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European Standards for Insurance Supervision With Reference to Their Implementation in the Republic of Serbia and Bosnia and Herzegovina

Abstract: Corporate scandals that have affected the financial sector have significantly impacted the operations of insurance companies and the trust of insurance service consumers in these companies. At the European Union level, this problem has been recognized, leading to the adoption of the Solvency II Directive. This Directive aims to address challenges and issues faced by insurance companies through appropriate management and supervision of their operations. Supervision includes continuous monitoring to ensure that insurance and reinsurance companies are properly conducting their business and complying with supervisory provisions.

In this paper, the author attempts to analyze the supervisory provisions established with the adoption of the Solvency II Directive. In the second part of the paper, the author focuses on analyzing the existing supervisory models in the Republic of Serbia and Bosnia and Herzegovina, considering that both countries aspire to EU membership and will need to align their legislation with European provisions in the future. The author pays particular attention to the supervisory body, noting that in the Republic of Serbia, the insurance market is supervised by the National Bank of Serbia as the central bank, whereas in Bosnia and Herzegovina, a separate Agency for the Supervision of the insurance market has been established.

Key words: Solvency II Directive, insurance supervison, supervisory body, insurace companies, EU.

1. INTRODUCTION

A well-structured framework and controlled processes form the foundation of optimal operations and are essential for both insurance companies and regulatory and supervisory bodies. It's important to note that effective supervision isn't only about applying regulations but also ensuring feedback is provided to the regulator. The supervisory authority needs to understand the changes and issues that arise in the implementation of regulations and the business practice requirements

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for modifying and adapting certain solutions.[1] The specificity of insurance sector requires a high level of expertise from both the management and employees of insurance companies and the individuals entrusted with performing supervisory function.[2]

State control over the entry of insurance companies into the market, including the oversight of their business operations, is essential because these companies are significant financial hubs where substantial amounts of funds are concentrated. As a result, other objectives may cause owners or management to neglect and overlook the company's primary duty, which is to meet the obligations stipulated in the insurance contract. [3]

Entering the market represents the first checkpoint and the right moment for the supervisory body to prevent a company that does not meet the prescribed conditions from entering. These conditions relate to the organization, legal acts, management structure (both organizational and personnel), and their fulfillment represents the initial guarantee of the entity's solvency, i.e., the assumption of fair, legal, secure operations, and sustainability in the market. In the insurance business, this time factor and continuity of service provision to the client is a key requirement and the basis of market trust. However, equally important is the phase of supervisory body activities that continues after granting the permit to operate, which involves various forms of monitoring the behavior of the company and its compliance with internal (autonomous) and external (legal and other) legal rules.[4] Supervisory bodies perform oversight in the insurance sector to control the operations of insurance companies, aiming to protect policyholders and insurance beneficiaries. It is undeniable that clients will have more confidence in insurance companies where there is an adequate system of supervision and control of solvency and operations. For these reasons, member states should ensure that supervisory bodies possess the appropriate expertise, capability, and authority to achieve this goal. To ensure the effectiveness of supervision, the activities of supervisory bodies must be proportionate to the nature, scope, and complexity of the risks present in the operations of insurance and reinsurance companies.

Given the new supervisory provisions in the EU and the aspirations of both the Republic of Serbia and Bosnia and Herzegovina for EU membership, it is necessary to assess the readiness of these countries to implement these provisions. The focus is primarily on the supervisory body, as the structure of this body determines its ability to conduct supervision in accordance with the provisions, both professionally and conscientiously.

2. TYPES OF SUPERVISION IN INSURANCE COMPANIES

Supervision of insurance companies can be categorized into three models: institutional, functional, and integrated.

Institutional model represents the oldest model, following the traditional division of the financial market into three pillars: banking, insurance, and capital markets. Ac-

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[1] Stojković, Lj. (2016), *Pravni aspekti kontrole i upravljanja rizicima u akcionarskom društvu za osiguranje* (doktorska disertacija). Pravni fakultet Univerziteta u Beogradu. 255.

[2] Dedeić, P., Gasmi, G. (2014). Nadzor u osiguranju i relevantni modeli u EU. *Pravo i privreda. 2*. 557.

[3] Nenadić, B. (2006). Ovlašćenja državnih organa u postupku osnivanja društva za osiguranje u uporednom pravu, s posebnim osvrtom na ovlašenja Narodne banke Srbije. *Zbornik radova sa Savetovanja: Osiguranje u susret procesu pridruživanja Srbije i Crne Gore Evropskoj Uniji*. Palić. 261.

[4] Dedeić, P., Gasmi, G., 558.

cepting this division implies the existence of a separate supervisory body for each branch. This body is sometimes a state entity (a department within a ministry or a central bank) or a special agency. Many authors advocate for an independent, autonomous agency that, due to the expert knowledge of its employees and a higher degree of independence, has greater potential to resist political pressures or those from market participants.[5] The main arguments against this type of supervision concern the fact that the once clear distinction between activities in the banking and insurance sectors is becoming increasingly blurred.

In the functional model, the legal status of the supervised entity is not essential; rather, the emphasis is on the object of control. Consequently, the supervisory authority, within its jurisdiction, monitors the behavior of all entities in the financial market, regardless of whether they are banks or insurance companies. Another supervisor directs their activity towards prudential control, overseeing all entities in this regard. Although this approach has its advantages, the costs are significant, and in practice, it has proven complicated for the same entity to be subject to the control of multiple supervisory bodies applying different rules.[6]

Integrated model is a more recent approach that entails the organizational unification of supervision over entities in banking, insurance, and capital markets. It stems from the understanding that all three pillars have more similarities than differences in terms of status and business operations, and it is beneficial to consolidate the supervision of all entities in the financial markets within a single body. This body would undoubtedly have several specialized departments, but the assumption is that their close connection and synergy would yield better results than the institutional approach.[7]

It is important to note that the ongoing development and convergence of financial market participants are expected, and in this sense, communication and cooperation between supervisory bodies are essential. Even if the integrated model is adopted, it is necessary to form a new, special supervisory body for the financial market, within which there will be specialized departments for each financial market entity. It is unjustified to apply the integrated model in such a way that the central bank oversees the entire market, considering that its nature is more oriented towards the banking sector than other sectors.

Taking the aforementioned into account, a compromise solution would be a combination of the integrated and institutional models. This would involve a special body overseeing each financial market entity and a unified body supervising these bodies' operations and facilitating communication and cooperation between them.

3. NEW SUPERVISION SYSTEM IN THE EU - SOLVENCY II DIRECTIVE

The existence of numerous insurance regulations at the national level, along with the lack of harmonization in consumer protection and European contract law, has resulted in a relatively small number of concluded cross-border transactions. Harmonized insur-

5 Wymeersch, E. (2006). The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors. *European Business Organization Law Review*. 251.

6 Dedeić, P., Gasmi, G., 561-562.

7 For more arguments supporting the choice of the integrated model, see: Herring, R., Carmassi, J. (2008). The Structure of Cross-Sector Financial Supervision. *Financial Markets, Institutions & Instruments*. 1. 51–76.

ance contract law would increase the number of such transactions and benefit all parties involved. It would enable insurers to apply the same concepts and calculations across their policies and to spread large risks throughout the EU. On the other hand, it would allow insurance policyholders access to foreign insurance products without the need to adapt their policies and coverage types to the various requirements prescribed by member states. [8]

Financial supervision serves three main and closely intertwined goals: maintaining the safety of financial institutions, protecting consumers (depositors, investors, and policyholders), and preserving financial stability, meaning addressing the risk of one institution's failure causing others in the financial market to fail, leading to the destabilization of the entire financial system.[9]

3.1. Objectives of the New Supervision System

The aim of the Solvency II Directive is to create a supervisory system that is more risk-based, transparent for consumers, and more flexible in its application compared to the previous system.[10]

The Directive represents a key instrument for achieving the internal market, thus allowing insurance and reinsurance companies that have been approved in their home member states to conduct some or all of their activities across the entire EU by establishing branches or providing services. Therefore, it is necessary to achieve alignment among member states for mutual recognition of approvals and supervisory systems, thus enabling a single approval valid throughout the EU and allowing the supervisory authority to be carried out by the home member state.[11] The priority of protecting insurance policyholders on the financial market in insurance supervision law, both at the EU level and at the level of member states,[12] is one of the significant differences compared to banking regulation, where financial market stability is equally important. This priority for protecting insurance policyholders continues to exist in the new regulatory regime. Contemporary rules for protecting the interests of policyholders do not insure through legislative interference in the content of relationships established by insurance contracts, but through unification of control over the establishment, and then the operations, of insurance companies.[13]

3.2. Authorities and conditions necessary for achieving the objectives of supervisory body

Member states should ensure that supervisory bodies have the necessary resources and relevant expertise, capacity, and authority to achieve the main objective of supervi-

[8] Kyriaki, N. (2010). Politika EU u oblasti prava osiguranja i reosiguranja i mogućnost harmonizacije: stvarnost ili fikcija. *Revija za pravo osiguranja*. 3. 25.

[9] Staikouras, P., (2016). Triantopoulos, C. Financial Supervision after the Crisis: The Structures, the Lessons, and the Way Forward. *Europena Business Law Review.* 76.

[10] See: Tošić, I. (2017). Nadzor osiguranja – Direktiva Solventost II. *Strani pravni život.* Institut za uporedno pravo. Beograd. 2. 147-162.

[11] Recital 11 Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), Official Journal of the European Union – Directive.

[12] Recital 16, Recital 105, Recital 106, Recital 141, Art. 27, Art. 132, para. 2 Directive.

[13] Berr, C.J., (1995). Droit european des assurances fascicule 1010 du Juris- Classeur de droit communautaire, Paris. *Editions Techniques- JURIS Classeurs*. 3.

sion.[14] Member states provide supervisory bodies with the resources to fulfill their obligations under the Directive, including all necessary capacities, as well asfinancial and human resources.[15] Supervision is future-oriented and risk-based, involving continuous monitoring of proper performance of insurance and reinsurance activities, as well as ensuring these companies' compliance with supervisory provisions. Supervision of insurance companies includes an appropriate combination of indirect and direct supervision.[16] The Directive extensively regulates the reporting of the supervisory authority, as well as the supervisory review process conducted by the supervisory authority. Thus, it enables the transformation of the supervisory review process into continuous and prospective supervision, based on the processing and interpretation of both quantitative and qualitative information obtained from insurance companies. Therefore, according to the new supervisory review process, there is an additional "tool" which enables the supervisory authority to take appropriate preventive measures in most situations if the financial stability of an insurance company deteriorates due to inadequate decisions adopted by its management.[17]

Supervisory bodies have the authority to take preventive and corrective measures to ensure that the operations of insurance companies comply with the laws and other regulations. Furthermore, they have the authority to take all necessary measures, as needed, including administrative or financial measures, regarding insurance companies and members of their management or supervisory bodies.[18]

3.3. Business Model Analysis - New Direction in Insurance Supervision

The implementation of the Solvency II Directive has led not only to a revision of insurance company business rules but also to changes in supervisory methods. Detailed and well-elaborated regulatory framework for management systems has been established. Another innovation concerns the replacement of the previous supervisory reporting system, based on accounting principles, with a system based on risk data that will be supplemented by the obligation to disclose data to increase transparency.[19]

According to some authors, it is necessary to apply a new supervisory system, more recent than the one based on risk, the so-called business model analysis-based supervision, considering that this type of supervision conducts a more detailed analysis of the insurance company than traditional supervision or risk-based supervision. This approach is focused on the future and aims to ensure that resources are directed towards the greatest risks and that future risks facing the company are identified in advance.[20]

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14 Art. 27 Directive.

15 Recital 17 Directive.

16 Art. 29 Directive.

17 Petrescu, R. M., (2015). Modernizing the Insurance Law in the Light of the New Supervision System Solvency II. *Conferinta Internationala de Drept, Studii Europenesi Relatii Internationale*. 248.

18 Art. 34, para. 1 and 2 Directive.

19 Sebeledi, F. (2015), Novi pravci u nadzoru osiguranja – nadzor zasnovan na poslovnom modelu i upravljanje proizvodima, *Pravo osiguranja, uprava i transparentnost- osnove pravne sigurnosti*. XVI Savtovanje. Palić: Udruženje za pravo osiguranja Srbije, Nemačka fondacija za međunarodnu pravnu saradnju, Nemačko udruženje osiguravača. 123.

20 Breckenridge, J. Farquharson, J., Hendon. R. (2014). The Role of Business Model Analysis in the Supervision of Insurers. *Bank of England Quarterly Bulletin*. 51.

Having that in mind, this supervisory method is not much more developed than the traditional risk-based supervisory method, nor does it represent a completely new method that will replace previous ones. Risk-based supervision has not invalidated the rule based on traditional techniques, so business model analysis represents just a new aspect of supervision that complements the previous method. The essence of this supervisory method is for the supervisory authority to more comprehensively examine the operations of the insurance company and evaluate it from both economic and business perspectives. It is necessary to ascertain the sustainability of its operations as a whole and conduct profitability analysis over different timeframes. An important part of supervision is understanding both the future risks and current risks that may jeopardize the sustainability of insurers' operations. [21]

This expands the scope of supervision in two directions. First, it expands the scope of supervision because the company is analyzed from a business perspective (instead of just assessing compliance with regulations and risk aspects). Additionally, the timeframe of supervision is being extended. By applying the traditional method, events from the past were assessed from a legal perspective (with an emphasis on regulatory breaches). The risk-based method interrupted such an approach by analyzing the current and near-future state, thus significantly increasing the role of the economic aspect. Business model analysis extends the time span to the duration of implementing the established strategy (for example, short-term profitability also appears in the medium and long term, etc.), and it also indicates business rationality alongside (non)legality of operations and adequacy of risk controls. Thus, the business aspect becomes a part of supervision based on the principle that there is no sustainability of operations without adequate profitability, as loss of business adequacy is only a matter of time.[22] This new supervisory method introduces a challenge in establishing rules for facts classification, evaluating them, and deciding on the measures to be taken.[23]

In conclusion, according to this model, it is necessary to use a three-step approach to prudent conduct in order to obtain a more detailed picture of the company subject to supervision. The first step of the analysis is based on traditional legality of operations, assessing whether the company complies with legal regulations. Within this part of supervision, events from the past are analyzed. The second step is based on risk supervision, which also deals with accumulated and current risks existing in the company. Risks arising from past events with present and future consequences are analyzed. The third and final step is based on business model analysis, assessing the sustainability of profitability of the institution over different time spans. In this way, the previous two methods are complemented.[24]

However, supervision of the operations of insurance companies must be adapted to the business of each supervised entity, considering that it is specific and unique to each company. Therefore, it is necessary for the supervisory authority to analyze each specific case and provide a clearer and more comprehensive explanation of the criteria by which the analysis and evaluation of the company were conducted. The reason for this approach is precisely to create the possibility of preventing different decisions of supervisory au-

[21] *Ibid.*

[22] Sebeledi, F. 124-125.

[23] Za više v: *Ibid.,*125-127.

[24] *Ibid.*, 129.

thorities, in terms of consistency of these decisions, threatening the principle of equality of all subjects in legal traffic.[25]

A disadvantage of supervision conducted through business model analysis is highlighted as the difficulty in controlling omissions, deficiencies, or gaps, i.e., the circumstances that the insurance company has overlooked. For the supervisory authority to establish facts and evaluate the business model, it must assess whether existing business model documentation is based on the actual business of the company.

It is necessary to have prescribed authorities of the supervisory body and the possibility of issuing early warning measures for this method of supervision to be functional.[26] An additional problem with the application of this method is that the supervisory authority must conduct an analysis and in a commercial manner, which is completely foreign to supervisory bodies. These mentioned problems can be overcome through communication with the management of the insurance company, timely pointing out omissions, and informing the management of possible consequences, assuming that the correct measure is found in action.[27]

3.4. Supervisory Review Process

The supervisory review process is a comprehensive review conducted by supervisory authorities to ensure compliance with laws, regulations, and administrative provisions. To harmonize the oversight of European insurers, the Directive identifies a standardized control procedure that must be applied to the insurer's specific risk profile.[28] Therefore, the supervisory review process is a comprehensive process conducted by the supervisory authority aimed at assessing and monitoring the risks arising from the insurer's activities, all for the purpose of protecting the interests of policyholders and insurance service users. This process applies to all insurers to ensure that all policyholders receive the same level of protection regardless of the insurer with whom they have contracted insurance.[29]

The aim of the supervisory review process is to assess the insurer's management system, risk profile, self-assessment capabilities, and compliance with specific quantitative requirements to identify weaknesses or deficiencies as early as possible.[30] As prescribed by the Solvency II Directive, the supervisory review process, in its function as part of insur-

25 Stojković, Lj. 265.

26 For example, in Serbian insurance law, there is a provision for the issuance of a written warning by the NBS.

27 Stojković, Lj. 266.

28 The supervisory authorities shall in particular review and evaluate compliance with the following:
a) the system of governance, including the own-risk and solvency assessment,
b) the technical provisions
c) the capital requirements
d) the investment rules
e) the quality and quantity of own funds
f) where the insurance or reinsurance undertaking uses a full or partial internal model, on-going compliance with the requirements for full and partial internal models. Art. 36. Directive

29 Grazia Sarita, M., Malafronte, I. (2014). *Capital Requirements, Disclosure, and Supervision in the European Insurance Industry - new challenges towards Solvency II.* Palgrave Macmillian. 145.

30 Johanna Erd, O. (2015). *Twin Peaks for Europe: State-ofthe-Art Financial Supervisory Consolidation Rethinking the Group Support Regime Under Solvency II*. Springer. 30.

ance supervision, follows the general principles of the new insurance supervision scheme. One such principle is risk-oriented insurance supervision, a quality that requires supervision to align with the actual risk status of insurance companies. This principle requires that, in assessing whether supervisory requirements are met, the individual circumstances of each insurance company be taken into account (the principle of proportionality).[31] The supervisory review process ensures that the insurance company meets the requirements of the first and second pillars of the Directive.[32]

3.4.1. Components of the Supervisory Review Process

The supervisory review process consists of four components:

- Reporting (Solvency and Financial Condition Report and Report to Supervisors and other specific reports);
- Preliminary assessment;
- Determination of supervisory action priorities;
- Follow-up assessment.

The first component of the supervisory review process involves informing the supervisory authority. The insurer must prepare a Solvency and Financial Condition Report at least once a year, containing information on the solvency status disclosed to the public, and a report to the supervisory authority that will also contain private information on the solvency position and the management system. The supervisory authority will add other information about the risks managed by the insurer. Using this information, the supervisory authority should conduct a preliminary assessment of the risk profile of all insurers, aiming to prioritize supervisory actions and determine the appropriate intensity of ongoing supervision based on the nature, scale, and complexity of the insurer's risks.

It is important to note that a series of adverse events can change the preliminary assessment. This often occurs if the insurer, for example, takes on greater risk than its risk tolerance; there are errors in internal control within the internal control system; it operates in a challenging environment, such as maritime operations, etc.[33] According to the results of the preliminary assessment, the supervisory authority will be able to measure the insurer's risk profile and, consequently, prioritize supervisory measures. Based on the conclusions drawn during the review, the supervisory authority should identify any weaknesses, actual or potential deficiencies, or non-compliance with requirements that could necessitate the implementation of supervisory measures.[34]

The national supervisory body should have an established management procedure for implementing supervisory measures to ensure they are applied consistently, proportionally, and objectively, with proper documentation.[35] It is also necessary to timely inform the company of the specific measures it needs to implement, specifying the appropriate timeframe within which it must undertake necessary activities to comply with measures.[36]

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31 Dreher, M. (2015). *Treatises on Solvency II*. Springer Berlin Heidelberg. 27.

32 Heep-Altiner, M., Mullins, M., Rohlfs, T. (2018). *Solvency II in the Insurance Industry Application of a Non-Life Data Model*. Springer. 9.

33 Grazia Sarita, M., Malafronte, I. 149.

34 EIOPA, Guidelines on supervisory review process, 2015, Guideline 33.

35 EIOPA, Guidelines on supervisory review process, Guideline 38.

36 EIOPA, Guidelines on supervisory review process, Guideline 39.

The follow-up assessment is crucial for determining whether the action taken by the supervisory authority has yielded the expected results. In this regard, supervisory experience plays a fundamental role. It is necessary first to determine whether the insurance companies are implementing planned measures appropriately,[37] and then to review the measures and update the supervisory plan depending on the success of the measures.[38]

In summary, risk-based supervisory review approach is designed to ensure that the supervisory authority accounts for the risk profile of each insurer. Thus, supervisory review process provides an additional incentive for insurers to improve risk management. These components describe a continuous process that allows supervisory authorities to oversee insurers through a series of monitoring actions and take the most appropriate actions according to a predefined scale of supervision.[39]

3.4.2. EIOPA Guidelines for the Supervisory Review Process

EIOPA has issued Guidelines for the supervisory review process provided for implementing Article 36 of the Solvency II Directive. Their aim is to establish how a proportionate, risk-based, and forward-looking approach to supervision can be achieved within the supervisory review process. The idea is to achieve consistent outcomes through the harmonization of supervisory procedures and practices within the supervisory review process, while ensuring sufficient flexibility for national supervisory authorities so they can appropriately tailor their decisions on a case-by-case basis, taking into account the specificities of the insurance and reinsurance companies and groups involved, their own markets, and other supervisory priorities.[40]

The national supervisory body should ensure that the supervisory review process is consistently applied over time to all insurance and reinsurance companies. It should be noted that unlike Directives, guidelines are not binding and represent so-called “soft” law, so their legal nature raises questions about the effectiveness of their implementation.

4. SUPERVISION OF INSURANCE IN THE REPUBLIC OF SERBIA

With the adoption of the Insurance Law in 2004, the National Bank of Serbia (NBS) became the authority responsible for supervising insurance activities in the Republic of Serbia, followed by appropriate provisions contained in the Law on the National Bank of Serbia (NBS Law).[41] Current Insurance Law states that the role of the NBS in supervising insurance companies is to preserve and strengthen the financial stability of the insurance market as part of a modern, efficient, and stable financial sector, with the aim of protecting the rights and interests of policyholders and other insurance users. According to Article 13, paragraph 1 of the Insurance Law,[42] the NBS supervises the performance of insurance activities in accordance with this law and the law regulating its status, organization, powers, and functions. The supervisory function of the regulator is extensively defined in Ser-

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37 EIOPA, Guidelines on supervisory review process, Guideline 41.

38 EIOPA, Guidelines on supervisory review process, Guideline 42.

39 Grazia Sarita, M., Malafronte, I. 147.

40 EIOPA, Guidelines on supervisory review process, Guideline 1.2 i 1.4.

41 Law on the National Bank of Serbia [Zakon o Narodnoj banci Srbije], Official Gazzete, 72/2003, 55/2004, 85/2005 , 44/2010, 76/2012, 106/2012, 14/2015, 40/2015 – decision CC and 44/2018.

42 Insurance Law [Zakon o osiguranju], Official Gazette RS, 139/2014 i 44/2021.

bian law, reducing the maneuvering space for the subjects under supervision.[43] According to Article 4 of the NBS Law, it issues and revokes permits for conducting insurance activities,[44] controls these activities, i.e., supervises their performance, issues and revokes authorizations for performing certain tasks within insurance activities, and carries out other tasks in accordance with the law regulating insurance. Therefore, administrative supervision is involved, and the NBS is, in this context, an independent state non-administrative organization acting as an executor of administrative work.[45] Considering that this is an administrative supervision, for comprehensive understanding of the NBS's activities and to decipher its nature, it is first necessary to determine the subject of this control, the control procedure, and the type and content of the NBS's authority and the measures it can impose on insurance companies during the supervision process. These issues are regulated by the NBS Law, the Insurance Law, as well as a by-law – the Decision on the conditions and manner of supervising the operations of insurance/reinsurance companies and other entities under supervision in the insurance sector.

The NBS Law uniformly regulates the supervisory function of the NBS over all financial institutions in Chapter IV, providing only that the supervision of financial institutions within the NBS is carried out in a manner ensuring the operational autonomy of organizational units performing these tasks and their separation from other functions and tasks of the NBS, as well as preventing conflicts of interest. The NBS may issue regulations establishing standards for stable and secure operations of the entities it supervises, carry out control over these entities, examine their business books and other documentation, as well as persons connected to them by property, managerial, or business relationships, and prescribe closer conditions and methods for exercising the supervisory function, in accordance with this and other laws. It is precisely these closer conditions and methods for exercising the supervisory function that are regulated by the mentioned Decision.

The NBS supervises companies' operations through continuous monitoring, solvency assessments, risk profiling, monitoring of the comprehensiveness and reliability of established corporate governance and management systems, monitoring of business transparency and market behavior, verifying the accuracy of business changes recorded in business books, compliance of company operations with law and regulations, or principles established by law, as well as other matters subject to supervision,determination of irregularities and violations in company's operations.[46]

The main task is to ensure that insurance companies are financially capable at all times to fulfill their obligations to policyholders, insurance beneficiaries, and third-party injured parties, and that individuals selling insurance are adequately prepared to meet the

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43 Petrović Tomić, N. (2021), Načelo zakonitosti poslovanja u sektoru osiguranja- tezice o odgovornosti članova uprave društva za osiguranje u svetlu compliance funkcije. In: Vuk Radović (ed.) *Usklađivanje poslovnog prava Srbije sa pravom EU*. Pravni fakultet Univerziteta u Beogradu. 101.

44 See: Tomić, Z., Petrović Tomić, N. (2009). Izdavanje i oduzimanje dozvola za rad osiguravajućim društvima. *Pravo i privreda*. 5-8. 185-215.

45 See: Tomić, Z. (2002). *Upravno pravo. Sistem.* Beograd - Službeni list SRJ. 248-249.

46 Para. 2. Decision on the conditions and manner of supervising the operations of insurance/reinsurance companies and other entities under supervision in the insurance sector. [Odluka o uslovima i načinu vršenja nadzora nad poslovanjem društva za osiguranje/reosiguranje i drugih subjekata nadzora u delatnosti osiguranja], Official Gazette RS, 51/2015.

needs of citizens and economic entities for insurance.

We can notice that the situation in Serbia is specific because it is not common for central banks to oversee insurance sector. Given the importance of supervision and the expectation that the supervisory authority be knowledgeable, competent, and capable of achieving its set objectives, and considering that the supervisory authority needs to supplement its legal knowledge with practical knowledge of financial market and insurance market operations, the most appropriate solution is to establish a separate body to supervise the operations of insurance companies, grant and revoke permits, thereby protecting insurance users as well as insurers, i.e., ensuring compliance with the rules of the Directive. This will be particularly significant in the process of Serbia's accession to the EU, when it will have to fully implement the Directive rules. It should be noted that the NBS Law provides for three cumulative conditions for the implementation of supervision over the operations of insurance companies:

- operational autonomy of organizational units performing supervision over the operations of insurance companies;
- their separation from other functions and tasks of the NBS;
- prevention of conflicts of interest.

However, question arises as to whether there really is a separate organizational unit for supervising the insurance sector, considering the Statute of NBS which provides that, among other things, supervision over the work of insurance companies is conducted within the basic organizational units of the NBS. However, the same article envisages that one or more tasks can be performed within basic organizational units, and individual tasks can be performed in multiple basic organizational units, while departments, sections, and services or organizational units of another name can be formed within basic organizational units if it suits the nature of the tasks performed in them.[47] This way, neither operational autonomy nor separation from other functions of the NBS is ensured. For these reasons, it is questionable whether there really is an independent organizational unit within the NBS responsible solely for supervising the work of insurance companies, and even if it exists, how capable it is of being separated from other functions of the NBS, especially in a situation where the majority of its functions are geared towards the banking sector. From the above, it can be seen that certain solutions in Serbian legislation call into question the realization of legal security, legal certainty, and the rule of law. Primarily, by granting discretionary powers to the NBS when deciding on revoking permits for entities under supervision, legal certainty and security in carrying out insurance activities are put into question. Such solutions are contrary to the principles of natural law, as the realization of the right to engage in insurance activities depends on the arbitrariness and free will of NBS representatives.[48] Progress compared to the previous law is the definition of criteria that must be applied when adopting supervisory measures, thereby partially limiting the scope for abuse of rights by supervisory authorities, as well as for omissions in assessing and determining supervisory measures.

Considering the above, we believe that supervision of insurance companies should be excluded from the jurisdiction of the NBS and a separate Agency should be established,

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[47] Art. 15, para. 4. The Statute of the National Bank of Serbia [Statut Narodne banke Srbije], Official Gazette RS,12/2013, 18/2015, 72/2015 i 50/2018.

[48] Stojković, Lj. 273.

consisting of prominent experts in the field of insurance, whose sole responsibility would be to carry out supervision over the operations of insurance companies. The fact is that both banks and insurance companies are part of the financial sector, but there are significant differences between these companies, so it would be more appropriate for a separate Agency to supervise, which could have the status of a public, independent, and control body, as is the practice in most countries.[49] However, it should not be overlooked that the daily development and convergence of financial market members are expected, and in that sense, communication and cooperation between supervisory authorities are necessary. Even if the integral model of supervision were accepted, it is necessary to establish a new separate body for financial market supervision, within which specialized departments would exist for each subject of the financial market. It is unjustified to apply the integral model in a way that central bank supervises the entire market, considering that it is by its nature more oriented towards banking than other sectors.

Regarding the Republic of Serbia, best solution seems to be a combination of integral and institutional models, whereby there would be a separate body supervising individual subjects of the financial market, but also a unified body supervising the work of these bodies and facilitating communication and cooperation between them. When it comes to compliance with the supervisory provisions of the Solvency II Directive,[50] NBS has envisaged a Strategy for the Implementation of Solvency II, which is being implemented in three phases.[51]

5. SUPERVISION OF INSURANCE IN BOSNIA AND HERZEGOVINA

Insurance supervision in Bosnia and Herzegovina differs from that in the Republic of Serbia, as it is carried out by special Agencies - the Insurance Agency of Republic of Srpska and the Insurance Supervisory Agency of the Federation of Bosnia and Herzegovina (Federation of BiH), which oversee the entire market. The division of Bosnia and Herzegovina into two entities, the Federation of BiH and Republic of Srpska, guaranteed by the Constitution of Bosnia and Herzegovina, resulted in the division of responsibilities in the field of insurance, leading to the establishment of entity agencies. The umbrella institution at the state level, the Insurance Agency of Bosnia and Herzegovina, serves as a link between the entity supervision agencies and the state authorities of BiH. Its main task is to harmonize the legislation of entities in field of insurance and align it with legislation of the European Union, as well as to create a unified and competitive insurance market in BiH and align insurance policy of BiH with that of the European Union.[52]

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49 Tomić, Z., Petrović Tomić, N., (2016). Ovlašćenja Narodne Banke Srbije u sprovođenju nadzora nad delatnošću osiguranja - pravo osiguranja u zagrljaju upravnog prava. *Aktuelna pitanja savremenog zakonodavstva,* Budva - Savez udruženja pravnika Srbije i Republike Srpske. 204.

50 See: Tošić, I. (2022). Usklađivanje prava osiguranja Republike Srbije sa Direktivom Solventnost II. *65 godina Rimskih ugovora - Evropska unija i perspektive evropskih integracija Srbije*. Institut za uporedno pravo. Beograd. 157-170.; Tošić. I. (2017). Izazovi u implementaciji Direktve Solventnost II u Srbiji. *Pravo i privreda*. Udruženje pravnika u privredi Republike Srbije. 7-9. 526-541.

51 https://www.nbs.rs/export/sites/NBS_site/documents/osiguranje/strategija_solventnost_II.pdf , 30.05.2024.

52 Škrbić, N., Sajić, A., (2015). *Registracija i osnivanje osiguravajućih društava u Bosni i Hercegovini*. Banja Luka: Advokatska firma Sajić. 7.

These Agencies are independent and nonprofit institutions with regulatory and supervisory functions aimed at protecting individuals entitled to insurance coverage and compensation, as well as the welfare of the insurance industry. In carrying out their functions, they act in manner most conducive to achieving regulatory goals (supervising implementation of laws; regulating operations in the insurance market; building market trust; preventing and detecting financial crime; educatngi on the benefits and risks associated with various types of insurance and providing appropriate information and advice; consumer counseling and protection).

The Agency issues a permit for insurance companies to conduct one or more types of insurance business. Additionally, it may temporarily or permanently revoke the issued permit for all or some types of insurance business conducted by that company. The supervision procedure itself is regulated by a specific Regulation. In accordance with the Law on Insurance Companies of Republic of Srpska, the President, members of the Board of Directors, and the Director of the Agency must be citizens of BiH, with university education, a good reputation, and professional experience in the field of insurance or finance, and must not have been convicted of crimes related to financial crime or violations of public or professional duties.[53] On the other hand, at the Federation level, a special regulation on the selection of competent individuals to carry out supervision has been adopted, which regulates in detail the qualifications required of persons conducting supervision in the insurance market.[54] This ensures that supervision of the insurance market is conducted by qualified individuals with specialized knowledge in the field of insurance, who are focused on this sector, meet the requirements in terms of expertise and competence, and have the ability to achieve the expected objectives.

As a signatory to the Stabilization and Association Agreement with the EU, Bosnia and Herzegovina has committed to developing, amending, and harmonizing its insurance legislation with EU legislative activities. Based on this Agreement, BiH and the EU should establish close cooperation to contribute to the overall development and progress of BiH. However, the only strategic document in Bosnia and Herzegovina addressing this issue is the Strategic Framework for Transition to a Solvency II-based Regulatory Framework, issued by the Insurance Agency of Republic of Srpska. This document defines priority activities for preparing for the transition period and aligning/implementing operations with the new regulatory requirements. Bosnia and Herzegovina has not yet begun effective and efficiently programmed preparations for Solvency II. Since starting date of implementation in BiH is uncertain, it would be necessary to study and adopt the experiences of European insurers in preparatory activities for the implementation of this Directive. The Insurance Agency in BiH could use the strategic plan already in place in Republika Srpska as a basis for taking necessary steps in research and implementation.

6. CONCLUSION

Solvency II Directive introduces a very modern system of insurance supervision based on risks, with the main goal of protecting insurance service consumers, while other

[53] Art. 8 Law on Insurance Companies of Republic of Srpska [Zakon o društvima za osiguranje Republike Srpske], Official Gazette Republic of Srpska, 17/05, 01/06, 64/06, 74/10, 47/17, 58/19.

[54] Regulation on the selection of expert personnel for conducting supervision [Pravilnik o izboru stručnih osoba za provođenje nadzora], Official Gazette Federation of Bosnia and Herzegovna, 1/18.

objectives serve to achieve that main goal. In this way, the main objective of supervisory provisions in insurance companies differs from that envisaged in the rest of the financial sector. The role of the supervisory authority lies in its ability to enable adequate access to corporate governance and risk management in insurance companies through continuous verification of proper conduct of business and compliance of insurance and reinsurance companies with supervisory provisions. As we have seen, the Directive requires member states to establish supervisory bodies with appropriate expertise, capability, and authority to achieve the main supervisory goal. The principle of proportionality is also applied here, ensuring that supervisory activities are aligned with the nature, scope, and complexity of the risks present in the insurance business, thereby enhancing the effectiveness of supervision. Considering the specificity of each part of the financial sector and the fact that daily development and convergence of financial market members are expected, as well as the necessity of communication and cooperation between supervisory authorities, the author advocates for a mixed supervision model (a combination of integrated and institutional model). This would entail the existence of a special body overseeing each financial market participant, as well as a single body overseeing the work of these bodies and facilitating communication and cooperation between them. The Directive also establishes a supervisory review process designed to ensure that the supervisory authority assesses the risk profile of each insurer and thereby provides an incentive for insurers to improve risk management.

The Republic of Serbia and Bosnia and Herzegovina are in the process of aligning with the provisions of the Solvency II Directive, although it should be noted that this will not be a simple task. When it comes to the supervision of insurance companies in the Republic of Serbia, in order to improve the supervision system, it should primarily be considered to remove supervision from the jurisdiction of the NBS and organize a separate Agency to deal with this issue. The author advocates for this standpoint not because of incompetence of the NBS to conduct supervision, but due to the role and significance of insurance market in the financial sector. It is also noted that the collapse of one insurance company could lead to a collapse in the entire financial sector, and that the nature of the NBS's responsibilities is more oriented towards banking than insurance. Therefore, it would be more suitable to establish a separate Agency, with experts primarily engaged in the field of insurance, in order to implement an adequate supervision system. This would also relieve the NBS, which, besides being the Central Bank in the country, is responsible for supervising practically the entire financial market. On the other hand, it is observed that such practice is not common, as central banks do not usually supervise insurance companies. While the banking and insurance sectors are closely related, there are certain differences between them, and establishing a separate Agency for insurance market supervision would lead to compliance with the provisions of the Directive and the approximation of the insurance sector of the Republic of Serbia to the European Union market. On the other hand, in Bosnia and Herzegovina, supervision is carried out by a separate Agency, and the regulations clearly prescribe the conditions that must be met by individuals performing supervision, ensuring their expertise and competence. However, unlike in the Republic of Serbia, where the NBS has envisaged a Strategy for the Implementation of Solvency II, in Bosnia and Herzegovina, almost nothing has been done in this regard. For now, the only strategic document in Bosnia and Herzegovina addressing this issue is the Strategic Framework for Transition to a Solvency II-based Regulatory Framework, issued by the Insurance Agency of the Republic of Srpska. Entity agencies have partially harmonized regulations among themselves and are well on their way to aligning laws and sub-laws with the Solvency II Directive, as well as other regulations stemming from this Directive. However, at the state level, it is necessary for the Insurance Agency in Bosnia and Herzegovina to take steps and prepare for the implementation of the provisions of the Solvency II Directive into the legislation of Bosnia and Herzegovina, as an adequate supervision system will achieve greater stability in the financial sector.

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Evropski okvir nadzora osiguranja sa osvrtom na njegovu primenu u Republici Srbiji i Bosni i Hercegovini

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Apstrakt: Korporativni skandali koji su pogodili finsijski sektor, znatno su uticali na rad osiguravajućih društava i poverenje korisnika usluga osiguranja u ova društva. Na nivou Evropske unije, prepoznat je ovaj problem usled kog je doneta Direktiva Solventnost II, upravo sa ciljem da se adekvatnim upravljanjem i nadzorom nad radom osiguravajućih društava spreče izazovi i problemi sa kojima se ona mogu susresti. Nadzor obuhvata kontinuiranu proveru pravilnog obavljanja poslova i usklađenost društava za osiguranje i reosiguranje sa nadzornim odredbama.

U radu autorka nastoji da analizira odredbe nadzora koje su uspostavljene donošenjem Direktive Solventnost II. U drugom delu rada autorka se fokusira na analizu postojećih modela nadzora u Republici Srbiji i Bosni i Hercegovini, imajući u vidu da obe zemlje pretenduju na članstvou EU, pa će u budućosti morati da usklade svoje zakonodavstvo sa evropskim odredbama. Autorka se posebno fokusira na organ nadzora, imajući u vidu da nadzor nad tržištem osiguranja u Republici Srbiji vrši Narodna banka Srbije kao centralna banka, dok je u Bosni i Hercegovini formirana posebna Agencija za nadzor tržišta osiguranja.

Ključne reči: Direktiva Solevntnost II, nadzor osiguranja, nadzorni organ, osiguravajuća društva, EU.