slovenian pension fund), the large insurance and reinsurance companies including, Triglav, Sava Re, AdriaticSlovenica, Maribor, Vzajemna, and leading law and audit firms and the actuarial profession.

The review consists of two main sections supported by two annexes. The first section, background, provides a description of the methodology employed, the key arguments for the importance of analyzing governance of the insurance sector, an overview of the insurance sector in Slovenia and a description of the Slovenian legal framework for the sector. The second section, key findings, presents the findings and recommendations of the reviewing focusing on four key issues that relate to the governance of the insurance sector: (1) ownership structure and transparency, (2) supervisory boards, (3) risk management, and (4) insurance supervision. Annex I provides a summary list of the recommendations presented in the review. Annex II presents the detailed analysis and recommendations based on the set of good practices.

The final report should be seen as no more than a “work-in-progress.” Nevertheless, it is expected that it will play a useful role in contributing to guidelines for strong corporate governance of insurers in both developed and emerging markets. It could also lay the basis for further governance-based reforms of the Slovenian insurance sector and provide a baseline diagnostic review for measurement of the reforms. Implementation of some of the report’s recommendations may require revision to legislation, including changes to the Companies and Insurance Acts. Other recommendations may be relevant to the planned financial sector reform program. It should be emphasized that this report presents the view of an outside institution and leaves it to the Slovenian authorities to decide if (and how) the recommendations should be implemented.

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[1] A copy of the reports on collective investment funds and insurance governance can be downloaded at www.worldbank.org/capitalmarkets

Methodology

The corporate governance good practices for insurance companies have been drawn from a wide range of materials in addition to the pilot diagnostic review carried out for Slovenia. These include guidance notes and the international core principles prepared by the International Association of Insurance Supervisors (IAIS), the various OECD Corporate Governance Principles and various national codes on corporate governance. The April 2005 OECD guidelines for insurance governance provided valuable input, as did the European Commission's Action Plan to modernize company law and enhance corporate governance in the European Union (EU.) In addition, the Commission's February 2005 Recommendations on strengthening the role of non-executive or supervisory directors (2005/162/EC) provide useful suggestions on the role of supervisory boards, the independence of non-executive board members, the structure of board committees and minimum training requirements for board members.[2] The template, including the set of good practices, has been transmitted to the IAIS, which has stated its intention to examine the topic of corporate governance of insurance sectors.

Importance of Corporate Governance in the Insurance Sector

A sound corporate governance framework ensures that corporate insiders do not use their privileged position to exploit other stakeholders, notably small minority shareholders, creditors such as lenders, and in the case of insurance companies, policy-holders. La Porta et al have noted that "the empirical evidence rejects the hypothesis that private contracting is sufficient". In addition, La Porta el al cite evidence that "insiders in major firms oppose corporate governance reform and the expansion of capital markets. Under the status quo, the existing firms can finance their own investment projects internally or through captive or closely connected banks. Poor corporate governance delivers the insiders not only secure finance, but also secure politics and markets. Thus they have an interest in keeping the system as it is."[3]

The main weapons in ensuring an equitable distribution of power and rights between the various stakeholders in an enterprise are judicially enforced law and government enforced regulation, supported by adequate levels of disclosure and transparency. The challenge is to introduce regulation that has sufficient scope but at the same time does not become an excessive cost for business. It is also important that the courts and regulatory/supervising processes cannot be captured by insiders for their own benefit.

In the early stages of development, the insurance sector is often seen as a commercial enterprise. The primary insured parties are industrial firms and entrepreneurs. At this stage, relatively light regulation and oversight of the insurance companies is all that is needed. However the situation changes once compulsory classes of insurance are introduced. When motor third party liability insurance is required for all automobile drivers and major liability classes of business have been introduced, the public at large starts to rely on insurers for significant sums of money in the event of an accident or tort. At this stage, high standards of governance of insurance become necessary. The stakes rise further when life insurance and pensions become common and the public invests its long-term savings, including retirement incomes. At this latest stage, the government has an obligation to ensure that insurers and pension providers follow high standards of corporate governance, and risk management in particular. Slovenia is well into this final stage.

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[2] A copy can be downloaded at
http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2005/l_052/l_05220050225en00510063.pdf

[3] La Porta, Rafael et al., *Investor Protection: Origins, Consequences, Reform*, World Bank, 1999

All insurance companies--but particularly life insurers--are obliged to meet long-term obligations. Policy-holders expect that when payments fall due, sometimes 40 years or more after the policy was purchased, the insurance company will have the financial resources to fulfill its obligations. The establishment of adequate technical provisions and the accumulation of sufficient reserves is thus a critical element of sound insurance financial management. The calculations are based on complex assumptions involving mortality rates, allowance for future expenses, lapse and discontinuance rates and future investment yields. As a result, standard corporate accounting and financial reporting make it difficult to gain appropriate insights into the financial position of a life insurer. Insurance policy-holders are thus dependent on the ability and inclination of management, and the insurance company's oversight board, to take conservative and prudent risks and have sound capital management. In addition policy-holders depend on the willingness and ability of key shareholders to contribute additional capital when needed—and the insurance industry to ensure that all key shareholders have the willingness and capacity.

Strong governance in the insurance sector requires two lines of defense. The first line of defense consists of the internal organs of the company—its management, the systems of risk management and internal controls, the company's actuary and the company's supervisory board that should have oversight of them all. More than most financial activities, life insurance requires that management and directors of insurance companies find a trade-off among the rights of various constituencies and stakeholders. In a number of countries, the law makes it clear that life insurance company directors have an overriding responsibility to policy-holders. External measures provide the second line of defense. The external measures cover both the supervising authority that oversees the insurance companies and market mechanisms that monitor and influence the sector. Both lines of defense are needed to ensure a high level of transparency and accountability in the sector. Furthermore the burden on the supervisory authority is significantly reduced if the companies' internal governance arrangements are strong, or where the market provides an effective form of discipline over the insurance companies.

Corporate governance is therefore a vital part of the formal supervisory framework for the insurance sector. The IAIS Core Principles point to the specific governance issues which apply to insurance enterprises:

"In most jurisdictions corporate governance rules exist for general purpose corporations; these likely also apply to insurers. Often, however, it is necessary to establish additional requirements, through insurance legislation, that deal with the matters of specific concern and importance to insurance supervisors. These matters are described in the criteria below. As the supervisory authority may not have the power to specify the details of general corporate governance rules or to enforce compliance, several criteria under this principle refer to the responsibility of the board of directors rather than requirements from the supervising authority."[4]

Key criteria relevant to the insurance sector are as follows:

- The supervisory authority requires and verifies that the insurer complies with applicable corporate governance principles.

    - The supervisory board satisfies itself that the insurer is organized in a way that promotes the effective and prudent management of the institution and the board's oversight of that management. The supervisory board has in place and monitors independent risk management functions that monitor the risks related to the type

[4] Paragraph 9.3. IAIS Core Principles, October 2003

of business undertaken. The supervisory board establishes audit functions, actuarial functions, strong internal controls and applicable checks and balances.[5]

- The supervisory board is able to carry out its functions in an objective and equitable manner. The supervisory board has access to information about the insurer, and asks for and receives any additional information and analyses that it needs.

- The supervisory board communicates with the supervisory authority as required and meets with the supervisory authority when requested.

- The supervisory board identifies officer(s) with responsibility for ensuring compliance with relevant legislation and required standards of business conduct and who reports to the board at regular intervals.

- When a "responsible actuary" is part of the supervising process, the actuary has direct access to the supervisory board or a committee of the board. The actuary reports relevant matters to the supervisory board on a timely basis.

The IAIS Core Principles make it clear that the supervisory board of directors performs a distinct overview role separately from the responsibilities of senior management of an insurer. Recent events in countries with Civil Code legal systems, such as Germany and Austria[6], have demonstrated that such responsibilities are entirely consistent with Civil Code systems.

Effective regulation of corporate governance involves finding the right balance. Too many rules will discourage the entrepreneurial spirit that drives a dynamic corporate sector and can result in an unhealthy compliance burden. Too few rules open the door to abuse and corporate fraud. Each country must find the balance appropriate to the level of financial sector development, the local business culture and the agreed objectives for further development.

The diagnostic review suggests measures that would help to prevent corporate governance abuses in the Slovenian insurance sector, while optimizing the regulatory burden. In particular the diagnostic review employs a market-based approach to supervision and governance, as epitomized by the Basel II approach to bank risk management and the insurance Solvency II model that is currently being developed. Such a market-based approach sees supervisors focusing on ensuring that insurance companies have adequate economic capital and internal controls, that company balance sheets have sufficient transparency, and enlightened market conduct rules are in place and functioning well.

Legal Foundations

Corporate governance is a relatively new concept in the Slovenian insurance sector and is largely manifested through the risk management requirements specified in the Insurance Act and supporting regulations. Under the Slovenian legal system specific law overrides general law. Hence the Insurance Act prevails over the Companies Act where there is contradiction.

Relevant law and regulations are:

[5] The EU has tried to overcome the problem of terminology relating to bicameral boards versus single boards by reference to a functional approach. Under the EU terminology, the supervisory board assumes ultimate responsibility and monitors that appropriate audit functions, actuarial functions, strong internal controls and applicable checks and balances are established.
[6] See for example, the 2003 German Corporate Governance Code (The Cromme Code) and the 2002 Austrian Code of Corporate Governance. Both can be downloaded http://www.ecgi.org/codes/all_codes.php.

- Insurance Act

  The Insurance Act was passed on 27 January, 2000. It was amended in 2002 and extensively in 2004 (Official Gazette of the RS, No 102/04)

- Regulations

  ISA has issued 28 regulations. The first tranche, passed in 2004, consisted of nine regulations stipulating detailed rules for meeting prudential standards. The three other tranches, which were implemented in 2005-06, regulate reporting to the ISA, actuarial matters and insurance intermediaries.

- Other Legislation

  - Compulsory Motor Third Party Liability Act (2002, 2005) relates to damage caused to third parties by motor vehicles, public transport, aircraft and ships.
  - Health Care and Health Insurance Act (2000, 2005) sets the framework for health care and health insurance, both compulsory and voluntary.
  - Pension and Invalidity Insurance Act (2000) regulates the supplementary pension and invalidity insurance of persons covered by compulsory insurance.
  - Companies Act (CA) sets out the basic legal framework.
  - Act on Financial Conglomerates (2006) sets the rules for financial conglomerates.
  - Financial Operations of Companies Act (1999) sets fiduciary rules for board members of companies that are insolvent or bankrupt.

In addition, the Managers' Association of Slovenia (MAS) has prepared a voluntary Code of Corporate Governance for commercial enterprises, but no specific code has yet been prepared for the insurance sector. Also in 2005 the Slovenian Insurance Association published a book on insurance governance with emphasis on internal auditing.

Slovenia continues to enact legislation rapidly in order to harmonize its legal framework with the EU. This process is anticipated to continue.

Overview of the Insurance Sector

In recent years, the insurance sector in Slovenia has grown substantially although it still remains weaker than in other EU member states, such as Germany. Table 1 shows the standard measures of penetration and density (premium income as a percentage of GDP and premium income per capita respectively) in Slovenia compared to Germany. Table 2 provides similar data compared to European averages. Note that the significant growth achieved in density in 2004 must be viewed with some caution, as 60 percent of the growth in Slovenia can be attributed to the appreciation of local currency against the US dollar.

Table 1: Comparative Insurance Penetration & Density

	2000		2002		2004		2005	
	Slovenia	**Germany**	**Slovenia**	**Germany**	**Slovenia**	**Germany**	**Slovenia**	**Germany**
Premium Income as % of GDP	4.5	6.8	4.8	7.0	5.1	7.0	5.65	6.79
Premium Income per Capita (USD)	444	1,719	564	1,950	810	2,287	978.1	2310.5

Sources: Swiss Re. Sigma No 5/2006; SIGMA annual surveys, Slovenian Insurance Association

While Slovenia's insurance sector has achieved significant growth, it continues to lag behind other EU member states. Table 2 illustrates that the Slovenian market is not as efficient as that of the EU-25 countries—and that opportunities exist to expand the market.

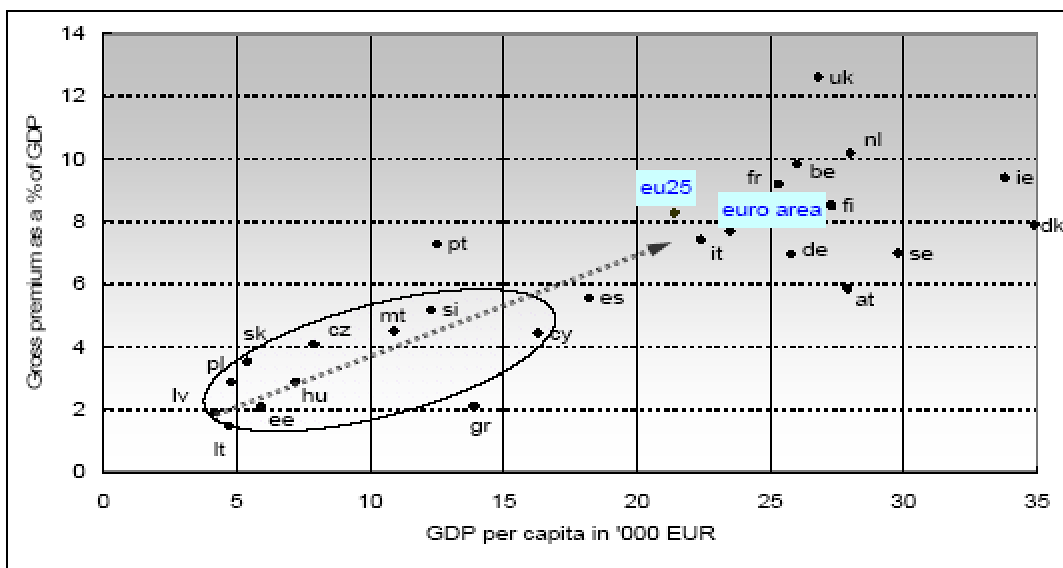
Table 2: Comparative Analyses with the European Union

	Slovenia	European Union 25 (average)
Premium Income as % of GDP	5.7	8.5
Premium Income per Capita (Euro)	774	1,897
Average Premium per Insurance Company (Euro million)	103	187
Average Premium per Insurance Employee (Euro thousand)	263	981

Source: Slovenian Insurance Association
Data refers to Slovenia in 2005, EU in 2004.

Consistent growth in the sector can be expected for an extended period, based largely on the need for voluntary long-term savings through life insurance and pension products, as increasing demographic pressures reduce replacement rates under the PAYGO pension system (covering the mandatory "first pillar".) This trend is borne out by developments of the sector in other EU countries.

Figure 1*: Premium Income & Economic Development in the EU*



Source: European Commission, *Financial Integration Monitor 2005, Background document*

While the Slovenia insurance industry is still relatively small, it is already becoming a significant capital market player, as seen in recent insurance/ banking comparatives.

Table 3: Forms of Household Financial Assets

SIT Billion	Household deposits at banks	Shares and bonds	Mutual Funds	Investments abroad	Life Insurance	Supplementary pension insurance	Total financial " assets"
Dec. 00	1,274	468	10.7	0.7	-	-	1,753
Dec. 01	1,731	603	14.7	1.4	123.8	6.2	2,480
Dec. 02	1,944	727	55.4	4.6	179.0	24.7	2,935
Dec. 03	2,097	804	93.1	12.1	221.9	48.9	3,277
Dec. 04	2,292	891	210.2	29.0	276.0	95.4	3,793
Dec. 05	2,418	817	331.9	81.5	326.2	141.9	4,117

Source: CSCC, SMA, Bank of Slovenia, ISA, AMC

The insurance sector acts as a significant investor in the bond market, although this is declining as alternate uses are found for investible funds of insurance companies.

Table 4: Fixed Income Securities

SIT Billion	**2000**	**2002**	**2004**
Fixed Income Securities held by Insurance Companies	98.6	210.5	326.3
Market Capitalization of Slovenian Listed Bonds	255.0	690.7	1,106.6
Fixed Income Securities as % of Bonds' Capitalization	38.7	30.5	29.5

Sources: Ljubljana Stock Exchange, Insurance Supervision Agency

The number of insurance companies operating in Slovenia was relatively stable from 2000 to 2004, although two new companies started in 2004 (and another three in 2005.) Most companies are composite life and non-life insurance companies.

Table 5: Current Types of Insurance Companies

	2000	**2002**	**2004**	**2005**
Total	11	11	13	14
Of which: life	1	1	0	1
non-life	1	1	4	6
composite	9	9	9	7

Source: Insurance Supervision Agency

The Slovenian insurance market is highly concentrated. The four largest insurance companies write around 85 percent of premiums, with the largest insurer accounting for 43 percent. Three of the five largest companies represent almost 60 percent of the insurance market and are directly (or indirectly) controlled by the Government through its restitution fund (SOD) and pension fund (KAD.) If health insurance were not taken into account (since health insurance is neither "life" nor "non-life" insurance in the narrow definition of insurance), the three Government-controlled companies would represent 73 percent of the market. None of the Slovenian companies has either debt or equity traded on the Ljubljana Stock Exchange or listed on a foreign stock exchange.

Table 6: Ownership of Major Insurance Companies

	Direct Shareholding Structure	Ultimate Shareholding Structure	Business	2005 Premiums written (SIT billion)	Market Share %
Zavarovalnica Triglav, d.d.	SOD 45.68% KAD 35.22% Diversified owners 13.25% Others 5.85%	Republic of Slovenia	Life & Non-Life	148.0	42.9
Vzajemna zdravstvena zavarovalnica, d.v.z.	Mutually owned	Policy-holders	Health	55.2	16.0
AdriaticSlovenica, d.d.*	KD Holding 92.95% KD ID (investment company) d.d. 6.72% Others 0.33%	Bank Austria Creditanstalt AG (Austria) DRI d.o.o. (Slvovenia) Hypo-Alpe-Adria Bank (Liechtenstein)	Life & Non-Life	48.0	13.9
Zavarovalnica Maribor, d.d.	NKBM (bank) 49.96% Sava Re (reinsurer) 45.79% Probanka 2.60% Others 1.65%	Republic of Slovenia	Life & Non-Life	45.2	13.1
Zavarovalnica Tilia, d.d.	Sava Re 99.60% Others 0.40%	Republic of Slovenia	Life & Non-Life	11.7	3.4
Others (9 companies)				37.3	10.7
Total				345.4	100

* - Adriatic, d.d. (9.7%) and Slovenica, d.d. (5.5%) merged in late 2005.

Sources: Report on Business Performance of the Insurance Industry in 2005, Insurance Supervision Agency Annual Report; KDD database.

For most Slovenian insurance companies, the ownership structure is clear and transparent. However for AdriaticSlovenica, the ultimate owners include a limited liability company, for which the ultimate shareholding structure is not publicly disclosed.

The Insurance Act specifies that newly licensed insurance companies may offer either life or non-life insurance products, but not both. However in 2000 when the Insurance Act was approved, most Slovenian insurance companies offered both products. The composite companies were grandfathered but under strict rules. They are obliged to keep separate accounting records for their life and non-life businesses. Composite companies must also separate the assets backing reserves for life insurance policies from those backing non-life policies.

The Insurance Act defines the types of assets which can be held by insurance companies to support technical provisions on minimum reserve capital. The rules have been amended twice and are complex. They are summarized in Table 7.

Table 7: Permitted Types of Assets and Limits on Technical Provisions

	Type of Asset	Maximum Proportion on Technical Provisions
1.	Securities issued by the Republic of Slovenia, the Bank of Slovenia, a Member State, an OECD Member State, an international financial organization or an entity for which one of the former acts as guarantor	Investments in securities of the same issuer in items 2 to 5 and 7 to 9 must not exceed 5%.
2.	Bonds or other debt securities traded on an organized securities exchange in Slovenia or a member State or an OECD Member State	Investments in securities in items 3 to 5 must not exceed 10% in total. They may reach 40% if they are subject to special public supervision, are issued by bank with registered office in Slovenia or a member state, or allow the settlement of liabilities arising on their basis throughout the entire period until their maturity.
3.	Bonds or other debt securities not traded on an organized securities exchange, if they are issued by a legal entity whose head office is in Slovenia, member State or an OECD Member State	Investments in item 3 must not exceed 1%.
4.	Shares traded on an organized securities exchange in Slovenia or a member State or an OECD Member State	Items 4,5 and 6 must not in total exceed 30%.
5.	Shares not traded on an organized securities exchange, if they are issued by a legal entity whose head office is in Slovenia, member State or an OECD Member State	Investments in securities of the same issuer in item 5 must not exceed 1%, and 5% in total.
6.	Investment coupons of mutual funds or shares of investment companies which only place their assets in securities in order to spread and restrict risks	Covered above, if investment fund rules require more than one-half of investments in securities having guaranteed return, 40% in total.
7.	Claims arising from loans collateralized by a mortgage on real estate, and it the claim does not exceed 60% of the value of real estate as appraised by an expert appraiser	No reference
8.	Claims arising from loans given to banks whose head office is in Slovenia, member State or an OECD Member State and whose payment is guaranteed by a bank whose head office is in Slovenia, member State or an OECD Member State	No reference
9.	Claims arising from loans collateralized by a lien on securities referred to by items 1,2 and 4	No reference
10.	Claims arising from other loans collateralized appropriately	2% each, 5% in total
11.	Advance payments with regard to the surrender value of insurance policies, collateralized by the surrender value of those insurance policies	No reference
12.	Immovable property, if the purchase price was appraised by an expert appraiser, free of all burdens, except material use	30% in total, with a maximum of 10% in any one property
13.	Investments in deposits held by a bank whose head office is in Slovenia, a Member State or an OECD Member State	30% in total, with a maximum of 10% in any one bank
14.	Cash in hand or sight deposits	3%
15.	Derivatives	Allowed for risk management purposes and effective portfolio management

Source: Insurance Act 2000, amendments

Key Findings & Recommendations

The Slovenian insurance industry has made a number of significant advances in improving the transparency of the sector. Corporate websites provide detailed information on the company and its financial results. In addition, the insurance association has appointed an ombudsman who deals with customer queries and complaints. However the sector is still evolving and not yet fully equipped to compete in an open market environment.

Four key issues are highlighted.

1) With almost 60 percent of the sector's equity held by parastatal agencies, the sector is largely exempt from the corporate governance disciplines of the market, notably the market for corporate control;
2) In well-governed insurance sectors, company supervisory boards are regarded as an essential element in maintaining strong corporate governance but they are ineffective in Slovenia;
3) Risk management is practiced by the insurance companies but the full array of risks is not systemically monitored, measured or mitigated; and
4) The supervisory agency relies on compliance-based supervision (rather than risk-based supervision as will be required under Solvency II) and fails to fully recognize the need for strong and effective corporate governance.

Ownership Structure & Transparency

The primary issue for corporate governance of the Slovenian insurance sector lies with the Government control of the sector. Through the parastatal agencies, SOD (restitution fund) and KAD (pension capital fund), the Government owns 59 percent of the sector as seen in Table 8.

Table 8: Government Holdings in Insurance Sector

Company	Asset Share	Government Ownership
Triglav	43%	77% by SOD & KAD
Maribor	13%	97% by Sava Re (owned 99% by SOD) & SOD
Tilia	3%	99% by Sava Re (owned 99% by SOD)
Total	59%	

Both parastatal funds, SOD and KAD, are *de facto* financial conglomerates. Together they have holdings in several hundred companies. Each has more than 20 percent shares in more than 20 major corporations, including in the largest insurance company, Triglav.

By charter, SOD will be phased out and its holdings sold no later than 2016. KAD will continue to invest in securities, as needed to meet its pension obligations. One area of concern is KAD's intention to create its own insurance company and thus act as a competitor to the existing insurance companies in the market. It would be best if both KAD and SOD were to divest their holdings of insurance companies and withdraw from control of the sector. If some shareholdings are needed for investment purposes, the maximum holding (for KAD and SOD combined) could be limited to a minority shareholding, for example, 25 percent of the voting shares of any company.

A still greater problem is the lack of clarity of the ownership structure of Triglav. After many years of court cases, decisions by the Constitutional Court, complicated legislation, widely varying corporate valuations and endless discussions, the ownership structure of Triglav remains less than fully defined. About one-third of Triglav's voting shares are held by a group of legal persons who purchased insurance policies in 1991—and whose identity is not yet clear.

While much success has been achieved in maintaining a stable and viable insurance sector in Slovenia, continuing holdings by parastatal agencies and insufficient private sector competition have taken their toll. Compared to peer countries, historical returns on equity of the major Slovenian insurance companies have been inadequate, expense levels high and efficiency low. For example, Triglav's official target of 10 percent pre-tax return on equity lies substantially lower than the target after-tax returns of 12 to 16 percent by the international insurance companies, almost all of whom are listed on stock exchanges. Such low profit objectives suggests that the company lacks a sufficiently competitive approach—or that the company is run largely for the benefit of management and staff rather than its shareholders. To encourage management to operate as efficiently as possible, owners should set performance targets in line with those of the international insurance companies. (Government owners, including banks regarded as "strategic partners," rarely put such pressures on managers.)

To impose full market disciplines on the sector, it would be preferable if the equity shares of Triglav were listed and publicly traded. Triglav could seek to list, by means of an initial public offering (IPO) of shares, a minority share such as 10 to 25 percent of the company's equity. [7] In order to gain international institutional investors, this IPO could be achieved by means of a "book build," through both the Ljubljana Stock Exchange and an international stock exchange such as London or Frankfurt. A stock listing would accomplish several objectives. It would require that Triglav follow the transparency requirements of a public listing. It would also establish a fair market price for Triglav's equity shares—thus facilitating negotiations with a future strategic owner. It would also set a market price as a basis for negotiations with existing shareholders who may wish to sell their shareholdings.

Both Sava Re (owner of the fourth and fifth largest companies, Maribor and Tilia) and Triglav have the potential to become financial conglomerates operating both in Slovenia and regionally. However to do so, both companies need stable ownership able to assist them in introducing modern information and product distribution systems, prepare them for competition from companies in the EU and, most importantly, help them raise future capital. Sales of parastatal holdings in both companies could provide such stable and effective owners.

In addition, the Sava Re Group will likely need to be restructured, preferably as a newly established holding company. Tilia could be merged with Maribor and the group divided into separate companies for life insurance, non-life insurance and reinsurance. Eventually the Sava Re group could seek an international strategic partner, or list via IPO in a similar manner proposed for Triglav.

To further increase transparency of the insurance sector, four measures are also recommended:

1) Triglav could take steps to obtain credit ratings from international credit rating agencies.

[7] With a less than fully clear ownership structure, an IPO for Triglav will no doubt have some complications. For example, consideration will need to be given to methods of ensuring that the pre-emptive rights of existing shareholders are maintained (i.e. that they have the opportunity to participate in a new equity issue). The prospectus will also need to include a discussion of any ownership uncertainties. However it is expected that such issues can be resolved with adequate disclosure and, if necessary, a set-aside of a portion of equity shares for future owners.

2) In order to make the companies attractive to institutional shareholders, insurance companies should also adopt international financial reporting standards as soon as possible, rather than waiting for the requirement to be imposed in 2007.

3) Whether listed or not, Slovenian insurance companies should be required to prepare annual disclosure statements of their compliance (or lack thereof) with the Corporate Governance Code of the Ljubljana Stock Exchange.

4) Insurance companies should be obliged to publicly disclose all ultimate significant and controlling shareholders.

Supervisory Boards

The corporate governance scandals of recent years—and the collapse of several major international insurance companies—have highlighted the need for strong and effective supervisory boards with clear accountability to their stakeholders. Corporate governance and risk management should be overseen by the company's supervisory board, which should ensure that management follows company's corporate governance principles and ethical standards and that robust risk management systems are in place. While the management board plays a critical role in the day-to-day operations, the supervisory board should be the ultimate authority on all corporate matters, including approving the corporate strategy.[8]

In Slovenia, the functions performed by the supervisory board vary considerably from company to company. Insurance companies are managed by management boards, which are generally accountable to the supervisory boards. However Slovenian supervisory boards are not endowed with the wide ranging levels of authority associated with boards of directors from Anglo Saxon economies or supervisory boards in western European markets. In many cases, the “real” authority of an Slovenian insurance company lies with the management board, which operates under direct instructions from the company's owners. Reflecting the minimal role of supervisory boards, the published annual reports of Slovenian insurance companies include pictures and profiles of members of the management board, but not of the supervisory board.

Members of supervisory boards have clear fiduciary duties set by statute. The Companies Act says that members of both management and supervisory boards must conduct their duties with the carefulness of a conscientious and honest manager and must protect the business secrets of the company. The Insurance Act provides for similar provisions. In addition, all board members are subject to the Financial Operations of Companies Act that provides for personal liability in case a company becomes insolvent or bankrupt. However the law does not state that supervisory board members have a specific responsibility to policy-holders of insurance contracts.

However in practice, the provisions are largely ineffective and supervisory boards play only a limited role in the governance of insurance companies. As evidence of the weakness of the awareness by supervisory boards of their statutory duties, the Bank Team found that in all but one of the insurance companies visited, none of the supervisory board members had purchased directors and officers (D & O) liability insurance. Only one company had acquired D & O

[8] Recent amendments to the Commercial Code will permit companies to choose between a single tier or dual tier board structure, although implementation in insurance companies would require similar revision to the Insurance Act. If a single-tier board structure were put in place, consideration should be given to further developing the concept of “independent” (i.e. non-executive) board members.

insurance for the members of the management board and even that company had no D & O insurance for supervisory board members.

One weakness lies with the law. The Insurance Act makes the company's supervisory board responsible for the adequate functioning of internal controls and compliance with the capital adequacy requirements. However the law does not require that supervisory boards be responsible for the satisfactory functioning of the company's corporate governance regime, including its risk management function.

Another problem is that supervisory boards have little direct access to information and must rely almost entirely on reporting from management. The only other source of direct information is the internal auditor, who reports in person to the supervisory board twice a year. Formal contact between the supervisory board and the appointed actuary and the external auditors is confined to receiving their annual reports. Generally neither the appointed actuary nor the external auditor is present at the supervisory board meeting to provide verbal explanations or to respond to any queries.

Furthermore supervisory boards have no legal obligation to create board committees, such as audit committees. The Bank Team found that the supervisory boards of none of the major insurance companies had audit committees or remuneration or other committees as suggested by the Ljubljana Stock Exchange's Corporate Governance Code—and international good practice.

Nevertheless supervisory board members are adequately compensated with fees of around 500 Euros per meeting, with as many as ten meetings a year. In addition, supervisory board members generally receive a bonus based on the company's annual profits. Such profit-sharing is a violation of the oversight role of the supervisory boards and should be discouraged. (The Ljubljana Stock Exchange Code also recommends against such incentive schemes.)

Another weakness is the opaque way in which supervisory board members are selected and then elected by the shareholders' meeting. In theory, members of the supervisory board are appointed at the company's annual general meeting. However in an industry that is largely Government-controlled, it is unclear what criteria are used by the owners to select supervisory board members or evaluate their performance or choose new board members.

In addition, Slovenian insurance companies have no independent directors, i.e. directors that are free of conflicts of interest. Furthermore one third of supervisory board members represent employees, creating substantial conflicts of interest for the employee representative on supervisory boards. By contrast, the banking legislation prohibits employees from electing representatives to the supervisory boards. The argument is that, as financial institutions, banks are too sensitive to allow employee representation. The same provisions should apply to insurance companies.

To strengthen the legal framework and practices of supervisory board members for insurance companies, several measures are recommended:

- The statutes of Slovenian insurance companies should be revised to clarify that the management board is fully accountable to the supervisory board. This company's statute and other information on corporate governance arrangements should be made available to the public at large, including through the corporate website.

- Members of the supervisory boards should have explicit responsibility for the company's compliance with corporate governance principles and should have direct fiduciary obligations to policy-holders set by law.

- Supervisory boards should be required to form committees for auditing and internal controls, financial reporting, and risk management.

- Supervisory board audit committees should be responsible for the company's relationship with the company's external auditors, including the selection of the auditing firm. The audit committee should also conduct periodic meetings with the external auditor, including some meetings without the presence of management.

- Supervisory boards should make their financial decisions with full information received both from management and the company's appointed actuary.
    - The appointed actuary should be required to prepare a financial condition report meeting minimum criteria such as those of the American Academy Standard of Actuaries No. 19. A financial condition report would provide members of the boards with detailed information about the insurance operations and relevant trends. It would also estimate if the company's investments were expected to be sufficient to cover the company's short and long-term obligations to policy-holders.
    - For companies with life insurance obligations, the appointed actuary should be legally obligated to present the report to the supervisory board at least once annually before the accounts are approved and before dividends are declared. The actuary should present the report in person and highlight the report's key findings.

- Consideration should be given to measures to require that a minimum number of directors be part of insurance company supervisory boards.

- It would be better if employees were not permitted to elect representatives to the supervisory boards of insurance companies.[9]

- Supervisory board members should not be eligible for profit-sharing bonuses.

- Supervisory boards should be encouraged to obtain D & O liability insurance (and may be reimbursed for the expense.)

- The professional experience and academic training of supervisory board members should be published, including any ownership or control of other financial institutions in Slovenia and outside the country.

In addition, the capacity and technical expertise of supervisory board members should be strengthened. The Slovenian insurance industry could put in place programs to "fast track" the quality of supervisory board members. This can be achieved by means of appointing only directors with a high quality of relevant education by strict application of the requirements stated by the insurance act, and subsequently insisting on continuous and accelerated professional training programs for them. The Slovenian Insurance Association could also provide training for supervisory board members on corporate governance issues.

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[9] However the recommendation may be difficult to implement. The Bank Team was advised that such a prohibition was found to be unconstitutional by the Slovenian courts.

Risk Management

Risk management refers to the management, monitoring, and mitigation of all inherent risks of an insurance company. In carrying out its operations, insurance companies face an array of risks, which, if unchecked or badly monitored, can lead to large financial losses and even corporate insolvency. The procedure for insurers in developed economies is to identify all risks, manage them in the department in which they occur, and monitor them through a risk manager, whose sole responsibility lies with monitoring all risks. The risk manager's role is similar to that of an internal auditor. (Indeed frequently the internal auditor reports to the risk manager.)

In general, eight key inherent risks need to be managed by insurance companies.[10]

- Insurance Risk

  Insurance risk relates to the types of insurance products the company writes. Some products have much a lower insurance risk than others. For example, products involving many small policies such as household contents insurance are much less risky--systemic events excepted--than products which insure single large risks such as commercial buildings or multi million dollar life insurance policies. Similarly policies with a short duration during which claims can be made (for example, auto insurance) are much less risky than policies where claims can be made for a number of years after the insured event (for example, professional indemnity insurance.) The relative risks are reflected in varying levels of capital which the insurer needs to hold. The higher the risk, the greater amount of capital required to support those risks.

- Operational Risk

  Operational risk refers to all the risks associated with the operating units of an insurance company, such as the underwriting, claims and investment departments. Each department has its own risks which must be managed. For example, when writing a high value life insurance contract, the underwriting department must accept (straight out or with exclusions), decline, or load (accept a risk but charge more for it) the application in accordance with strict internal guidelines. Cross-checks need to be in place to ensure that internal guidelines are duly followed.

- Liquidity Risk

  The company must ensure that it can draw on sufficient cash to meet its liabilities, which are primarily payments of claims and benefits to policyholders. The company must have processes in place to convert investments and other assets into sufficient cash, as needed to meet its liabilities.

- Strategic Risk

  Any strategic initiative carries risks, which must be identified and quantified. Corporate strategies can involve low risk levels (for example, remaining in the same market or distributing the existing product range) or they can involve elements of high risk (for example, purchasing a competitor or distributing a new and more risky product range.)

[10] Note that the definitions and structure of key risks differs somewhat from that of Solvency II. However regardless of how the risks are described, all eight risks will to be addressed to ensure a robust system of risk monitoring, management and mitigation.

- Contagion and Related Party Risk

  When an insurance company is a member of a large group of companies or a conglomerate, it is exposed to some of the risks of the group as a whole. In addition, under stress the owners of the group may divert capital and resources, including management, from the insurance company to other companies of the group. Such diversion may weaken the ability of the insurance company to meet its claims—or develop a long-term competitive strategy.

- Balance Sheet and Market Risk

  Balance sheet and market risk relate to the strength of the company's balance sheet and the degree of risk inherent in the investment portfolio. Low risk assets include government bonds from OECD countries, whereas company shares may be associated with a high risk category. Risk levels are further influenced by the quality of the individual investment, measured by credit ratings from independent ratings agencies.

- Counterparty Default Risk

  Insurance companies rely on being paid by third parties, including the company's reinsurers and investment counterparts. Counterparties may not be able to pay their ongoing obligations (for example, interest on a corporate bond or rent by a lessee) or they may not be able to meet their obligations on time. Also an investment may not be convertible into cash despite a legal obligation to do so (for example, a redeemable preference share) or such conversion to cash may not occur within the contracted time frame.

- Legal and Regulatory Risk

  Insurance companies run the legal risk of being sued for a denial of a claim. Insurers companies can take an aggressive stance on claims payments, leading to low claims payments and high litigation costs. Alternatively they make take a compliant position, which would lead to high claims payments but low litigation costs. Regulatory risk relates to the risk of the company's officers or its agents failing to comply with the rules of the industry regulator.

The Slovenian legal framework addresses two of the most important underlying elements of risk management—the reserving of adequate capital and the establishment of internal accounting controls. Capital adequacy and internal controls are clearly established by law and strong internal accounting controls and cross-checks are in place. Internal and external auditors and appointed actuaries all have reporting responsibilities to both supervisory boards and the ISA, if any irregularities are found. The Bank Team found that company managers, auditors, actuaries, and the ISA clearly understood the legal requirements.

However the Slovenian approach is a traditional one that fails to adequately consider the increasingly volatile and unstable nature of risk in the international capital and financial markets. Traditionally Slovenian insurance companies have relied on levels of capital (in excess of operating requirements) and internal accounting controls to address risk exposures. However the traditional approach leaves companies vulnerable with either uncompetitive pricing or terms for their insurance products or insufficient capital for the long-term.

Risk-based systems would minimize this vulnerability. Risk-based management consists of a complex process of tracking each of the risk categories and managing them at both the operational level and through a centralized risk management function. Risks continuously change. For example, a single insurance company investment, such as an equity shareholding in a listed company, can be downgraded by a ratings agency. The risk management system needs to be able to monitor such risks and take action as needed.

Risk-based management—which would attempt to control all eight risk categories noted above--is not commonly practiced in the Slovenian insurance sector. None of the insurance companies interviewed had a full time risk manager on staff although Triglav had recently appointed an internationally experienced risk manager. However it seems unlikely that insurance companies, such as Triglav, would retain their current business models if a full risk management approach, including appropriate capital requirements, were installed. For example, if insurance companies were obliged to use the same capital reserving for risks as banks, it is unlikely that the insurance sector would continue to accept retain credit risk from the banking system.

Furthermore the EU adoption of Solvency II for the insurance sector will require extensive revision of the risk monitoring and management systems of Slovenian insurance companies. The companies would be well advised to start the review process as early as possible.

To strengthen the risk management of Slovenian insurance companies, five measures are recommended:

1) Each of the major insurance companies should be encouraged to establish a dedicated risk management function which should monitor and manage the company's risks. The risk manger should periodically report to the supervisory board with details of each of the key risk categories: insurance risk, operational risk, liquidity risk, strategic risk, contagion and related party risk, balance sheet and market risk, counterparty default risk and legal and regulatory risk. The risk manager should also develop contingency plans to address problems if the risks materialize.

2) In determining the risk related to the balance sheet, investments, and counterparty defaults, management should be legally required to take into account, at a minimum, the international agency credit ratings for both direct investments and reinsurance companies. Preferably insurance companies should assess all legal and financial aspects of the reinsurer before it enters into a contract with a reinsurance company.

3) All insurance companies should be encouraged to begin preparing for Solvency II by running stress tests on their balance sheets and building advanced risk management techniques (e.g. ALM, duration analysis, VAR.) This may require international technical assistance.

4) Internal auditors should be made aware of the wide array of risk management issues, so that they begin to apply international approaches to reviewing the company’s risk management systems in conjunction with the company’s risk manager.

5) The Slovenian Insurance Association could strengthen its expertise in corporate governance, including risk management. Courses on corporate governance, including the insurance risks and risk mitigation strategies, would be added to the training agenda.

In addition, insurance companies should be required to conduct risk management of their purchases of loan portfolios from banks. Preferably mono line insurance companies for credit

insurance should be created with capital requirements equivalent to the relevant risk elements of the underlying banking products. Alternatively the credit insurance portfolio of the insurance companies should be reduced and eventually wound up. (Retail lending is one of the areas likely to be targeted by international banks entering the market given its historic profitability if managed appropriately.)

Insurance Supervision

The Insurance Supervisory Agency (ISA) performs the role of insurance industry regulator and supervisor. This role involves ensuring that insurance companies conduct themselves in accordance with the Insurance Act, applying sanctions where necessary, and monitoring insurance companies through both off-site data analysis and on-site inspections. The ISA also provides statistics, including a detailed annual report on the insurance industry as a whole. In addition, the ISA is actively involved in EU governance issues and devotes considerable resources to the EU Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS.)

The current regulatory and supervisory model for the Slovenian insurance sector was designed around tight control of the day-to-day operations of insurers. Such direct supervision was appropriate in the early days of the market's establishment but the supervisory structure is now in danger of missing the larger risk management picture. At the same time, such direct supervision adds significant compliance costs for insurance companies.

Shortcomings are evident in the ISA processes. On-site inspections are frequently carried out by rotation. The procedures used in such inspections are laid out in a manual jointly developed by the ISA and PricewaterhouseCoopers in 2002. This process relies on extensive checking of historical data. Internationally this approach has been largely replaced by risk-based supervision, which places heavy emphasis on identifying potential problems which might become major issues in future. The risk-based supervision approach was developed in response to the insolvencies and bankruptcies of major insurance companies throughout the world in the 1990s and early 2000s.

It would be preferable if the ISA were to adopt a risk-based supervision approach which would ensure that the risk associated with each insurance company is measured by use of objective methodology. The companies identified as "high risk" of potential failure would be supervised more closely and in a more focused manner than those of "low risk." The ISA would provide a strategic use of resources, concentrating on those elements of potential risk which are found to be unsatisfactorily controlled. To adopt risk-based supervision, the ISA would start by conducting a review of its activities, identifying those activities which add little or no value, and eliminating them, and replacing them with a methodology based on focused risk-based supervision. Risk-based supervision will become mandatory with the adoption of Solvency II and early adoption of risk-based supervision would help make a smooth transition.

To strengthen corporate governance the sector, it would be best if the ISA were take the lead by promoting good governance in the supervision process. Currently the decision making processes within the ISA are considered by the market to be opaque. Companies are not advised as to the methodology used in deciding which companies are to be inspected or determining the scope and depth for on-site inspections. When one company is investigated to a greater extent than another, the ISA is open to criticism of exercising favoritism. Also the reasoning behind official decisions, in particular on key controversial subjects such as license revocation, is not made public.

The ISA could adopt procedures to ensure that it operates transparently in its dealings with all stakeholders, including the insurance companies, policyholders, journalists and the public. All decisions affecting stakeholders would be disclosed in such a manner that they are seen to be open, fair and impartial.

1) Methodologies relating to on-site insurance company inspections would be clearly enunciated and published on the ISA website.

2) ISA's risk evaluation methodology associated with insurance companies would be made publicly available, particularly if the ISA adopts a risk-based supervision approach.

3) Subject to any restrictions in the privacy legislation, all official decisions would be published, accompanies by the reasoning for the decision to be provided–similar to a court decision rulings.

In addition, the ISA would advise the insurance industry that it has adopted risk-based supervision and would provide its new supervision parameters in some detail so that insurance companies can prepare themselves to be evaluated and investigated under this new approach.

To assist the market in understanding the insurance sector, analysts need substantial information on the key issues and developments in the sector. The information currently provided on the sector, and in particular on life insurance, is scant. As a starting point, the ISA could review the template of information provided in the ISA's annual report on the insurance industry. Consideration could be given to ensuring that meaningful and relevant data is provided in this report. Information could be provided by business line, premiums in force, new business, business discontinued, claims and surrenders, investment returns on mean assets, expenses, and mathematical provisions. It would be best if information were provided for each company rather than in aggregate form.

Five additional measures are also recommended.

1) As noted above, insurance companies should be required, by regulation, to establish audit committees within supervisory boards with an experienced director responsible for the risk management function. The ISA would then able to conduct focused reviews of internal controls by referring to committee members risk managers and without having to conduct a full on-site inspection.

2) The ISA could require that only the key annual returns be audited. The requirement to have all other returns audited could be dropped, which would lead to significant cost savings to the sector.

3) The ISA should strengthen its expertise and familiarity with IFRS in order to provide effective supervision of insurance companies using IFRS for their financial accounts.

4) The ISA could review cross-border issues arising from applications under the EU Single Passport rules to ensure that it maintains an overview of the whole market.

5) Consolidated supervision should be introduced for insurance companies that are part of financial or mixed financial-industrial conglomerates.

In addition, the regulatory and supervisory structure for the sector is in need of review. In total, Slovenia has three separate financial sector regulators covering banking, insurance, and collective

investments. The use of three separate regulators has served Slovenia well to date. However a number of developments suggest reconsideration. Common distribution systems have evolved, which cover all three products in various combinations from banking, insurance and investments. The regulatory requirements for similar products differ and there is anecdotal evidence that providers of financial products use regulatory arbitrage to transfer risks. For example, certain types of credit risks are transferred from banks to insurance companies. In addition, some financial products are sold by entities which are supervised by more than one supervisory agency, but with different regulatory requirements. For example, supplementary pension products are provided by both insurance companies and mutual funds. The Bank Team was advised of one case where a pension company was fined separately by each of the three regulators for the same offence.

In addition, the Bank Team identified "cracks" among the three supervisory agencies, where financial products that are sold to consumers are supervised by none of the agencies. For example, retailers are selling aggressively loans and other consumer credit products, but none of the regulators supervise the loan sellers. Also the EU's Conglomerates Directive involves the application of complex new legislation, with a lead supervisory agency to regulate all the financial activities of the conglomerate. Countries without integrated regulatory agencies have generally encountered difficulties in adequately providing consolidated supervision of financial conglomerates.

Integrated regulation—and consolidated supervision—are highly complex issues. The Pilot Diagnostic Review of Governance in the Collective Investment Fund Sector provides a summary of European and international experience in creating integrated regulatory agencies. As a first step, the Ministry of Finance could review the international experience, carry out an analysis in the Slovenian context, and then prepare a policy statement. The Ministry may require international support in completing these tasks. Once an overall strategy is agreed, a joint working group could be established to implement the legal, organizational, media and sequencing issues involved in creating an integrated regulatory agency.

Annex I: List of Recommendations

Management

- The senior management should be hired and dismissed, and their remuneration set, by the companies' supervisory boards. The statutes of Slovenian insurance companies should be revised to clarify that supervisory boards have such responsibilities. Priority: High

Risk Management Systems and Controls

- Insurance companies (both large and small) should be encouraged to establish a dedicated risk management function which is required to manage, and report to the supervisory board in detail on each of the key risk categories: insurance risk, operational risk, liquidity risk, strategic risk, contagion/related party risk, counterparty default risk and legal/regulatory risk. Priority: High
- All insurers should be encouraged to begin preparing for Solvency II by running stress tests on their balance sheets and building advanced risk management techniques (e.g. ALM, duration analysis, VAR.) This may require international technical assistance. Priority: Medium
- Internal auditors should be made aware of the wider risk management issues, so that they begin to apply international approaches to reviewing the company's full risk management systems. Priority: High
- Insurance companies that are part of conglomerates should be required to prepare consolidated financial statements. Priority: High
- In determining risk related to the balance sheet, investments and counterparty defaults, management should be legally required to take into account, at a minimum, the international agency credit ratings for both direct investments and reinsurance companies. Priority: High
- Preferably insurance companies should assess all legal and financial aspects of the reinsurer before it enters into a contract with a reinsurance company. Priority: Medium
- Insurance companies should be required to conduct risk management of their purchases of loan portfolios from banks. Priority: High
- Preferably, mono line insurance companies for credit insurance should be created with capital requirements equivalent to the relevant risk elements of the underlying banking products. Priority: Medium

Responsible (or Appointed) Actuary

- The actuary should be required to prepare a comprehensive annual financial condition report. Priority: High
- The actuary should be legally obligated to present his report personally to the supervisory board at least annually, before the accounts are approved and dividends are declared. In presenting this report, he should be required to highlight his key findings. Priority: High
- For the larger companies, actuaries should peer review each others' work, in addition to the review carried out by the external auditors. Priority: Medium
- The legal framework could be amended to specifically prohibit an Appointed Actuary from becoming a member of the supervisory board. Priority: Low
- Actuaries should be required to disclose key assumptions in all written reports. Priority: Medium

Oversight of Management by the Supervisory Board

- Members of supervisory boards should have explicit responsibility for the company's compliance with corporate governance principles and should have direct fiduciary obligations to policy-holders set by law. Priority: High
- The statutes of Slovenian insurance companies should be revised to clarify that supervisory boards have full corporate governance responsibilities, and that management is fully accountable to the supervisory board. Priority: Medium
- The statutes relating to the appointment and duties of supervisory directors should be public documents, preferably published on the company's website. Priority: High
- Supervisory board members should have strong financial skills. A short summary of their professional experience and relevant academic training should be published in the Annual Report. Priority: Medium
- Supervisory boards should have some independent members (i.e. members who are not management or associated with controlling shareholders) to ensure that the interests of minority shareholders and long-term policyholders are addressed. Priority: Medium
- Supervisory boards should be mandated to include a minimum number of directors. Priority: Hight
- Supervisory boards should be compelled to form board audit and risk management committees to deal with all issues relating to auditing, internal controls financial reporting and risk management, in line with international practice. In fulfilling this responsibility, they will be able to draw on Article 279 of the new Companies Act (2006), which provides the supervisory board with the power to establish such board committees.[11] Priority: High
- The supervisory board audit committee should be compelled to become responsible for the relationship with the company's external auditors. This includes the auditor's appointment, and direct periodic meetings, including the meetings without the presence of management. In fulfilling this responsibility, they will be able to draw on Article 280 of the new Companies Act (2006), which provides the supervisory board with the power to establish such board committees[12]. Priority: High
- Supervisory board members should be paid salaries in lieu of per meeting fees and bonuses based on the company's annual profits. Audit committee members should receive higher allowances. Priority: Medium
- D&O liability insurance should be taken out for all board members, including supervisory board members and the insurance premia could be reimbursed by the companies. Priority: Medium
- The chairman of the audit committee and a member of the management team (either the CEO or CFO) should be required to sign the disclosure statements attesting to their accuracy and completeness. Priority: High
- Company employees should not be permitted to sit directly on supervisory boards, or to elect representatives to supervisory boards. Priority: Medium
- Training programs for members of supervisory boards in the principles of corporate governance should be conducted and run through the insurance association. Priority: Medium

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[11] The recommendation based on the English translation of the Companies Act revised in April 2006, (Articles 279 and 280), which has been provided in the comments received from Slovene Ministry of Finance and Insurance Supervision Agency.

[12] Same as above.

Insurance Supervision

- It would be best if the insurance supervisor were to adopt procedures to operate as transparently as possible in all its dealings with stakeholders: the insurance companies, policyholders, journalists and the public. Priority: High
- In preparation for Solvency II, the best approach would be for the ISA to adopt risk-based supervision. This will involve a review of its activities, identifying those activities which add little or no value, and eliminating them, and replacing them with a more focused RBS methodology. Priority: Medium
- The insurance industry should be advised that the ISA has adopted risk-based supervision methodology and, where appropriate, a consolidated approach. The ISA should explain its new supervisory model in some detail, so that insurance companies can prepare themselves to be evaluated and investigated under this new approach. Priority: High
- The ISA could implement a regulation requiring insurance companies to establish a board audit and risk management subcommittee. Priority: Medium
- The ISA could require that insurance companies establish a senior officer with designated responsibility for legal and regulatory reporting and compliance. Priority: Medium
- The ISA could improve efficiency and reduce costs by requiring that the key annual returns be audited and dropping the requirement to have all other returns audited. Priority: Medium
- The ISA should be notified within 30 days by the company whenever the company has changed its external auditor. Priority: Medium
- The ISA should review its activities to identify those that add little or no value, and eliminate such activities. Priority: Low
- The ISA should conduct a group-training to prepare for the risk-based approach. Priority: High
- Once the 8th Company Law Directive is enacted in the EU, a national oversight body for the auditing profession should be created to comply with the Directive. Priority: High

Appointed Actuary

- The ISA, in conjunction with the Slovenian Institute of Actuaries, could review Decision 9, and place greater emphasis on outcomes rather than on prescribing the precise methodology as to how to calculate specific reserves. Priority: Medium
- The report of the appointed actuary as laid out in Decision 9 could be expanded to a fully fledged Financial Condition Report, as per American Academy Standard of Actuaries No. 19. Actuaries should be required to disclose key assumptions in all written reports. Priority: Medium
- The appointed actuary should be legally obligated to present his report to the supervisory board at least annually. He should also be required to highlight his key findings. Priority: Medium
- The legal framework could be amended to specifically prohibit an appointed actuary from becoming a member of the supervisory board. Priority: Medium
- In large companies, actuaries should commence peer reviewing each others' work, in addition to the peer review carried out by the external auditors. Priority: Medium

Public Disclosure and Market Discipline

- The ultimate significant controlling shareholders of all insurance companies should be publicly disclosed. Priority: Medium
- The larger insurance companies, Triglav in particular, could be encouraged to obtain and publish an international credit rating. Priority: Medium
- Education to financial journalists on the financial statements of insurance companies could be provided through the Slovenian Insurance Association. Priority: Low
- The template of information provided in the ISA's annual report on the insurance industry should be revisited, and more meaningful data should be provided in this report. The information presently provided on life insurance in particular is scant. Information, by business line, on premiums in force, new business, business discontinued, claims and surrenders, investment returns on mean assets, expenses, and mathematical provisions could be provided. Consideration should also be given to provide more information by company, rather than aggregate information. Priority: High
- Insurance companies should adopt the international financial reporting standards as soon as possible. Priority: High
- Whether listed or not, Slovenian insurance companies should be required to prepare annual disclosure statements of their compliance (or lack thereof) with the Corporate Governance Code of Ljubljana Stock Exchange. Priority: Medium
- Companies should address, as a matter of course all major risk categories and state how they manage them. Priority: High

External Audit

- The insurance legislation or regulations should require that the supervisory board become involved directly with the auditors: by appointing them through a committee, which also becomes responsible to interact with the auditors by reviewing a management letter prepared by auditors, and overviewing the preparation of a formal response. Priority: High
- The reporting requirements for external auditors should be expanded, so that they are obliged to report material irregularities directly to the supervisory board. Priority: High
- The ISA should conduct meetings with external auditors on a regular

Industry Initiatives

- The Slovenian Insurance Association should strengthen its expertise in corporate governance in the industry and provide training of corporate governance for supervisory board members in insurance companies. Priority: Medium
- The institute of directors should become more visible, and provide guidance on the importance of implementing good corporate governance principles. Priority: Low
- ISA should strengthen its expertise in IFRS in order to provide effective supervision of insurance companies using IFRS. Priority: High

Special Issues

- An integrated regulator for all financial institutions, including banks and insurance companies, could be considered, with an appropriately timed and sequenced diagnostic and implementation program. Priority: Medium
- In order to impose full market disciplines on the sector, Triglav's equity shares should be listed and publicly traded. Priority: High

Annex II: Detailed Diagnostic Review of the Corporate Governance Framework for the Insurance Sector: A Comparison of Rules and Practices against Proposed Good Practices

The corporate governance good practices are divided into two groups: (1) internal elements of corporate governance within insurers, and (2) external factors that influence the corporate governance of insurers.

The internal factors are:

1) Management, i.e. the management board and other senior management;
2) Risk management systems and internal controls;
3) The responsible (or appointed) actuary; and
4) Oversight of management by the supervisory board.

The external factors are:

1) The insurance supervisory authority;
2) Public disclosure and market discipline;
3) External audit; and
4) Industry initiatives.

In addition, the good practices discuss special provisions related to insurance companies that are wholly or majority owned or controlled subsidiaries of foreign parent insurers or financial groups, or branches of foreign insurers.

	INTERNAL GOOD PRACTICES
	Section A – Management
Benchmark A.1	**The management team as a whole, and each member of it, should have clearly defined responsibilities and the necessary authority to manage the insurer in a manner consistent with the strategic direction approved by the supervisory board. All members of the management team should be required to perform their duties with due care and diligence, and for the purpose of maintaining the insurer's capacity to meet its obligations to all counterparties and constituencies at all times. Members of the management team should be free of material conflicts of interest that could unduly influence their judgment. Where management is constituted as a management board, no non-executives should be part of the management board.**
Description	The management board is stipulated to consist of a minimum of 2 members (Insurance Act Article 22(1)). They must be full time executives of the company (article 22(2)). Members of the management board must operate with due care and ensure that the company is able to meet its financial obligations at all time (IA Article 26). Individual responsibilities are not set out in the Act. Conflicts of interest are mainly dealt with in the IA Article 22, whereby board members must have full time employment contracts. Conflicts of interest are also governed by the Companies Act, Articles 39 and 40, relating to confidential information, and CA Articles 39, 40 and 271, which prohibit competitive activities. The Bank Team found that the management teams of the insurance

	companies were professional, with clearly defined responsibilities and adequate authorities to fulfill their duties. The management boards consisted only of executives.
Recommendation	None
Benchmark A.2	**Management should have sufficient skills and experience in relation to insurance, finance and other disciplines relevant to the management of an insurer. All members of the management team should have access to sufficient resources and receive sufficient training to assist them in the performance of their roles.**
Description	Members of the management board are required to have "adequate professional qualifications, characteristics and experience needed to manage the operations of an insurance undertaking". The ISA is able to perform an independent check on the suitability of a board member (IA Article 25). The Bank Team found that the management of the major Slovenian insurance companies was highly professional and demonstrates sufficient skills to fulfill their duties. The Bank Team did not review the management of the smaller insurance companies.
Recommendation	None
Benchmark A.3	**Members of the management team should be fully accountable to the supervisory board. The accountability should be clearly specified in the company statutes.**
Description	The IA prescribes a dual structure of management board and supervisory board, and requires that insurers establish both boards (IA Articles 22 and 29), which overrides the CA (Article 253) allowing single tier board structures. The IA further prescribes that the management board must report to the supervisory board, but only in instances relating to solvency of the company being threatened, or a related party transaction involving board members has occurred (IA Article 27). The IA also lays out the reporting requirements of the appointed actuary and the internal auditor. The company statutes lay out the reporting requirements between the management board and the supervisory board. Article 272 stipulates that management board must report to the supervisory board at least once per quarter. The Bank Team found that appointments are made by shareholders and Government (the industry is substantially owned by Government and/or Government agencies), rather than by the supervisory board. The level of management reporting to supervisory boards appears to vary considerably from company to company. It is not apparent that management feels that it is fully accountable to the supervisory board.
Recommendation	In order to fully implement a dual-board structure, the senior management of Slovenian insurance companies should be hired and dismissed--and their remuneration set--by the companies' supervisory boards. The statutes of Slovenian insurance companies should be revised to clarify that supervisory boards have such responsibilities, and that management is fully accountable to the supervisory board.
	Section B - Risk Management Systems and Controls
Benchmark B.1	**An insurer should have reliable risk management systems to identify, measure, monitor and control all business risks of the insurer. The risks should be assessed on both solo and consolidated bases (that is, among upstream parents and downstream subsidiaries and across borders). Key risks relate to credit, interest rates, exchange rates, basis risk, compliance risk, operations, reputation, exposures to related parties, liquidity concentration of exposures to single or grouped counterparties, sectoral, geographical or industry exposure concentration, and**

	risks associated with criminal activity and money laundering. In large organizations, the risk management function should be a separate unit.
Description	IA Article 26(1) sets out that the management board must ensure that the company operates in accordance with risk management principles as defined in the Act. Risk management itself, however, is quite narrowly defined as relating to solvency and capital adequacy (IA Article 104), and compliance is then dealt with in IA Articles 106-111. Article 26(2) states more generally that the management board is obliged to insure that the risks to which the operations of the company are exposed, are monitored and managed. No further legal definitions are given as to these risks. The Bank Team found that the concept that risk management as a much wider topic than capital adequacy is not fully understood by the senior management of insurance companies. Consequently, insurers do not have an all-encompassing risk management function. Instead, risk is managed within the insurance department in which it takes place. The largest insurer, Triglav, is in the process of establishing an all-encompassing risk management function. A dedicated risk manager has been appointed, and will commence work at the end of May 2006.
Recommendation	Insurance companies should be encouraged to establish a dedicated risk management function which is required to report to the supervisory board in detail on each of the key risk categories (insurance risk, operational risk, liquidity risk, strategic risk, contagion/related party risk, counterparty default risk and legal/regulatory risk) on a quarterly basis. Positive action to manage these risks would then need to be taken.
Benchmark B.2	**The insurer's risk management systems should be subject to regular internal review, and periodic review by suitable, independent experts, to ensure that the systems are appropriate for the nature of its business activities and risks.**
Description	The IA defines risk management narrowly as being solvency and capital adequacy (IA Article 104). These must be regularly reviewed by internal auditors and reported upon (IA Article 165). There is no legal requirement to carry out internal reviews of full risk management systems. Insurance companies generally have a strong internal audit function. This function reviews in detail solvency and capital adequacy- related matters, including the internal controls pertaining thereto. The company's wider risk management systems are not reviewed internally.
Recommendation	Internal auditors should be made aware of the wider risk management issues, so that they commence applying international approaches to reviewing the company's full risk management systems.
Benchmark B.3	**The insurer should maintain effective internal controls, including internal audit arrangements, with adequate resources and independence.**
Description	The management board is responsible for setting effective internal controls (IA Article 26(3)). The IA also sets out that there be an independent internal audit function which reports to the management board (Article 161), and requires that each insurer employs at least one full time internal auditor (Article 163). The internal auditor must report at least semi-annually to both the management board and the supervisory board (Article 165), with mandatory reporting to the boards in respect of any irregularities affecting liquidity (Article 166). Internal auditors usually report to the chairman of the management board (CEO) and are able to operate without undue managerial influence. The Bank Team found that insurance companies have adequate internal financial controls in place to meet a traditional approach to risk

	management—but are not sufficient for a risk-based system.
Recommendation	Consideration should be given to further refining the risk-based systems used by insurance companies.
Benchmark B.4	**The insurer should maintain reliable systems and controls for identifying, monitoring, and managing exposures to, and dealings with, related parties, including upstream parent entities or other controlling or significant shareholders and downstream subsidiaries and affiliates. All business dealings with related parties should be on arm's length terms and be in the interests of all shareholders, creditors and policyholders.**
Description	Decision 8 (decisions are insurance regulations) defines dealings with related parties widely, with Article 8 within Decision 8 requiring extensive reporting to the ISA on any such dealings. Related party transactions such as loans, guarantees, equity investments, reinsurance and even agreements to share costs are caught by this legislation. The Bank Team found that the concept of related party transaction is well understood by industry, and is continuously effectively monitored by the ISA. In one recent case (Slovenika), the ISA forced restitution of USD 300,000 on a related party transaction whereby an insurance asset was acquired by an owner at a price which was not at non-arms length.
Recommendation	None
Benchmark B.5	**For composites (i.e. companies offering both life and non-life insurance), assets covering life insurance liabilities should be completely segregated from all other assets and be first applied to meeting life insurance policyholders' entitlements in the event of a liquidation or portfolio transfer.**
Description	The seven composites are legally permitted to continue to operate in Slovenia. However, IA Article 5(6)12 requires that all composites account for life insurance businesses and non-life insurance businesses separately. This article also requires that costs be allocated correctly between life and non-life business. Further stringent measures then require that assets be specifically set aside to cover non-life technical provisions (IA Article 120(1) and life mathematical provisions (IA Article 125(2)). In the event of a liquidation, the assets set aside for the payout to policyholders under the technical provisions and mathematical provisions can only be used for that purpose, with policyholders receiving further preferential treatment in case of a shortfall (IA Article 208). In the spirit of the EU Life Insurance Directive, there is full implementation and strict application of the relevant EU rules for composites including earmarking of assets and apportionment of income and expenditures based on a system approved by the supervisory authority.
Recommendation	None
	Section C – Responsible (or Appointed) Actuary
Benchmark C.1	**Each insurance company should have a responsible (or appointed) actuary for each of its major lines of business (i.e. life, general insurance, health). The actuary should have specified skills, appropriate for the type of insurance for which he/she is responsible. The responsible actuary should be required to advise on levels of technical reserves, on the proper risk premium calculation of insurance products, prepare periodic analyses of surplus (profits) and advise on the distribution of surplus arising from long-term business (i.e. life insurance) and long tail business (i.e. general liability, worker's compensation and motor third party liability).**
Description	Each company must have an appointed actuary ("AA") (IA Article 74(1)). In the specific regulation relating to the AA's report (Decision 9), the AA is directed in detail as to how to calculate technical reserves, mathematical

	reserves and valuations of policyholder liabilities. There is no legal requirement to carry out periodic analyses of surplus and distribution of surplus. The Bank Team found that actuaries were well qualified and sufficiently professional to carry out their tasks. They do carry out periodic analyses of surplus and distribution of surplus as a matter of course. The legal framework is narrowly prescriptive in some areas of liability valuation/calculation of reserves, so that the AA, in fully complying with the methodology set out in Decision 9, may not achieve appropriate values including sufficient risk margins to ensure the long-term stability of insurance companies.
Recommendation	The ISA, in conjunction with the Slovenian Institute of Actuaries, could review Decision 9, and place greater emphasis on outcomes rather than on prescribing the precise methodology as to how to calculate specific reserves. The report of the AA as laid out in Decision 9 could be expanded to a fully fledged Financial Condition Report, as per American Academy Standard of Actuaries No. 19. This approach would provide the board of management, the supervisory board and the ISA with far greater information on the activities of the insurance company.
Benchmark C.2	**The actuary should be professionally certified and subject to best practice actuarial standards, continuous professional development (formal education), appropriate ethics standards and disciplinary proceedings. In all written reports, the actuary should be required to specifically state all assumptions and highlight any uncertainties.**
Description	IA Article 73(2) requires the AA to be professionally qualified and having passed a proficiency examination laid down by the ISA, who then provides a license to the actuary. Decision 14 sets out the requirements in detail. The actuary is not compelled to specifically state all assumptions, however in the actuary's annual report he is able to include details of his assumptions (IA Article 159(1)). In this report, the actuary must state whether calculations were performed in accordance with the regulations; there is therefore an ability to highlight uncertainties. Continuous professional development is not a legal requirement, although it was recently introduced by the Slovenian Institute of Actuaries. The Slovenian Institute of Actuaries is actively involved in building the standing of the profession to international standards. This process will take time, but seems to be progressing at a satisfactory rate.
Recommendation	Actuaries should be required to disclose key assumptions in all written reports.
Benchmark C.3	**Management should recommend the levels of technical and mathematical reserves for the purposes of published and statutory reporting and this should be reviewed and approved by the supervisory board. The responsible actuary should have an advisory role and not be a member of the supervisory board. The actuary should also be independent of management in determining the assumptions underlying his or her recommendations regarding the levels of technical and mathematical reserves. All reports on reserving prepared by the responsible actuary should be made available both to the full supervisory board and the insurance supervisory authority.**
Description	The AA is in an advisory role and may not be a member of the management board (IA Article 74(2)). Legally, there is no prohibition on the AA being a member of the supervisory board. Decision 9 outlines in detail the minimum contents of the AA's report which includes reporting on

	the levels of actuarial reserves and the assumptions contained therein. This information must be made available to both the management board and the supervisory boards (AA Article 76(3)). It is also made available to the ISA. The actuary is independent of management. He is therefore able fulfill the role of expert advisor to management, the supervisory board and to the regulator. In practice, the AA's reports are generally not reviewed by the supervisory board – there seems to be little personal interaction between the AA and the supervisory board. Although the AA is technically able to join the supervisory board, there are no known instances of such an occurrence.
Recommendation	The AA should be legally obligated to present his report to the supervisory board at least annually. He should also be required to highlight his key findings. The legal framework could be amended to specifically prohibit an AA to become a member of the supervisory board.
Benchmark C.4	**The work of the responsible actuary involved in setting provisions and reserves for published accounts or regulatory returns should be subject to an effective independent review process. This requirement could be satisfied by a certified actuary employed by the external auditor.**
Description	The regulation on audit (Decision 10) requires compliance with international audit standards which in turn require actuarial involvement in reviewing the actuarial calculations included in the annual report/ published accounts. The larger insurance companies have more than one actuary on staff, and therefore, a peer review is able to take place within an insurance company. In practice, peer reviews do not take place- the concept of peer reviews is not understood in Slovenia. A cross-check/ peer review of actuarial calculations is provided by the audit companies, all of whom use consulting actuaries in completing their annual audits.
Recommendation	In large companies, actuaries should commence peer reviewing each others' work, in addition to the peer review carried out by the external auditors.
	Section D – Oversight of Management by the Supervisory board
Benchmark D.1	**The supervisory board should have clear, well defined and well understood roles and responsibilities, including responsibility to approve the insurer's strategic direction, oversee management, and take ultimate responsibility that the insurer is managed prudently.** **They should also ultimately be responsible for ensuring, through management, that the insurer has the capacity to meet its obligations to all counterparties, creditors and policy-holders at all times.** **The insurer's founding documents should specify the process by which members of boards are appointed and discharged. Members of the supervisory board should legally be required to perform their duties with due care and diligence, and for the purpose of maintaining the long-term soundness of the insurer. Members of the supervisory board should be free of material conflicts of interest that could unduly influence their judgment.**
Description	The CA, Article 274, sets out that members of the supervisory board are appointed at a general meeting of shareholders. In many cases, members of the supervisory board are shareholder representatives, and therefore there is potential for conflict of interest through related party transactions.

	This matter is dealt with in detail by Decision 8, and requires immediate reporting to the ISA (IA Article 31). IA articles 27 and 29 also provide that members of the supervisory board shall not be related to entities in which the insurer has voting rights in excess of 5 percent. They may also not be a member of the supervisory board or management board of any other insurer. The IA defines the fiduciary responsibilities of the supervisory board in Article 31, in terms of reviewing financial reports and insuring that internal controls remain in place. CA Article 263 relates to acting with a duty of care, protecting confidential information, and acting for the benefit of the company. Article 264 refers to personal liability for damage incurred by members of the supervisory board. The supervisory board's powers are laid out in CA Articles 281 to 283: they can request any information they deem necessary, and they must review the annual report in detail before accepting it. The remaining roles and responsibilities of the supervisory board are laid out in the company's statutes. The supervisory boards are not yet in a position in many cases to fully supervise management and management boards, and play a strong role in setting corporate strategy, although through the extensive reporting mechanisms they are in a strong position to review solvency and capital adequacy positions regularly. The process of appointing members to the supervisory board is unclear. It is recognized that there is a significant shortage of experienced people to serve on the board of Slovenian insurance companies. As a modern insurance industry has been in operation in Slovenia for only the past 15 years, this is not unusual.
Recommendation	The by-laws relating to the appointment and duties of supervisory directors should be public documents, preferably published on the company's website. A short summary of the professional experience and relevant academic training of supervisory board members should be published. The insurance association should target supervisory board members for education programs specifically relating to insurance matters, so that these members can play an increasingly important role in the industry.
Benchmark D.2	**Members of the supervisory board should have liability for actions taken, or not taken as a result of governance failure, that could harm the company. Members of the supervisory board should have adequate professional indemnity insurance (such as directors and officers insurance) provided by an insurance company independent from the insurance company concerned.**
Description	IA Article 31(1) requires the members of the supervisory board to supervise the adequacy of internal procedures checked by the internal audit function. IA Article 31(2) states that members of the supervisory board are jointly liable to the company for losses incurred due to omission of duties under Article 31(1). There is non legal requirement to provide Directors' and Officers' liability insurance. The breadth of the concept of corporate governance is not understood by the Slovenian insurance industry – instead, the concept is applied more narrowly to the company's internal financial controls. Directors and Officers Liability insurance is generally not taken out for members of the supervisory board. This seems to imply that the members

	of the supervisory board do not fully understand the level of their personal responsibilities in case of an major irregularity.
Recommendation	Members of the Supervisory boards should be educated in the concepts of corporate governance and be made legally responsible for the company's compliance with corporate governance principles. At the same time, D&O liability insurance should be taken out for all board members in such a manner that their salaries are not reduced. Steps should be taken within Slovenia's legal framework to require insurance companies to appoint independent directors.
Benchmark D.3	**The supervisory board should have a sufficient number of members to achieve broad based understanding of the insurer's business activities and effectively discharge its responsibilities. Members should have the skills, experience and knowledge required to effectively perform their roles. Members should be able to devote sufficient time to their director duties as to make a sound contribution to the supervisory board's functions. All members of the supervisory board should receive sufficient training to assist them in the performance of their roles and the insurer should provide induction programs for new members.**
Description	There is no legal requirement to have a sufficient number of members to carry out the duties as outlined in this benchmark. In respect of expertise, IA Article 29a(2) stipulates that members of the supervisory board need to have a minimum of four years' experience in the management or supervision of a company comparable in size and activity to the insurance undertaking, or be an insurance expert. Most insurance companies have sufficient numbers of supervisory board members to achieve a broad based understanding of the insurance company's activities. However, many board members lack the expertise required to fulfill all of these duties.
Recommendation	Given that there have also been significant recent changes to the legal and regulatory frameworks affecting insurance companies, periodic education programs for members of supervisory boards could be run through the insurance association.
Benchmark D.4	**The supervisory board should be chaired by a non-executive director (i.e. a non-executive of the insurer concerned) and include a majority of non-executive members and have a sufficient number of independent directors to serve on the relevant supervisory board committees. Even closely-held subsidiaries should have a minimum number of independent directors with specific responsibility to monitor related-party transactions, particularly with the parent company.**
Description	The board is elected at the annual general meeting of the company (IA Article 274). Any detailed requirements on the board composition and the election of the chairman are addressed by the company's statutes, which are not generally available to the public. Members of the management board may not be members of the supervisory or management board of another insurer (IA Article 29). Many insurers have employee representatives on their board, in line with the German model. Slovenian law, (Workers Co-determination Act, Official Gazette No 42/93 and 56/01) requires that one third (and up to one half) of members of the supervisory board of State owned enterprises represent company employees. As members of the management board are not permitted to be members of the supervisory board, the chairmen of the supervisory board are all non-executive members. There are few, if any, "independent" board members on the supervisory board: they either represent shareholders or workers. There are presently no supervisory board committees in any Slovenian insurance companies.

Recommendation	Company employees should not be permitted to sit directly on supervisory boards or elect representatives to supervisory boards. In addition, the law should make it clear that the appointed actuary cannot be a member of the supervisory board. Supervisory boards should also have some independent members (i.e. members who are not management or associated with controlling shareholders) to ensure that the interests of minority shareholders and long-term policyholders are addressed.
Benchmark D.5	**The supervisory board should establish and maintain committees to assist it in the performance of its roles. Such committees should, at a minimum, include an audit committee responsible for oversight of all matters related to internal audit and controls and external audits and review and approval of published financial accounts. The audit committee should ensure that the internal controls system meets the standards of COSO.[13] The audit committee should ensure that the company's internal audit personnel have unimpeded access to the committee. The audit committee should receive regular reports from the company's internal audit department, including any material breaches of controls or limits.** **Other desirable committees could include: (1) a risk management committee responsible for oversight of the insurer's systems and controls for monitoring and managing risks; (2) a remuneration committee responsible for oversight of the remuneration and compensation arrangements for senior management, and (3) a nomination committee responsible for selecting members of the supervisory board. The supervisory board should ensure that incentive structures (including stock options) for insurance management are consistent with the insurer's long-term soundness. The audit and nomination committees should comprise a majority of non-executive board members and be chaired by a non-executive and independent director.**
Description	There is no legal requirement for a supervisory board to establish any committees. Internal audit has access to the supervisory board by means of semi annual reporting (IA Article 165), and immediately in any case where the company has violated its liquidity/ capital adequacy rules. No insurance companies were found to have established any board committees.
Recommendation	ISA should implement a regulation requiring insurance companies to establish a board audit and risk management subcommittee. At the very least, the supervisory board should be required to form a form an audit committee to deal with all issues relating to auditing, internal controls and financial reporting. This is in line with international practice. The Insurance Association should promote right now that insurers voluntarily establish such a subcommittee.
Benchmark D.6	**The supervisory board should maintain regular processes for reviewing its performance and that of each of the supervisory board members. The review processes should include periodic external review by independent experts.**
Description	There is no legal requirement for the supervisory board to review its performance or the performance of each of its members. This is a relatively recent development in international corporate governance. Supervisory boards in Slovenia do not maintain processes for reviewing their own performance.
Recommendation	None

[13] COSO refers to The Committee of Sponsoring Organizations of the Treadway Commission, which focuses on internal controls. The Committee was originally formed in the USA in 1985 to sponsor the National Commission on Fraudulent Financial Reporting.

Benchmark D.7	**Members of the supervisory board should be adequately remunerated. The remuneration arrangements should be transparent and consistent with the demands and liabilities attaching to the duties undertaken (e.g. committee work).**
Description	Payment is usually made on a "per meeting" basis. The payment per meeting, is around 500 Euros per meeting and seems to be at appropriate commercial rates. Supervisory board members also generally receive profit-based bonuses. These payments are generally made public as per the code of conduct applying to companies publicly listed on a stock exchange
Recommendation	Supervisory board members should not receive bonuses based on the company's annual profits both of which introduce moral hazard. The director's salary should be sufficient for him or her to be able to purchase directors' and officers' liability insurance in addition to remunerating himself or herself adequately for directors' duties. Audit committee members normally receive higher allowances.
	EXTERNAL GOOD PRACTICES
	Section E – Insurance Supervisory Authority
Benchmark E.1	**The supervisory authority should have the legal capacity to impose corporate governance requirements on insurers where necessary. The supervisory authority should issue guidance to insurers on desirable corporate governance policies, practices and structures.**
Description	IA Article 246(3) provides that the ISA is autonomous and independent in implementing its tasks and responsibilities. There is no specific legal reference to the ISA's ability to impose corporate governance requirements, although many aspects of corporate governance (such as internal controls, external audit and related party transactions) are covered in individual Articles and detained regulations/decisions. The independence of the ISA may need to be queried. Although the law states that he is independent, and the ISA has independent funding from levying industry, the Director of the ISA is appointed and dismissed by the Government at the recommendation of the Minister of Finance (IA Article 259(1)). However Article 253 notes that the grounds for dismissal of the director of the ISA (or members of the council of experts) is limited to such issues sentencing to a prison term of over three months, losing the capacity to work, violating the obligation to protect confidential data, or violating the prohibition that they not have any contractual relations, employment or equity holdings in legal entities to which the ISA grants authorization or approval with regard to operation and that they not perform tasks in bodies of political parties. The key issue of corporate governance not covered in sufficient detail is risk management, which is referred to elsewhere in this report.
Recommendation	An integrated regulator for all financial institutions, including banks and insurance companies, could be considered. Uniform regulation which also addresses corporate governance, could then be implemented throughout the financial sector.
Benchmark E.2	**The law should set a "fit and proper" test to members of an insurer's supervisory board, senior managers and controlling and other significant shareholders. The supervisory agency should have the authority to remove directors or freeze shareholders' voting rights as appropriate if such tests are not met. The supervisory authority should be able to identify the ultimate direct and indirect beneficial owners of an insurer where they exercise control or own significant blocks of shares. The authority should use comprehensive and sophisticated criteria for determining control.**

Description	IA Article 29a sets out a "fit and proper" test for members of the supervisory board. Where an existing supervisory board member has violated the "fit and proper" requirements, the ISA may require the insurance company to hold a general meeting and dismiss that board member. Related party transactions in respect of the member of the supervisory board must be reported to the ISA (IA Article 31(3)2). The ISA is also able to conduct a "fit and proper" test on members of the management board, as they need ISA approval prior to commencing their duties as a board member (IA Article 24). The ISA, through application of Decision 8, is able to flush out related entities and "hidden" shareholders, as this decision defines "insurance group" widely. The "fit and proper" test applying to the supervisory board is narrow and inadequate. The Bank Team was advised that further legislation on conglomerates has been passed by Parliament and will shortly be enacted. Once this is the case, Slovenia will be in line with the EU on this issue.
Recommendation	All of the provisions of EU Directives 95/26/EC (generally called the "Post-BCCI Directive") and 2002/87/EC on supplementary supervision of mixed conglomerates should be fully implemented, if this is not covered by Slovenia's version of law on Conglomerates. As no English version of this is available, the Bank team could not check whether the Slovenian law covers EU Directives 95/26/EC.
Benchmark E.3	**The supervisory authority should review each insurer's statutes to ensure that they comply with any requirements it imposes. Insurers' statutes and changes to them should be subject to supervisory authority approval or notification to the supervisor.**
Description	Statutes are checked by the ISA during the on-site inspection procedures. This check is specifically included as needing to be carried out in the on-site inspection manual prepared by PricewaterhouseCoopers for the ISA.
Recommendation	None
Benchmark E.4	**The supervisory authority should periodically evaluate (including through meetings with the audit committee, risk manager, and the internal auditor) each insurer's internal controls and risk management systems, either directly or via independent parties it approves.**
Description	The internal control procedures are checked in significant detail by the ISA on-site inspection team during company inspections. As noted elsewhere in this report, the insurance companies' risk management systems are limited. The supervisory boards have no audit committees, and presently no risk managers work in the Slovenian insurance sector.
Recommendation	The legal framework needs to change such that insurance companies need to establish audit committees and appoint risk managers. The ISA is then able to conduct far more focused reviews of internal controls by referring to committee members risk managers and without having to conduct a full on-site inspection.
Benchmark E.5	**The supervisory authority should approve a list of accepted auditors for insurers on the basis of a transparent set of approval criteria. The insurer should notify the supervisory authority of any changes of auditors. The supervisory authority should meet with each insurer's external auditors on a regular basis, including periodically without the insurer being present, to discuss the most recent audit results and corporate governance arrangements, internal controls and risk management systems and financial reporting arrangements of the insurer.**
Description	The ISA does not have a list of accepted auditors. However, if in the opinion of the ISA, an audit was unsatisfactory, the ISA can legally require the insurance company to have another audit conducted with another

	auditor (IA Article 170(4)). The supervisor has the power to meet with the external auditor, without the presence of insurance company management, as per IA Article No 170(3)). Auditing is carried out in a professional manner in the Slovenian insurance industry. The auditors are all large multinational with the resources to conduct professional audits to international standards. Auditors are invited by the supervisory boards of some companies to present their annual report, but no instance could be found where external auditors meet with members of the supervisory board without the presence of management. It was found that the ISA rarely meets with external auditors.
Recommendation	The ISA should conduct meetings with external auditors on a regular basis. This approach will assist with improving both the quality of information about insurance companies, and also the impact of on-site inspections. The ISA should be notified within 30 days by the company whenever the company has changed its external auditor.
Benchmark E.6	**The supervisory authority should require each insurer to have a designated function for legal and regulatory reporting and compliance and that function should be obliged to draw to the attention of the supervisory authority any breaches of such requirements.**
Description	The Bank Team found that no Slovenian insurance companies have a compliance officer. The legal and regulatory reporting are generally carried out through the company secretarial office.
Recommendation	The ISA should require that insurance companies establish a designated officer for legal and regulatory reporting and compliance.
Benchmark E.7	**Where control of insurers by non-financial entities is permitted, or where an insurer is part of a non-financial conglomerate, the supervisory agency should require more stringent controls over related party transactions and a majority of independent directors on the supervisory board. Insurers should not be permitted to control or operate non-financial activities either directly or indirectly, in so far as those activities do not support insurance activities.**
Description	There are no legal provisions limiting non-financial control of insurance companies. Related party transactions are controlled, mainly through Decision 8. There is no requirement to have independent directors. Insurance companies must confine their activities to insurance related matters and therefore cannot carry out activities unrelated to insurance (IA Article 3 (1)2). Related party transactions are stringently controlled through application of Decision 8, as noted elsewhere in this report. Ownership of insurance companies is currently largely with the Government. As noted elsewhere in this report, independent directors are not common in Slovenia.
Recommendation	As ownership of insurance companies is privatized over the next several years, ISA will need to closely monitor the acquirers of shares in insurance companies.
Benchmark E.8	**The supervisory authority should issue regulations defining related party transactions and limits on such transactions, and the regulations should include a precise definition of related parties. The regulations should ensure that insurers maintain reliable systems and controls for identifying, monitoring, and managing exposures and dealings with related parties. Related parties should include upstream parent entities or other controlling or**

	significant shareholders and downstream subsidiaries and affiliates. All business dealings with related parties should be on arm's length terms and be in the interests of all shareholders, creditors and policyholders. Any significant related party transactions involving cash transfers from the insurer should be subject to prior supervisory authority approval or notification.
Description	Related parties are defined in detail in Decision 8, "Supervision of an insurance group." This definition includes upstream parents. Decision 8, articles 6-8 provide for detailed reporting to the ISA on related party transactions. It appears that reporting and monitoring of related party transactions is effective.
Recommendation	None
Benchmark E.9	**The supervisory authority should prepare and publish industry and company-specific information sufficient to allow financial analysts and insurance intermediaries to evaluate the financial performance and strength of insurers.**
Description	The ISA is required to publish an annual report of the industry, as per IA Article 249. The law is not precise as to what is included in this report. The annual report on the insurance industry contains financial details about the industry in aggregate, continuing the template developed in 2000. This report is available on the ISA website. Upon special request, the ISA advised that it will provide additional detail.
Recommendation	The template of information provided in the annual report should be revisited, and more meaningful data should be provided in this report. The information presently provided on life insurance in particular is scant. Information, by business line, on premiums in force, new business, business discontinued, claims and surrenders, investment returns on mean assets, expenses, and mathematical provisions could be provided. Consideration should also be given to provide more information by company, rather than just in aggregate. Details on reinsurance contract should be excluded, as it is commercially sensitive.
Benchmark E.9A	The supervisory authority should operate in a transparent manner. Insurance Companies should be made aware of the key decision making processes taking place at the supervisory authority, such as the bases upon which on-site inspections are conducted. All formal decisions, such as the revocation of a license, should be based on clear and transparent criteria, and should be made public, including the reasoning.
Description	There is no legal requirement for the ISA to operate in a transparent manner. The ISA does not generally operate in a transparent manner. The industry is basically unaware as to the criteria used by the ISA in its dealings with insurance companies. The ISA generally does not provide reasons for its decisions. A transparent approach to on-site inspection procedures would give the industry an opportunity to arrange its affairs in such a manner that it could meet the ISA's criteria more readily. The current opaque approach also leaves the ISA open to criticism as to treating industry participants unequally.
Recommendation	The ISA should adopt procedures to operate as transparently as possible in all its dealings with stakeholders: the insurance companies, policyholders, journalists and the public.
Benchmark E.9B	The supervisory authority should use risk-based supervision methodology
Description	The ISA uses traditional methodology, developed in conjunction with PriceWaterhouseCoopers, to regulate insurance companies and to conduct on-site inspections. This is no longer "best practice", as this process is retrospective. Regulatory authorities now use a risk-based approach with the objective of establishing which insurance are the more risky ones, then deploying methodology to anticipate and resolve problems before they

	become crises.
Recommendation	The ISA should review its activities throughout the organization, identify those activities which add little or no value, and eliminate them. It should then conduct a group training program to prepare for the risk-based approach. The program should then by implemented, with industry being advised of the new methodology in some detail, so that insurance companies can prepare themselves to be evaluated and investigated in on-site inspections under this new approach.

Benchmark E.10	**The supervisory authority should require periodic reporting of asset movements and technical provisions movements at least quarterly. Reporting should be more frequent (i.e. daily or for each transaction) where corporate governance is weak or the insurer is under enhanced supervision. On at least an annual basis, and preferably semi annually the supervisory authority should prepare an analysis of solvency margins and technical reserves.**
Description	There is a legal requirement to report asset movements and technical provisions on a quarterly basis (Secondary legislative acts 1 and 7). The ISA does have the authority to ask for this report on a more frequent basis. The ISA does analyze solvency margins and technical reserves on at least a 6-monthly basis. The movements in investment assets and technical provisions is appropriately calculated at industry level, and well analyzed at the supervisory level.
Recommendation	None
	Section F – Public Disclosure and Market Discipline
Benchmark F.1	**Insurers should be required to prepare financial statements in accordance with international financial reporting standards (IFRS) on both a solo and consolidated basis. If more frequent financial reporting (than annual) is required, the reports should be publicly available. Where disclosures are not covered by IFRS, the supervisory agency should have the authority to set additional requirements. Pending the introduction of the Solvency II regime, the supervisory agency should require annual stress-testing as a supplementary solvency measure where assets and liabilities have a significant fair value component.**
Description	Insurance companies are required to prepare their accounts in accordance with Slovenian insurance standards. The standards are presently changing, and from 2006 these standards will be very similar to IFRS standards. From 2007, insurance companies must fully adopt IFRS (CA Article 54(1)), and the Slovenian accounting standard will terminate on 31 December 2006. Starting in 2005, publicly traded companies have been subject to the EU requirement to prepare consolidated financial statements using IFRS endorsed by the EU Commission (that is, all IFRS except certain parts of IAS 39). From 2007, all Slovenian insurance companies are required to prepare their financial accounts in accordance with IFRS as per CA Article 54. The Bank Team found that management of insurance companies is well aware, and appears to be prepared for, the onerous changes taking place in the requirements to introduce the new accounting standards, including IFRS. The larger insurers are also preparing themselves for Solvency II requirements.
Recommendation	None
Benchmark F.2	**Insurers should be required to prepare annual reports. The annual report should include: (1) the full financial statements, including**

	comprehensive notes and the auditor's opinion, (2) meaningful statements by the supervisory board and management of the performance of their responsibilities, and (3) a statement describing the major risks of the business and how these are managed. The annual report, and other more frequent disclosures as required by the supervisory authority, should be publicly available regardless of whether or not the insurer is listed or otherwise publicly traded. Life-insurers should annually disclose sources of surplus/ deficit.
Description	Insurers are preparing detailed annual reports including financial statements, comprehensive notes and the auditors' opinion. According to CA Article 282, the supervisory board must review the annual report, in particular in respect of profits and profit distribution, and must prepare a report for the annual general meeting. The supervisory board must also state that it has accepter the report and the audit. The Bank Team found that the financial reports, including extensive notes to the accounts, are to be of high quality. Additional data on the operations of the company is also provided by most insurers. One insurer has provided its risk management methodology in a note within the financial report. These reports are generally publicly available, both in hard copy and on corporate websites.
Recommendation	Companies should address, as a matter of course all major risk categories and state how they manage them. This approach will build on Slovenia's requirement (Decision on Annual Reports, Article 12(b)(7)) for insurance companies to address market, credit, liquidity and operational risks, and to state how they are managed. The ISA and the insurance association could provide guidance on how to identify and address all risk categories in principle.
Benchmark F.3	**Additional corporate governance disclosures do not need to be audited but at a minimum should include: (1) annually, listing of the names and roles of supervisory board members and key senior managers and their major affiliations and remuneration (by bands), (2) authorities and responsibilities of the company's governing bodies, and (3) annually, identity of controlling or otherwise significant direct and indirect beneficial owners of the insurer. As they occur, any significant changes in the aforementioned should be reported in a widely-read newspaper recognized as an official publication under by the national law. All disclosure statements required should be easily accessible by the general public, including on an insurer's website where one exists.**
Description	A law on Regulating Information in the Public Interest is being prepared. The names of the supervisory board members, the management board and the senior managers needs to be disclosed annually in the company's financial statements, and also the shareholdings of the top 10 shareholders. Disclosure in the Slovenian insurance market continues to improve, with a great deal of information already being made public as required by law (see paragraph above). Significant changes are not reported in newspapers, however it appears as though, this being a small community, such changes are advised through informal channels and then reported. Most of the insurance companies have websites, which are also used for reporting. There is no legal requirement to do so.
Recommendation	None
Benchmark F.4	**The chairman of the audit committee and a member of the management team (either the CEO or CFO) should be required to sign the disclosure statements attesting to their accuracy and completeness.**

Description	As covered elsewhere in this report, there are no legal requirements of needing to create an audit committee. There is also no requirement by the supervisory board to sign the accounts – they are signed by a member of the board of management as per CA Article 282. There is no legal requirement for a CEO to sign to sign disclosure statements. Companies follow the legal practice, and hence members of the supervisory board do not sign off on the accounts. The annual accounts are usually signed by the chairman of the management board, a position commensurate with a CEO.
Recommendation	The legal framework needs to be amended such that the chairman of the audit committee and a member of the management team (either the CEO or CFO) should be required to sign the disclosure statements attesting to their accuracy and completeness**.**
Benchmark F.5	**The regulatory structure should not impede contestability and competitiveness in the insurance sector, subject to ensuring that all insurer applicants meet the standards required for entry as an insurer. Regulatory and supervisory measures should not differentiate between like-institutions unless required for prudential reasons or the maintenance of a sound and efficient financial system.**
Description	The rules relating to applicants wishing to obtain an insurance license are laid out in IA Articles 66 to 69. There is no legal requirement for the ISA to not impede the insurance market, nor is there a legal requirement to treat all like-institutions in the same manner. Given the opaque nature of the ISA's operating procedures generally, it could not be determined whether all applicants are assessed on the same grounds. It could also not be determined whether all existing insurance companies are treated equally by the ISA.
Recommendation	As recommended elsewhere in this report, the ISA should adopt procedures to operate as transparently as possible in all its dealings with stakeholders***.***
Benchmark F.6	**Policyholder guarantee schemes should not be established unless there is an adequate supervisory and governance environment. Such schemes in any event should not unduly encourage moral hazard.**
Description	The legal framework addresses policyholder guarantee schemes in respect of compulsory insurance classes of business only.
Recommendation	Slovenia should monitor developments, but take no action at this time.
Benchmark F.7	**The supervisory authority should consider the possible feasibility, costs and benefits of alternative mechanisms for strengthening market disciplines on insurers that are wholly or majority-controlled by a parent entity. Leading insurance companies should seek internationally accepted claims-payment ratings, and where applicable, credit ratings.**
Description	There are no legal requirements for the ISA to strengthen market disciplines for insurers that are controlled by a parent entity, nor are there legal requirements to seek international ratings. There are some insurers with a holding company structure – market share would be less than 5 percent. One major insurance group, Sava, has an S&P credit rating (BBB+).
Recommendation	The larger insurance companies, Triglav in particular, should be encouraged to obtain and publish an international credit rating.
Benchmark F. 8	**An active independent financial press should be in place and willing and able to comment on financial activities and market conduct of insurance companies.**
Description	Slovenia, as a relatively small country with commensurate interdependent business relationships, has some difficulty in declaring its press truly independent. In addition, the complexity of accounting for insurance companies makes it difficult for the press to provide incisive thought into

	analysis of the financial statements. There is evidence that the press has reported on some controversial matters affecting insurance companies.
Recommendation	Education to financial journalists on the financial statements of insurance companies could be provided through the Slovenian Insurance Association.
	Section G - External Audit
Benchmark G.1	**Financial information in insurer disclosure statements should be audited by an independent external auditor at least annually.**
Description	IA Article 167(1) provides that the annual report of an insurance company must be audited by an independent and certified auditor. All insurance companies are audited by large international audit firms.
Recommendation	None
Benchmark G.2	**Audits should be performed using the International Standards of Auditing (ISA) set by the International Federation of Accountants (IFAC) or equivalent national standards. All approved insurance auditors should be certified by the professional audit body to apply international audit standards and have access to adequate actuarial expertise. Specific attention should be paid to audit of systems as well as accounting balances.**
Description	The auditors are required to use international auditing standards. Insurance companies in Slovenia are audited by international auditing firms which apply international standards of auditing. All of these firms have at their disposal actuarial expertise, which is used during the audit of Slovenian insurance companies as a matter of course.
Recommendation	Once the 8th Company Law Directive is enacted in the European Union, a national oversight body for the auditing profession should be created to comply with the Directive.
Benchmark G.3	**The audit firm should be sufficiently independent of the audited entity to ensure a fair and objective audit. Insurance audit partners should be required to rotate on a periodic basis (desirably at intervals not exceeding five years), with an appropriate cool-down period for the exiting audit partner. There should be an appropriate separation between audit and non-audit services, such that the performance of non-audit services does not compromise the independence and performance of the audit. Fees paid by insurers to audit firms should be disclosed and broken down by type of service.**
Description	IA Article 167(2) states that an audit firm needs to be replaced by the insurance company every five years. The auditing firms are completely independent of the insurance companies, and the legal requirement to rotate audit forms, not just audit partners as stated in the benchmark, may be an excessively costly burden to the insurance industry. Generally, the separation of providing audit services and non-audit services is understood by both the insurance companies and the auditors. In one case, it was found that the auditing company also performed a valuation of the company for the owner, although even then another international office of the audit company performed the valuation.
Recommendation	None
Benchmark G.4	**Auditors should have the legal obligation to report to the supervisory board and the supervisory authority any concerns they may have in relation to a client insurer, including in respect of breaches of laws or regulations.**
Description	IA Article 167(2) requires that the insurance company needs to submit audited accounts to the ISA within 8 days of receiving the auditor's report. IA Article 168 requires an auditor to report to the ISA immediately if it is

	found that the insurer is "threatened by illiquidity or insolvency". There is no requirement for the auditor to report to the ISA directly on any other matters. IA Article 168 requires that the auditor needs to report to the ISA on insufficient risk management practices. There is no requirement to report on other breaches of laws or regulations. The external auditors act in accordance with the laws described above.
Recommendation	The reporting requirements for external auditors should be expanded, so that they are obliged to report material irregularities directly to the supervisory board.
Benchmark G.5	**The engagement letter for the external audit should be approved by the audit committee of the supervisory board. At the end of the external audit process, the auditor should prepare a management letter, to which the insurer's management should prepare a formal response. The management letter and management's responses should be reviewed by the audit committee and should be presented to the supervisory authority upon request by the authority.**
Description	There is no legal requirement for auditors to be appointed by the supervisory board or by a committee, nor is there a legal requirement for auditors to produce a management letter. The interaction between auditors and corporate representatives takes place at the level of CFO, AA and the board of management. There is little direct interaction between the supervisory board and the auditors.
Recommendation	The insurance legislation or regulations should require that the supervisory board become involved directly with the auditors: by appointing them through a committee, which also becomes responsible to interact with the auditors by reviewing a management letter prepared by auditors, and overseeing the preparation of a formal response.
Benchmark G.6	**Key regulatory information submitted by an insurer should be audited at least annually by the external auditor where not already subject to audit.**
Description	There is a requirement to audit regulatory returns (IA Article 170(1)11). There are some 55 periodic regulatory returns to be submitted by insurance companies. It appears that, despite the legal requirement, many of these returns are not audited. Given the significant volumes of reporting to the ISA, external audit of all returns may be inappropriate.
Recommendation	The ISA could consider whether to insist that the key annual returns be audited on an annual basis, and the requirement to have all other returns audited be dropped.
	Section H - Industry Initiatives
Benchmark H.1	**The insurance sector should establish an insurance association. The association should promote good corporate governance practices, including the development of benchmarks and possibly a voluntary code, and training programs for insurance supervisory board members.**
Description	The Slovenian Insurance Association was established in 1992. The association has been active in providing training programs, and has also recently provided an ombudsman in respect of customer complaints. This association is regarded as having made a significant positive contribution to the insurance industry.
Recommendation	The Slovenian Insurance Association should place more emphasis on the importance of corporate governance in the industry. Courses on corporate governance could then be added to its education agenda.
Benchmark H.2	**Institutes of directors should be encouraged to provide guidance on desirable corporate governance practices and training for supervisory board members, in possible cooperation with the insurance association.**

Description	None of the managers interviewed by the Bank team advised us that there was an active institute of directors. There is an institute of managers which appears to deal with operational matters.
Recommendation	The institute of directors should become more visible, and provide guidance on the importance of implementing good corporate governance principles.
Benchmark H.3	**National stock exchanges should incorporate strong corporate governance provisions in their listing rules.**
Description	The stock exchange has strong corporate governance provisions within the Securities Act, in particular Articles 9 and 41. These rules are expanded upon in the publication Rules and Instructions of the Ljubljana Stock Exchange, 2005. As none of the Slovenian insurance companies are listed, the impact of the corporate governance principles on insurance companies was not investigated.
Recommendation	None at this stage. This matter will need to be addressed when Slovenian insurance companies intend to list on the stock exchange.
	Section I - Special Issues Relating to Wholly or Majority Foreign Owned or Controlled Insurance Subsidiaries and Branches
Benchmark I.1	**The management of a foreign insurance subsidiary should be directly accountable to the supervisory board of the subsidiary, even if they have reporting responsibilities to the parent entity.**
Description	In referring to the operations of a foreign insurance company, IA Article 97 specifically excludes the application of Article 27 which requires that management boards report to supervisory boards. Therefore, the management board of a foreign insurance subsidiary is not accountable to the supervisory board of the subsidiary. Foreign insurance companies make up less than 3 percent of the Slovenian insurance market, and hence this issue was not investigated in detail.
Recommendation	None
Benchmark I.2	**The host supervising authority of a branch of a foreign insurer should ensure that the head office of the insurer exercises appropriate control over the branch.**
Description	The EU rules in respect of this matter are covered by IA Articles 100 and 101. The insurers likely to enter the Slovenian market are from developed countries such as the EU, and perhaps the US, Canada or Australia. The supervising authorities of any of those countries exercise a high level of regulation over the insurance companies operating in their country.
Recommendation	None
Benchmark I.3	**Legal title to the assets covering the policy-holder liabilities of a foreign insurer's subsidiary should be in the name of the subsidiary rather than the parent. For a foreign insurance branch, the host supervisory authority should satisfy itself that the branch assets are legally available to meet its liabilities, in the case of head office failure.**
Description	IA Article 97(4) requires that branches of foreign companies keep sufficient investment assets within Slovenia to cover their obligations to their Slovenian policyholders. The law seems to be sufficiently adequate to cover this benchmark.
Recommendation	None

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