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# Switzerland: Financial Sector Assessment Program—Technical Note—An Assessment of Insurance Core Principles for the Reinsurance Industry

This technical note on the assessment of Insurance Core Principles for the reinsurance industry for Switzerland was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in May 2007. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Switzerland or the Executive Board of the IMF.

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

# SWITZERLAND

# TECHNICAL NOTE: DETAILED ASSESSMENT OF INSURANCE CORE PRINCIPLES FOR THE REINSURANCE INDUSTRY

MAY 2007

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

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## Acronyms

| | |
|---|---|
| ALM | Asset-liability-management |
| AOA | Audit Oversight Act |
| BE | Best estimate |
| CRO | Chief Risk Officer |
| CoC | Cost of capital |
| EEA | European Economic Area |
| EU | European Union |
| FINMA Act | Federal Act on Financial Market Supervision |
| FAOA | Federal Audit Oversight Authority |
| FOPI | Federal Office of Private Insurance |
| FOPI-SO | FOPI Ordinance on the Supervision of Private Insurance Companies |
| ICP | Insurance Core Principle |
| ISL | Insurance Supervision Law |
| IAIS | International Association of Insurance Supervisors |
| ISA | International Standards on Auditing |
| MoU | Memorandum of Understanding |
| SO | Ordinance on the Supervision of Private Insurance Companies |
| SAM | Self-Assessment Modules |
| SSA | Swiss Actuarial Association |
| SICA | Swiss Institute of Certified Accountants |
| SIA | Swiss Insurance Association (SIA) |
| SST | Swiss Solvency Test |
| ISL | The Insurance Supervision Law |

## I. General Information and Assessment Methodology

1. This assessment examines the regulation of the reinsurance industry in Switzerland, benchmarked against the Insurance Core Principles (ICP) issued by the International Association of Insurance Supervisors (IAIS) in October 2003.[1] It is based on: (a) a comprehensive self assessment dated July 2004, prepared by the Federal Office of Private Insurance (FOPI); (b) a review of applicable laws, regulatory/supervisory guidance and procedures; (c) an analysis of regulatory and market data; (d) interviews with staff of the FOPI, reinsurers, industry and professional associations; and (e) documentation provided by various interviewees.

2. The level of observance for each ICP reflects the assessment of the essential criteria only. Advanced criteria are not taken into account in assessing observance of the ICPs. On the basis of the assessment, each ICP is rated in terms of the level of observance as follows:

- "Observed"—when all the essential criteria are considered to be observed or when all the essential criteria are observed except for those that are considered not applicable.
- "Largely observed"—when only minor shortcomings exist, which do not raise any concerns about the authority's ability to achieve full observance.
- "Partly observed"—when, despite progress, the shortcomings are sufficient to raise doubts about the authority's ability to achieve observance.
- "Not observed"—when no substantive progress toward observance has been achieved.

3. The assessments are based solely on the laws, regulations, as well as on supervisory requirements and practices that are in place at the time of assessment. The Insurance Supervision Law (ISL), which came into force in January 2006, provides the broad parameters for the Ordinance on the Supervision of Private Insurance Companies (SO) and the FOPI Ordinance on the Supervision of Private Insurance Companies (FOPI-SO). The FOPI is in the process of elaborating a number of implementing decrees, regulations, and guidelines. Regulatory initiatives, which have yet to be fully implemented, are noted in the report by way of additional comments.

4. The mission is grateful to the FOPI for its full cooperation and assistance with the logistical arrangements and co-coordination of various meetings with industry bodies and companies. Discussions with and briefings by the FOPI during a series of technical meetings also facilitated a meaningful assessment of Switzerland's regime.

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[1] Prepared by Su Hoong Chang (Monetary and Capital Markets Department). A factual update of the overall insurance regulatory framework and supervisory regime is outlined in a separate note.

## II. Overview—Market Structure and Supervisory Scope

5. The Swiss reinsurance market is dominated by three large players with a strong international presence. The reinsurance industry comprises 20 professional reinsurers and 50 reinsurance captives with gross premiums written totaling SwF 37.4 billion for 2005. Swiss Re, European Re, and Converium have consistently maintained more than 75 percent market share. More than 95 percent of reinsurance premiums came from foreign business.

6. Overall, the catastrophic losses arising from the U.S. hurricane season in 2005 did not raise significant solvency issue for Swiss reinsurers. Nonetheless, two smaller reinsurers had to be recapitalized. In 2005, 8 reinsurers were admitted and 2 were liquidated. Five reinsurers are currently in run-off. Claim payouts rose by SwF 2.4 billion (14.2 percent), due mainly to the exceptional losses for 2005, while technical provisions rose by SwF 11.4 billion to reach SwF 81.5 billion.

7. As at end-2005, reinsurers recorded total assets of SwF 131.7 billion. Collateral deposits with cedants have been increasing steadily from less than 7 percent of assets (SwF 2.9 billion) in 1996 to 26 percent (SwF 34 billion) as at end-2005. Intra-group loans and investments in related companies amounted to another SwF 23 billion or 17.4 percent. Fixed income securities accounted for 25.4 percent, while investments in shares have remained relatively stable at less than 8 percent for the past 3 years, halved from the 16 percent in 2000. With an average investment return of 4.3 percent, technical performance and disciplined underwriting will be critical to the industry's profitability.

8. Total equity of the reinsurance industry stood at SwF 18.6 billion at end-2005. Despite the record losses, total surplus rose from SwF 0.5 billion to SwF 1.4 billion. Total reserves held by the industry represent 70 times of surplus and 5.4 times of equity.

9. Generally, the ISL adopts the same regulation for reinsurers and direct insurers, except for the requirements to maintain tied assets and transfer of portfolios.[2] Under the phased implementation of the Swiss Solvency Test (SST), reinsurers are required to implement the SST as from 2008 and compute target capital by 2010. Although the ISL applies to reinsurers domiciled in Switzerland, there is indirect control of foreign reinsurers—direct insurers need supervisory approval to get credit for outstanding claims against reinsurers. The FOPI is currently formulating criteria and supervisory rules for granting credit for reinsurance.

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[2] Article 35 of the ISL.

## III. Summary of ICP Assessment

| ICP | Description | Level of Observance * | | | |
|---|---|---|---|---|---|
| | | O | LO | PO | NO |
| 1 | Conditions for effective insurance supervision | √ | | | |
| 2 | Supervisory objectives | √ | | | |
| 3 | Supervisory authority | | √ | | |
| 4 | Supervisory process | | √ | | |
| 5 | Supervisory cooperation and information sharing | √ | | | |
| 6 | Licensing | | √ | | |
| 7 | Suitability of persons | | √ | | |
| 8 | Changes in control and portfolio transfers | | √ | | |
| 9 | Corporate governance | | √ | | |
| 10 | Internal control | | √ | | |
| 11 | Market analysis | | √ | | |
| 12 | Reporting to supervisors and off-site monitoring | | √ | | |
| 13 | On-site inspection | | | √ | |
| 14 | Preventive and corrective measures | √ | | | |
| 15 | Enforcement or sanctions | | √ | | |
| 16 | Winding-up and exit from the market | | √ | | |
| 17 | Group-wide supervision | | √ | | |
| 18 | Risk assessment and management | | √ | | |
| 19 | Insurance activity | | √ | | |
| 20 | Liabilities | | √ | | |
| 21 | Investments | | √ | | |
| 22 | Derivatives and similar commitments | | √ | | |
| 23 | Capital adequacy and solvency | | √ | | |
| 24 | Intermediaries | **Not assessed** | | | |
| 25 | Consumer protection | | | | |
| 26 | Information, disclosure and transparency towards the market | | √ | | |
| 27 | Fraud | **Not assessed** | | | |
| 28 | AML/CFT | | | | |
| **TOTAL** | | **4** | **19** | **1** | **-** |

* O - Observed
LO - Largely Observed
PO - Partly Observed
NO - Not Observed

## IV. Key Recommendations

Table 1. Key Recommendations to Improve Observance of Insurance Core Principles

| Insurance Core Principles (ICP) | Recommendations |
|---|---|
| **The Supervisory System**<br>ICP 2, 3, 4 and 5 | Consider providing greater clarity regarding the authority, circumstances and processes in addressing potential conflicts in supervisory objectives.<br><br>Enhance the FOPI's independence and accountability through: (a) public disclosure of the reasons if the Director of the FOPI is removed from office; and (b) establishment of an internal audit function within the FOPI.<br><br>Push ahead with the regulatory reforms under the ISL.<br><br>Strengthen regulatory resources to effectively supervise a sophisticated and globally diversified reinsurance industry and implement the regulatory reforms.<br><br>Consider formal regulatory cooperation and information exchanges with foreign regulators outside the EU/EEA. |
| **The Supervised Entities**<br>ICP 6 , 7, 8, 9 and 10 | Consider explicit requirements for: (a) composite reinsurers to ensure proper segregation of life and nonlife risks so as to better safeguard the interests of cedants; and (b) reinsurers to seek the FOPI's approval before they transfer all or any part of their insurance business so as to protect the interests of the policyholders of both the transferee and transferor. |
| **Ongoing Supervision**<br>ICP 11, 12, 13, 14, 15,16,17 | Build adequate regulatory resources and cost-effective systems and processes to: (a) enhance global market analysis; (b) conduct risk-focused on-site inspections; (c) enforce preventive and corrective measures; and (d) conduct group/conglomerate supervision.<br><br>Consider quarterly reports on selected key financial indicators, particularly on solvency and asset-liability management, to facilitate ongoing off-site surveillance and timely intervention. |
| **Prudential Requirements**<br>ICP 18,19, 20, 21, 22, 23 | Maintain the momentum in implementing the SST as planned. |
| **Markets and Consumers**<br>ICP 24, 25,26, 27 | Plan for the effective implementation of the IAIS standards on public disclosures so as to facilitate market discipline. |

## V. AUTHORITIES' RESPONSE

10. The FOPI noted its appreciation of the high quality of the detailed assessment. Its comments on the key recommendations in Section IV are the following:

**The Supervisory System**

11. The authorities agreed with the recommendation to consider greater clarity on the authority, circumstances and processes in addressing potential conflicts in supervisory objectives. The draft FINMA Act (Art. 7), to which the recommendation refers, is currently being discussed in Parliament.

12. As regards enhancing FOPI's independence and accountability through: (a) public disclosure of the reasons if the Director of the FOPI is removed from office; and (b) establishment of an internal audit function within the FOPI, The authorities noted that: (a) public disclosure of the reasons for FOPI Director's removal from office is possible under existing legislation; and (b) the Federal Audit Office acts as the internal auditor for the FOPI.

13. In respect of the momentum of regulatory reforms under the ISL, current efforts at regulatory reform focus on establishing integrated supervision of private insurance within the scope of the ISL.

14. Regarding the recommended strengthening of regulatory resources to effectively supervise a sophisticated and globally diversified reinsurance industry and implement the regulatory reforms, the authorities have ongoing efforts to that end.

15. The document recommends considering formal regulatory cooperation and information exchanges with foreign regulators outside the EU/EEA. The FOPI recently expressed its interest in signing the IAIS MMOU and providing a staff member for the validation team within the accession procedure. The process is expected to be initiated soon.

**The Supervised Entities**

16. The recommendation that explicit requirements for (a) composite reinsurers to ensure proper segregation of life and non-life risks and (b) for reinsurers to seek FOPI's approval before they transfer all or any part of their insurance business will be given due consideration.

**Ongoing Supervision**

17. As regards the recommendations to build adequate regulatory resources and cost-effective systems and processes to: (a) enhance global market analysis; (b) conduct risk-focused on-site inspections; (c) enforce preventive and corrective measure; (d) group/conglomerate supervision; and (e) direct supervision of intermediaries, the authorities' noted the following:

- On (a), as indicated in mission discussions, the market analysis function has been satisfactorily outsourced.

- On (b), Risk-focused on.-site inspections are being performed and could be expanded in the future.

- On (c), Effective preventive and corrective measures have been and will be taken as required.

- On (d), group/conglomerate supervision is being strengthened. Several Directives entered into force December 31, 2006, including on internal business transactions. Cooperation with foreign supervisors is being enhanced on a continuing basis.

- On (e), risk-based direct supervision of intermediaries is being initiated and may require additional resources.

18. On the recommendation to consider quarterly reports on selected key financial indicators, particularly on solvency and asset-liability management, to facilitate ongoing off-site surveillance and timely intervention, the authorities noted that major insurance undertakings have long been providing quarterly selected financial indicators, including of solvency and asset/liability management. The indicators have been and are being used for the purposes of off-site surveillance and intervention as required.

**Prudential Requirements**

19. The document recommends maintaining the momentum in implementing the SST as planned. The authorities noted that the implementation of the SST was on schedule.

**Markets and Consumers**

20. The recommendation to plan for the effective implementation of the IAIS standards on enhanced disclosure to facilitate market discipline will be followed up pending the intended consolidation of the standards into a single IAIS document. In the meantime, the provisions of the standards are being implemented in parallel with the application of the SST and IFRS disclosure requirements.

## VI. Detailed Principle-by-Principle Assessment

| Conditions for Effective Insurance Supervision | |
|---|---|
| **Principle 1.** | **Conditions for effective insurance supervision**<br>Insurance supervision relies upon:<br>- a policy, institutional and legal framework for financial sector supervision<br>- a well developed and effective financial market infrastructure<br>- efficient financial markets. |
| Description | Predictability of macroeconomic, legal and institutional frameworks has been a traditional strength of Switzerland and represents an essential foundation for its long-term success as an international financial center. A proactive and forward looking policy stance supports the key policy objective of practical, proportionate, and effective regulations.<br><br>Accounting and auditing standards are set by the regulators and the respective professional associations. The FOPI expects insurers to adopt accounting conventions that meet international standards e.g., IFRS, U.S. GAAP, and Swiss FER GAAP. No major problems have been reported in connection with the adoption of IFRS by Swiss internationally active (re)insurers.<br><br>To implement the requirement on the appointment of accountable actuaries under Article 3 of the ISL, the Swiss Actuarial Association (SAA) introduced a membership category of qualified actuaries, based on the core syllabus of the International Actuarial Syllabus. The SAA regulates the profession through various bylaws, a code of conduct and guidance notes. The SAA has not taken any disciplinary action against any of its members for the last 10 years. The FOPI has issued detailed rules on the responsibilities of the accountable actuaries and on the content of their reports to management for the purpose of Solvency I (Article 24 of ISL).<br><br>External auditors' statutory responsibilities, including the duty to notify the FOPI of criminal offences, serious irregularities, breach of good business principles and facts that compromise the solvency of an insurer or the interests of insurers are defined in the ISL (Articles 29 and 30). In June 2004, the Swiss Institute of Certified Accountants (SICA) adapted the Swiss Audit Standards. These standards implement all the International Standards on Auditing (ISA) which were published up to June 30, 2003. In 2007, the Swiss Audit Standards will include the Audit Risk Standards. The SICA has not taken disciplinary action against any of its members in respect of insurance audits.<br><br>A Federal Audit Oversight Authority (FAOA) will be established in 2007 pursuant to the Audit Oversight Act (AOA) enacted in December 2005. The AOA empowers the FAOA to license and supervise auditors performing statutory audits. It also covers the qualifications and duties of auditors in performing regular audits, reviews (limited audits) and audits of listed companies. It regulates auditors' professional conduct, including independence, quality assurance, documentation and the scope of audits. The independence guidelines issued by the SICA will be amended to comply with the AOA.<br><br>Switzerland is an international financial center with efficient and robust market infrastructures. The Swiss Stock Exchange is a leading money and securities market with a market capitalization of SwF 1,021 billion (companies in the Swiss Performance Index) |

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|---|---|
| | as at end-2005 and turnover of SwF 1,338 billion. *(Source: Figures on Switzerland as a location for financial services)* |
| Assessment | **Observed** |
| Comments | The Swiss insurance industry operates in stable and progressive macroeconomic, legal, and supervisory frameworks. Professional bodies adopt international standards and external auditors are also subject to FAOA's oversight. Switzerland's deep, liquid and well-functioning financial markets facilitate effective asset-liability management by insurers.<br><br>With more than 95 percent of reinsurance premiums written from foreign business, global market and regulatory developments have significant implications for the effective group/conglomerate supervision of reinsurers domiciled in Switzerland. |
| **The Supervisory System** | |
| **Principle 2.** | **Supervisory objectives**<br>The principal objectives of insurance supervision are clearly defined. |
| Description | The ISL "is designed to protect the insured from abuses and the insolvency risks to which insurance companies are exposed." The objective of the ISL has to be balanced with the need to consider regulatory costs as well as the international competitiveness and innovative capacity of Switzerland.<br><br>Article 7 of the draft Federal Act on Financial Market Supervision (FINMA Act) provides that FINMA will need to take into consideration how its regulatory projects, if deemed necessary, affect competition, the innovation capacity, and the international competitiveness of the Swiss financial sector. In response, the Federal Act on Financial Market Supervision (FINMA Act)), the SFBC, and the FOPI issued the Joint Guidelines for Effective Financial Market Regulation in September 2005 outlining three key objectives: a) facilitate international competitiveness; b) ensure functionality, efficiency, and stability; and c) maintain integrity. These objectives are supported by the following principles: predictability of framework conditions; transparency; competitive neutrality domestically; openness of the markets; impact-oriented (cost-benefit) approach; tailor-made design of Swiss policy; and comprehensiveness of policy.<br><br>While it is recognized that the principles will not address existing conflicts in prioritizing regulatory objectives, with greater transparency the authorities are likely to be more aware of the conflicts. It is intended that the implementation of the FOPI's supervisory objectives and any deviation from the objectives will be explained in the Annual Report. |
| Assessment | **Observed** |
| Comments | The supervisory objectives of the FOPI are clearly spelt out under the ISL. Going forward, the FOPI has to strike a delicate balance between the multiple objectives articulated in the Joint Guidelines for Effective Financial Market Regulation. In this regard, there are merits in considering greater clarity regarding the authority, circumstances and processes in addressing potential conflicts in objectives, and preserving the independence of the FOPI. |

| Principle 3. | **Supervisory authority**<br>The supervisory authority:<br>- has adequate powers, legal protection and financial resources to exercise its functions and powers<br>- is operationally independent and accountable in the exercise of its functions and powers<br>- hires, trains and maintains sufficient staff with high professional standards<br>- treats confidential information appropriately. |
|---|---|
| Description | The remit of the FOPI is clearly established under the ISL (Article 46):<br><br>• To monitor compliance with insurance and supervisory legislation;<br>• To check whether commercial activities of insurance companies are sound;<br>• To monitor compliance with the business plan;<br>• To check whether insurance companies are solvent, have established the statutory technical reserves, and manage and invest assets properly;<br>• To check whether the claims settlement function is performed properly in accordance with the provisions of the Road Traffic Law of 19 December 1958 on motor vehicle third party liability insurance;<br>• To protect the insured from any abuse by insurance companies or insurance intermediaries;<br>• To intervene in the event of any mismanagement that endangers the interest of the insured.<br><br>Other provisions complement this list.<br><br>The FOPI is subject to various external accountabilities. It reports to the minister of finance and its director is appointed by the government. However, the reasons are not publicly disclosed if the Director of FOPI is removed from office. It is also subject to audits by the FFA. The powers, structure, processes, and procedures of FOPI are transparent and publicly disclosed on its website. An inquiry by a parliamentary committee is possible, should a need arise.<br><br>Currently, the Federal Audit Office conducts audits for FOPI but there is no internal audit function within the FOPI.<br><br>In general, decisions affecting individual insurers may not be disclosed. The ISL requires that the FOPI protects privileged or personal information. Strict confidentiality under the general public service legislation applies to the FOPI staff and contractors.<br><br>The FOPI is pre-funded by the government, but the actual cost of supervision is recovered from licensed insurers in the subsequent year. The Federal Council regulates what supervisory costs are recoverable and determines the relevant premium income and fee rates. The FOPI accounts for its annual supervision expenses in its published "audited financial statement." In allocating its budget, the FOPI must comply with headcounts approved by the parliament. Staff of the FOPI is highly qualified and protected from administrative liability.<br><br>Currently, there are only five staff supervising 70 reinsurers, including 3 large and globally diversified reinsurance companies. |

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| | FOPI officials are not personally responsible (and liable) for damage they unlawfully cause third parties in the exercise of their duties. [Article 3 of the Federal Law on the Responsibility [and Liability] of the Confederation (RS 170.32)—"The Confederation is responsible for damage unlawfully caused to a third party by [its] officials in the exercise of their duties, whether their conduct was faulty or not"]. Further, persons affected may not take action against the official concerned.<br><br>Where the Confederation compensates the plaintiff for damages, it initiates action against the official(s) who intentionally or negligently caused the damages even after the termination of the official's employment. If an official acted to the best of his/her knowledge and belief, there will be no consequences. |
| Assessment | **Largely observed** |
| Comments | The independence and accountability of the FOPI could be strengthened by the public disclosure of the reasons if the Director of the FOPI is removed from office and by the establishment of an internal audit function.<br><br>The current staffing level dedicated to reinsurance regulation and supervision does not meet one of the key objectives of ICP3 (on which the essential criteria are based)—"*The supervisory authority:....hires, trains and maintains sufficient staff with high professional standards.*" It is critical that the FOPI has sufficient staff resources to effectively supervise the sophisticated and globally diversified reinsurers domiciled in Switzerland. |
| **Principle 4.** | **Supervisory process**<br>The supervisory authority conducts its functions in a transparent and accountable manner. |
| Description | The FOPI's supervisory approach is oriented towards self-governance and self-assessment based on relevant regulatory guidelines. The onus is on the Board of directors and senior management of insurers to ensure robust risk management and effective corporate governance as a safeguard for sound business activity. The FOPI has initiated a project to design Self-Assessment Modules (SAM) to facilitate evaluation of insurers' corporate governance practices. Industry benchmarks will be established for corporate governance, risk management and internal controls. Deviations from industry benchmarks may trigger regulatory interventions.<br><br>It is the policy of the FOPI to apply all regulations and administrative procedures consistently and equitably. Swiss administrative procedures also provide for substantive review of the FOPI's decisions. An independent Appeal Commission for Private Insurance is the first instance of appeal, and final appeal may be made to the Federal Court.<br><br>In urgent cases, the FOPI may waive the applicability of interim injunction. In mid-2004, the FOPI set up structures of competence and established lines of responsibility to enable the adoption of urgent measures, where required. Where particularly sensitive and urgent measures are taken, the applicability of interim injunction is waived by statute.<br><br>The FOPI's Annual Report is publicly available on its website, setting out its objectives, policies, and activities. |

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|---|---|
| | The public consultation process and cost-and-benefit analysis of regulatory proposals provided under the Guidelines for Financial market Regulation require additional regulatory resources to administer. |
| Assessment | **Largely observed** |
| Comments | The development of the SAM project is at an early stage. While SAM will facilitate the FOPI in understanding the risk profiles and corporate governance of reinsurers, consideration should be given to independent assessment to validate the responses. This will enhance the consistency of self-ratings and thereby contribute to robust industry benchmarks.<br><br>The principle-based regulatory regime introduced by the ISL is in transition. The FOPI is drafting a number of implementing decrees and guidelines to provide clarity to the legislative provisions and facilitate observance by the industry. It is important to ensure adequate resources are in place to maintain the momentum for regulatory reforms. |
| **Principle 5.** | **Supervisory cooperation and information sharing**<br>The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements. |
| Description | Article 81 of the ISL empowers the FOPI to cooperate with foreign supervisory bodies, even in the absence of a ***Memorandum of Understanding (MoU)*** subject to professional or official confidentiality. The information provided should be used solely for direct supervisory activities and is only passed on, with the prior approval of the FOPI or pursuant to a general authority arising from an international agreement, to competent authorities and bodies entrusted with a supervisory remit in the public interest. The FOPI shall not give this approval if the information is to be passed on to prosecuting authorities and mutual assistance has been excluded in criminal cases. The FOPI shall make its decision in consultation with the Swiss body responsible for mutual assistance.<br><br>If the information to be provided by the FOPI relates to individual insured parties, the Federal Law of December 20, 1968 on administrative procedures shall apply.<br><br>The Federal Council may conclude international agreements in order to regulate cooperation with the foreign supervisory bodies responsible for financial services.<br><br>The FOPI has an MoU with the SFBC to co-coordinate the supervision of financial conglomerates in Switzerland.<br><br>In April 2006, the FOPI signed an MoU with the insurance supervisory authorities of some 20 Member States of the European Union (EU) and the European Economic Area (EEA). The MoU facilitates the exchange of information and aims to foster regulatory cooperation for supervising insurance groups and financial conglomerates. Pursuant to the MoU, the FOPI is included in the work of the Coordination Committees established by the Helsinki Protocol on the supervision of insurance groups. Group and conglomerate supervision is, in addition to supervision at legal entity level, exercised on a solo basis by the respective home and host supervisors. |
| Assessment | **Observed** |
| Comments | With the MoU with the EU and EEA, Swiss insurance groups and conglomerates operating in the EU will not be subject to duplicate supervision at the group/conglomerate |

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| | level if the FOPI is appointed as the lead coordinator or co-coordinator.<br><br>The large Swiss reinsurers have a significant international presence beyond the EU/EEA. In this regard, the FOPI is encouraged to consider similar regulatory cooperation and information exchange arrangements with foreign regulators outside the EU/EEA. |
| **The Supervised Entity** | |
| **Principle 6.** | **Licensing**<br>An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public. |
| Description | The ISL covers all reinsurers domiciled in Switzerland. Reinsurers domiciled outside Switzerland are exempted if they only offer reinsurance (and no direct insurance) in Switzerland.<br><br>While direct insurance captives are regulated the same way as direct insurers, reinsurance captives are exempted from the SST. The FOPI may declare that this exemption does not apply to reinsurance captives with complex risk structures or substantial financial risks. (Article 2 of FOPI-SO). The FOPI has declared that two reinsurance captives are not exempted from the SST.<br><br>The FOPI checks the business principles of an applicant for compliance with legal requirements, with particular focus on solvency, organization and management. Applicants must submit a business plan, which should include information on: identity and fitness and propriety of principal owners, directors, managers, accountable actuary and auditors, as well as risk management systems. Minimum capital is SwF 10 million for professional reinsurers and SwF 3 million for captive reinsurers. Four existing captive reinsurers owned by insurance companies or writing third party risks have been grandfathered, and their license fees were set at SwF 5 million by the FOPI, in accordance with Article 10, SO.<br><br>If the applicant is part of an insurance group or an insurance conglomerate, approval may be contingent upon the existence of appropriate consolidated supervision by a competent supervisory authority.<br><br>The FOPI has implemented a systematic licensing process to track outstanding information under the application and business plan to facilitate timely follow up.<br><br>Reinsurers may write both life and nonlife business. However, there are currently no regulatory measures to satisfy the FOPI that a composite reinsurer has processes requiring that risks be handled separately on both a going concern and a winding-up basis. Typically, the segregation of life and nonlife portfolios is effected through the maintenance of separate funds for the two portfolios within the (re)insurer. Reinsurers in Switzerland are currently also not subject to the tied assets requirements.<br><br>Other business activities may be permitted if not prejudicial to policyholders' interests. One large reinsurance conglomerate has significant operations in the capital markets. |
| Assessment | **Largely Observed** |

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| Comments | The FOPI has implemented international best practices in vetting and approving licensing applications, pursuant to the ISL. The licensing process is systematic and facilitates follow-ups.<br><br>Given the different risk profiles for life and nonlife business, there is potential contagion risk within the same entity e.g., a catastrophic event resulting in insolvency of a reinsurer's nonlife portfolio although the life business is solvent. In the absence of clear segregation, legal complications arise as to whether all or only (which) part of the assets of the reinsurer should be available to settle claims from nonlife cedants. Under a going-concern scenario, there are regulatory risks such as cherry picking investments to favor certain portfolios. The FOPI is advised to require composite reinsurers to ensure the proper segregation of life and nonlife risks to better safeguard the interests of cedants. |
| **Principle 7.** | **Suitability of persons**<br>The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications. |
| Description | There was no legal provision on fit-and-proper test under the old insurance legislation.<br><br>“Guarantee of sound commercial activities” applies to insurers’ management and third party service providers under outsourcing agreements. The ISL empowers the FOPI to prescribe the required professional qualities (Article 14). For existing reinsurers, the fitness and propriety of their board members, senior management, auditors and actuaries will be reviewed when they submit their business plans to the FOPI in 2007. This is a one-off exercise to implement the ISL which came into force on January 1, 2006. Going forward, reinsurers must notify the FOPI of any changes in business plans and key persons.<br><br>Both the audit firm and the lead auditor are required to be approved by the FAOA and FOPI (ISL Article 28). The guidelines for the approval of auditors under Article 112 and 114 of the SO have been developed in consideration of the professional and independence requirements of the FAOA. In addition, any change in lead auditor or external audit firm requires approval. Changes relevant for the approval as external auditor also have to be reported to FOPI on a yearly basis.<br><br>An accountable actuary shall be of good standing, professionally qualified and in a position to properly assess the financial condition of the insurer. The Federal Council has issued the professional qualifications to be held by the accountable actuary.<br><br>The FOPI may demand the dismissal of persons entrusted with direction, supervision, control or management or that of the person(s) with general power of attorney or the accountable actuary and ban them from exercising further insurance activities for a maximum of five years (Article 51). Whether such persons may return to the insurance industry after 5 years and be considered as fit-and-proper depends on the specific circumstances. |
| Assessment | **Largely Observed** |
| Comments | Under the FOPI’s self-governance and self-assessment approach to supervision, the integrity, competence and experience of beneficial owners, directors and key |

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| | management staff are critical elements of its principle-based regulatory regime. The legal authority under the ISL to approve fit-and-proper persons supports the FOPI's supervisory approach.<br><br>The effective implementation of this regulatory measure will bring the Swiss regime in full observance of ICP7. |
| **Principle 8.** | **Changes in control and portfolio transfers**<br>The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer.<br><br>The supervisory authority approves the portfolio transfer or merger of insurance business. |
| Description | Changes in business plan, mergers, split, or restructuring are subject to the FOPI's approval (Article 5 of ISL)<br><br>Prior notification to the FOPI is required, under Article 21 of the ISL, for acquisitions or changes in ownership thresholds exceeding 10 percent, 20 percent, 33 percent or 50 percent of the capital or voting rights. The FOPI may prohibit a holding or impose conditions if the nature or extent of the holding might compromise the insurer or the interests of the insured.<br><br>On the basis that reinsurance contracts are between professional parties, reinsurers are exempted from Article 62, which requires insurers to seek prior approval from the FOPI for transfers of reinsurance portfolios in full or in part. Nonetheless, such transfers require the consent of the cedant, the original reinsurers and the receiving reinsurer under contract law. A requirement for notification of portfolio transfers is stated in the Guideline on intra-group transactions. It is planned that FOPI will also require disclosure of novations in a guideline on business plans. |
| Assessment | **Largely Observed** |
| Comments | The FOPI's power to vet and approve changes in control enhances its regulatory oversight of the fitness and propriety of beneficial owners, in line with international best practices.<br><br>While the exemption from seeking the FOPI's approval for portfolio transfers recognizes that reinsurers contract with professional (re)insurers, such transfers may lead to a significant deterioration of the financial position of the receiving or transferring reinsurer and would not be vetted by FOPI. The business could even be transferred to a reinsurer which is not licensed in Switzerland. The FOPI should require that insurers seek its approval before they transfer all or any part of their insurance business and must be satisfied that the interests of the policyholders of both the transferee and transferor are protected. |
| **Principle 9.** | **Corporate governance**<br>The corporate governance framework recognizes and protects the rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards. |
| Description | Pursuant to Article 14 of the ISL, the SO sets out the requirements for fitness and propriety of directors and management and prohibits the chairman of the board of |

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| | directors from holding the dual role of chief executive officer.<br><br>It is the legal duty of FOPI, under ISL Article 46 (1), to check whether (re)insurers' commercial activities are sound. This is interpreted to include corporate governance of (re)insurers. According to the "Message" of the Federal Council to the Parliament of May 9, 2003 on the draft ISL, the FOPI has the power to intervene where the interests of the insured are prejudiced, including lack of proper corporate governance.<br><br>In Switzerland, governance-related provisions are provided in the Commercial Law (Corporate Law or the Code of Obligations) and in the—voluntary—Code of best Practice for Corporate Governance (2002), which has been endorsed by the Swiss Insurance Association (SIA) and applies to all insurers domiciled in Switzerland. The FOPI has recently finalized its own Guidelines on Corporate Governance, which not only embody but go beyond those prescriptions and are binding for the (re)insurance industry in Switzerland. Supervisory rules relating to the respective roles of the executive and supervisory boards are under consideration.<br><br>The FOPI has no legal authority to enforce compliance with the Swiss Code of Best Practice for Corporate Governance (2002). This voluntary code has been endorsed by the Swiss Insurance Association (SIA) and applies to all insurers domiciled in Switzerland.<br><br>Through their involvement under the Solvency I and the SST, an accountable actuary plays an active role in (re)insurers' corporate governance. His/her role under the SST will be defined more precisely in a forthcoming statement of the FOPI: "The accountable actuary is only responsible for the SST to the extent that this is possibly based on his training and experience and based on the size and risk structure of the insurance company".<br><br>Article 30 of the ISL requires external auditors to notify the FOPI of criminal offences, serious irregularities, breach of good business principles and circumstances likely to endanger the solvency of the insurer or the interests of the insured. However, currently, the external auditors' role is limited to statutory accounts and their role under the ISL and SST will be defined by the FOPI. |
| Assessment | **Largely Observed** |
| Comments | The ISL empowers the FOPI to supervise corporate governance of (re)insurers, and the FOPI has recently issued corporate governance guidelines to the industry. The FOPI is also in the process of formulating various templates relating to corporate governance practices as part of the SAM project and defining the roles of external auditors and accountable actuaries. |
| **Principle 10.** | **Internal control**<br>The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations. |
| Description | ISL Article 27 requires (re)insurers to establish an internal audit function and to provide an annual activity report to external audit. The FOPI also has access to internal audit reports. In addition, for the supervision of insurance groups and conglomerates, the FOPI's guidelines state that the external auditor's report to the FOPI should include |

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| | the internal audit activity report.<br><br>The Swiss reinsurance industry consists of over 70 entities and is two-tiered. More than 75 percent of business is concentrated in 3 reinsurers. The state of internal control is uneven across entities with different size and complexities of operations. Large companies apply best practices of full fledged, in-depth internal controls. Although they may be efficient, small firms often run much thinner control operations, consistent with the scope and the nature of their business. |
| Assessment | **Largely Observed** |
| Comments | The effective implementation of the FOPI's enhanced powers to supervise internal controls of (re)insurers will bring the Swiss regime into full observance. |
| **Ongoing Supervision** | |
| **Principle 11.** | **Market analysis**<br>Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws conclusions and takes action as appropriate. |
| Description | Since 2004, the FOPI publishes both company-specific and aggregated data in its annual reports, available in electronic (CD and website) and paper copies.<br><br>The FOPI is keenly aware of market developments which have an impact on the Swiss reinsurance industry. It has access to timely market news and analysis from a variety of sources.<br><br>In view of the fact that more than 95 percent of the reinsurance premiums are written from foreign business, global market developments beyond Switzerland have a significant impact on the Swiss reinsurance industry. The FOPI needs to strengthen its resources, including cost-effective systems and processes for efficient market analysis that meets its regulatory objectives. |
| Assessment | **Largely Observed** |
| Comments | Given the sophistication and geographical diversification of the reinsurance industry, the FOPI is advised to plan for adequate regulatory resources and cost-effective processes for market analysis. |
| **Principle 12.** | **Reporting to supervisors and off-site monitoring**<br>The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market. |
| Description | Insurers shall submit an annual supervisory report, in a format prescribed by the FOPI. Where appropriate, the FOPI may require the submission of reports for periods of less than one year and/or impose special conditions in respect of regulatory reporting.<br><br>The FOPI analyses the regulatory data provided against industry and internal benchmarks. Meetings are held with reinsurers to discuss and follow up on issues that merit regulatory attention. The FOPI may require that additional work be performed by external auditors, where warranted e.g., to review the adequacy of technical provisions.<br><br>The FOPI is currently reviewing the content of statutory returns. It plans to incorporate |

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| | additional information such as run-off statistics, breakdown of technical provisions by lines of business in the revised returns to better monitor the reinsurers' risk profiles.<br><br>The FOPI is considering timelier reporting from reinsurers, based on their internal management/risk reports. This may pave the way for more standardized quarterly/semi-annual reporting to facilitate consistent off-site surveillance of the reinsurance industry.<br>. |
| Assessment | **Largely Observed** |
| Comments | The mission fully supports the FOPI's initiatives to enhance off-site monitoring through updated reports, in line with its risk-based supervision approach. More timely regulatory reporting, e.g., quarterly reports, focusing on selected key financial indicators, particularly on solvency positions and asset-liability management, contributes to ongoing off-site surveillance and timely regulatory intervention. |
| **Principle 13.** | **On-site inspection**<br>The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements. |
| Description | The FOPI typically meets reinsurers' management to discuss selected issues and risk areas. On-site visits have been conducted to address specific regulatory concerns in a few reinsurers in recent years.<br><br>Due to resource constraints and the immediate need to allocate resources for formulating regulatory policies to implement the ISL, decrees and guidance, the FOPI did not conduct on-site examinations in 2006. There is no inspection plan for 2007 at the time of assessment.<br><br>Reinsurers will start to perform the SST in 2008. There is a need to complement the SST computations with the FOPI's validation of the internal controls and governance. This will help ensure the integrity of data used for solvency computation and quality of risk-bearing capital. The FOPI also needs to inspect reinsurers exposed to vulnerabilities as indicated by their SST results to address the risks and regulatory concerns in a timely manner. |
| Assessment | **Partly Observed** |
| Comments | The FOPI needs to build up adequate regulatory resources, systems, and processes to allow for risk-based and effective on-site inspection of reinsurers.<br><br>In particular, the implementation of the SST requires FOPI staff with good insights into company-specific internal models and risks arising from diverse lines of business across the globe. More effective direct supervision of reinsurers to better understand their operations is one of the means to build regulatory capacity internally within the FOPI. |
| **Principle 14.** | **Preventive and Corrective Measures**<br>The supervisory authority takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision. |
| Description | Article 51 of the ISL empowers the FOPI to take appropriate preventive and corrective measures where an insurer fails to comply with the ISL or the FOPI's instructions or act in a way that is prejudicial to the interests of policyholders. The FOPI may:<br><br>a) deny an insurer's access to its own assets; |

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| | b) order the deposit of assets or block them;<br>c) assign powers entrusted to an executive body of an insurance company to a third party in full or in part;<br>d) transfer the insurance portfolio to another insurer;<br>e) demand the dismissal of key persons or the accountable actuary and disqualify them for a maximum of five years. |
| Assessment | **Observed** |
| Comments | The FOPI is empowered to take a range of proportionate preventive and corrective measures. |
| **Principle 15.** | **Enforcement or sanctions**<br>The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed. |
| Description | The FOPI is currently drafting regulatory intervention levels via regulatory rules covering:<br><br>• base capital adequacy ratios (Solvency I, SST);<br>• three sets of actions (company action level, supervisory action level, and withdrawal of license).<br><br>Orders issued by the FOPI are subject to appeals to the Appeals Commission for the supervision of private insurers. Rulings by the Appeals Commission are subject to administrative court appeals to the Federal Court.<br><br>The FOPI is obliged, under the ISL, to publish regular information on decisions on insurance laws. Such disclosures apply to decisions that:<br><br>a) set a precedent;<br>b) have implications for more than one (re)insurer; and<br>c) are of interest to the industry or public interest.<br><br>The ISL imposes a maximum administrative fine of SwF 100,000 on anyone who breaches the provisions of the ISL and the implementing provisions, including failure to submit management and supervisory reports within the stipulated time and failure to establish the required technical reserves (Article 86).<br><br>A prison sentence or a fine not exceeding SwF 1,000,000 may be imposed on anyone who contravenes licensing or registration (intermediaries) requirements, misrepresents or conceals from the FOPI the business relationships; fails to notify changes to the business plan; fails to maintain the minimum capital resources; removes, encumbers or compromises the safety of tied assets; and on any accountable actuaries or auditors who fail to discharge their statutory obligations. The court may ban a person sentenced to a prison term from any activity in a senior position with an insurer for up to five years. (Article 87).<br><br>There is no dedicated enforcement unit within the FOPI, and it may be limited by its regulatory resources in taking timely preventive and corrective measures. It is also advisable to establish enforcement functions as a separate unit to preserve the neutrality |

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| | of routine on-site inspections and off-site surveillance.<br><br>The draft FINMA Act provides for a streamlined and harmonized sanctions ordinance comprising both revisions to the existing criminal law provisions and new administrative sanctions (e.g., confiscation or occupational ban). |
| Assessment | **Largely Observed** |
| Comments | Effective enforcement of these provisions requires staff with the appropriate skill set and experience. |
| **Principle 16.** | **Winding-up and exit from the market**<br>The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedures for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders. |
| Description | Reinsurers' exits from the market and run-off of reinsurance portfolios have been conducted in an orderly manner, so far.<br><br>Approval from the FOPI is required before an insurer can commence bankruptcy proceedings. If an insurer goes into liquidation, the supervisory authority may appoint the liquidator.<br><br>Reinsurers are exempted from tied assets requirements. The lack of segregation of life and nonlife risks by composite reinsurers may also complicate the winding-up.<br><br>While the SST provides incentives for (re)insurers to have effective asset-liability management and hold quality assets, the target capital does not address legal entitlement and priority of claims of different stakeholders (shareholders, cedants of life and nonlife insurance and other secured/unsecured creditors) against (re)insurers' assets, even on a solo basis. |
| Assessment | **Largely Observed** |
| Comments | While exits of reinsurers have not posed any significant difficulties, the FOPI is advised to review the need to segregate assets held in support of reinsurers' life and nonlife technical provisions (see related comments in ICP6). |
| **Principle 17.** | **Group-wide supervision**<br>The supervisory authority supervises its insurers on a solo and a group-wide basis. |
| Description | Under the ISL, group and conglomerate supervision is recognized as equivalent to the relevant EU Directives. The equivalence of the Swiss regulations with the EU regulations has been formally recognized. While Switzerland is not part of the EU Helsinki Protocol, the equivalence allowed Switzerland to sign an MoU with all 28 member states of the EU and EEA. Pursuant to this MoU, the FOPI may serve as a lead supervisor or co-supervisor for the supervision of insurance groups and financial conglomerates headquartered in Switzerland. This recognition reduces the regulatory burden of Swiss insurance groups and conglomerates operating in the EU.<br><br>The FOPI has the option to exercise consolidated supervision of insurance groups and |

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| | insurance-based financial conglomerates. The FOPI's consolidated supervision encompasses all companies of a Swiss group, worldwide.<br><br>The criteria adopted by the FOPI for group supervision includes the geographical scope of operations and complexity of group structures. Currently, nine Swiss groups are placed under group supervision including: Baloise-Holdings, Swiss Life, Swiss Re, Winterthur Group, Zurich Financial Services Group, Helvetia, Mobilar, Vaudoise, and National.<br><br>Conglomerate supervision is exercised in addition to group supervision. The FOPI has the discretion for conglomerate supervision only if the conglomerate operates a bank or securities trader of significant economic importance in addition to its insurance activities. The five largest insurance-based conglomerates as at end-2005 are: Baloise-Holdings, Swiss Life, Swiss Re, Zurich Financial Services Group and Winterthur Group (part of Credit Suisse).<br><br>The FOPI may subject an insurance group/conglomerate to group/conglomerate supervision if it is actually managed from Switzerland or managed from abroad, but no equivalent supervision is exercised there. The FOPI may agree with a foreign supervisor who claims concurrent supervision of an insurance group/conglomerate on jurisdiction, procedures and scope of supervision.<br><br>The FOPI has issued rules on risk management and internal controls for insurance groups/conglomerates (Articles 68 and 76). Insurance groups are to provide the FOPI, annually, with a comprehensive structural organization chart including all active subsidiaries within the conglomerate. All significant changes to the organization charts are to be notified to the FOPI. If an insurance company is part of an insurance group/ conglomerate, the submission of consolidated accounts is obligatory.<br><br>Article 194 of the SO requires insurance groups to submit to the FOPI all important intra-group transactions and an annual report on the state of intra-group transactions. "Important internal transactions are those that result in a considerable change in the financial situation of an individual company or the group as a whole or will change it and that exceed the minimum values set by the supervisory authority." This allows the FOPI to monitor intra-group transactions that could adversely affect the interests, financial situation and dependencies of entities within the group, which could lead to a domino-effect or circumvent regulatory requirements.<br><br>The FOPI is developing requirements for internal models and group effects under the SST regime. Article 51 gives the FOPI the legal authority to require reinsurers to reduce their intra-group exposures "if the interests of the (re)insured appear threatened" |
| Assessment | **Largely Observed** |
| Comments | The ISL has expanded the FOPI's regulatory scope to include group/conglomerate supervision. The effective implementation of this new mandate will bring the Swiss regime into full observance of ICP17.<br><br>In respect of intra-group transactions, due consideration should be given to explicit and consistent regulatory guidelines on "important internal transactions" that are to be submitted to the FOPI, covering both quantitative (minimum values) and qualitative (e.g., declarations on transactions executed at arms' length) aspects, so as to manage |

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| | potential reputation risks of insurance groups/conglomerates.[3] |
| **Prudential Requirements** | |
| **Principle 18.** | **Risk assessment and management**<br>The supervisory authority requires insurers to recognise the range of risks that they face and to assess and manage them effectively. |
| Description | Article 96 of the SO requires a (re)insurer to apply risk management that is appropriate to its activity and internal monitoring procedures. (Re)insurers are also required to have proper and updated risk-management documentation and to manage operational risks (Articles 97 and 98 of the SO).<br><br>Current on-going discussions with large reinsurers on their implementation of the SST allow the FOPI to understand the risks assumed by reinsurers and their risk management practices. |
| Assessment | **Largely observed** |
| Comments | The SST, which will enhance risk-management practices of reinsurers, is in transition. Reinsurers are only required to implement the SST as from 2008, and the target capital requirement is expected to come into force in 2010. Currently, the FOPI is in active discussions with the reinsurers to prepare for formal SST implementation and guide them in formulating robust internal/group models, taking account of their risk profiles and risk management practice. |
| **Principle 19.** | **Insurance activity**<br>Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums. |
| Description | Article 96 of the SO requires (re)insurers to ensure: a) timely recognition and evaluation of all risks, including insurance risks; and b) timely measures necessary to prevent or cover substantial risks and accumulation of risks. These measures includes “a coverage policy taking into account the effects of the corporate strategy and including adequate capital resources;<br><br>Current on-going discussions on the SST allow the FOPI to understand the insurance risks assumed by reinsurers and their management of such risks. |
| Assessment | **Largely Observed** |
| Comments | The SST, which will enhance risk-management practices of reinsurers, is in transition. Given the diverse reinsurance operations of the significant reinsurers, it is important for the FOPI to have skilled and experienced staff to assess their management of reinsurance risks. |

[3]A Guideline on important internal transactions that are to be submitted to FOPI has been issued and will come into force at the end of 2006.

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| **Principle 20.** | **Liabilities**<br>The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary. |
| Description | Article 24 of the ISL requires reinsurers to maintain sufficient technical reserves and provides an explicit legal basis for the review of technical provisions by the FOPI. Insurers are required to designate an accountable actuary to ascertain the adequacy of technical provisions under Solvency I and SST. The FOPI coordinates with the SAA in this area.<br><br>The provisions of the law on public limited companies on the formation and release of undisclosed reserves shall not apply to technical reserves. Transparency and protection of the insured parties shall be guaranteed. (Article 26)<br><br>The ISL provides for penalties for failure to maintain technical provisions (see ICP 15)<br><br>Reinsurers are required to perform the SST in 2008. The FOPI will issue guidelines on technical provisions for life risks and draft guidelines on nonlife risks. |
| Assessment | **Largely Observed** |
| Comments | The ISL has strengthened the FOPI's role in ensuring that reinsurers maintain adequate technical provisions to meet policy liabilities. |
| **Principle 21.** | **Investments**<br>The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management. |
| Description | Tied asset requirements do not apply to reinsurers. However, rules on valuation of assets apply: market consistent basis under the SST and statutory basis for Solvency I.<br><br>Reinsurers are required to have sound investment management policies—security, return, liquidity and diversification. Investments in risky assets and asset liability mismatches lead to capital charges under the SST.<br><br>The FOPI has the legal authority, under Article 46 and Article 51 of the ISL, to require reinsurers to diversify their assets or reduce concentration risks. |
| Assessment | **Largely observed** |
| Comments | Current on-going discussions on the SST and internal models of reinsurers allow the FOPI to understand the investment risk profiles of reinsurers and their management of such risks. |

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| **Principle 22.** | **Derivatives and similar commitments**<br>The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements, as well as internal controls and monitoring of the related positions. |
| Description | Article 100 of the SO limits the use of derivative financial instruments by (re)insurers to hedging or efficient portfolio management. The treatment of derivatives used for the purpose of hedging risks or of improving the efficiency of the investment policy is defined in Articles 100 to 109 SO. The treatment of credit derivatives used in the context of the underwriting of financial guarantees is in particular derived from the articles of the ISL and AVO which relate to risk management. All commitments resulting from derivate financial instruments must be covered. Articles 101 to 108 set out the regulatory expectations in respect of derivative activities covering: investment strategy, documentation, risk/investment limits, risk analysis, management and internal controls, qualified personnel and management reporting. (Re)insurers are required to submit annual reports on derivative activities to the FOPI.<br><br>Under the SST, all risks arising from derivatives and off-balance sheet activities must be included in the internal models.<br><br>Some reinsurers conduct credit insurance/underwriting business in a separate legal entity within the reinsurance group. According to Arts. 193 and 194 SO, all intra-group transactions (including intra-group credit derivatives) have to be reported to the FOPI. Article 51 of the ISL gives the FOPI the legal authority to require insurers to reduce their intra-group exposures.<br><br>Under the SST, all risk and capital transfer instruments within a group have to be taken into account and all risks have to be quantified. The FOPI is developing requirements for internal models and group effects under the SST regime. According to Article 195 and 196 the group must have adequate risk management with corresponding documentation, which has to be submitted to the FOPI.<br><br>As regulatory arbitrage could be an issue within financial conglomerates, the FOPI conducts on-site inspections to review/assess credit risk transfers. |
| Assessment | **Largely Observed** |
| Comments | Current ongoing discussions on the SST allow the FOPI to understand the risks assumed by reinsurers in respect of their derivative activities both on a solo as well as group basis. |
| **Principle 23.** | **Capital adequacy and solvency**<br>The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses. |
| Description | Currently, all reinsurers, including captive reinsurers, are required to comply with Solvency I requirements. While direct insurance captives are regulated the same way as direct insurers, reinsurance captives are exempted from the SST. However, the FOPI may declare that this exemption does not apply to reinsurance captives with complex risk structures or substantial financial risks. (Article 2 of FOPI-SO). The FOPI has declared that two reinsurance captives are not exempted from the SST. |

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| | The SST adopts a principle-based solvency regulation and provides effective regulatory incentives for insurance entities to quantify and manage their risks. Pending the finalization of the EU Solvency II framework, the SST will apply in parallel with Solvency I requirements. It establishes target capital as a pillar 2 requirement. Reinsurers are expected to fully implement the SST in 2008. The target capital[4] requirement is expected to come into force as of 2010.<br><br>The SST aims to strengthen effective risk management by reinsurers, especially asset-liability-management (ALM) which serves as an early warning signal. Market, credit, and insurance risks are modeled to arrive at the target capital. This is complemented by a scenario evaluation, using both FOPI-prescribed and insurer-specific scenarios, to assess insurers' solvency from an ALM perspective. If the available risk-bearing capital is less than the target capital, this does not necessarily mean that an insurer is insolvent. Rather, either the necessary capital must be built up over a certain period of time, or the risks are to be reduced.<br><br>Under the SST, assets and liabilities are valued on a market consistent basis. For technical provisions the market consistent value is defined as the best estimate (BE) plus a market value margin (MVM). The MVM is calibrated using a cost of capital (CoC) approach. The use of internal models is mandated for reinsurers due to the complexity and diversity of their portfolios.<br><br>Effectively, the SST places the ultimate responsibility for ensuring an insurer's solvency on its management. The SST report serves to document both the risk profile and the determination of the target capital. The SST report must be presented in a way that the management and the FOPI can assess the true risk situation of the insurer and enable independent verification by an external actuary. Executive management is responsible for the SST report (Article 53 AVO). If the company has appointed a Chief Risk Officer (CRO) who is part of the executive management, it is expected that the report will be prepared by the CRO. The CRO may well not be a member of any professional association.<br><br>Under Article 24 of the ISL, an accountable actuary is responsible for ensuring that technical provisions are adequate, the solvency margin and related assets are maintained in accordance with the ISL and proper accounting principles are used.<br><br>The FOPI is developing requirements for internal models and group/diversification effects under the SST regime. The verification of the internal models used will be a challenge. This implies that the FOPI needs to have good insights into company-specific models and a good understanding of reinsurance risks both domestically and in other regions where the reinsurers have significant operations. |
| Assessment | **Largely Observed** |
| Comments | The SST will be in full observance of ICP23 when it is fully implemented and |

[4] Defined as the sum of the expected shortfall in a change of risk-bearing capital within one year at the 99 percent confidence level plus the market value margin.

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| | effectively supervised by the FOPI. |
| **Principle 26.** | **Information, disclosure & transparency towards the market**<br>The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed. |
| Description | The FOPI and the SIA publish selected reinsurance data, at both entity and industry level, in their annual reports, freely available on their websites.<br><br>Going forward, consideration should be given to how best to implement the public disclosure standards established by the IAIS, without compromising commercial confidentiality: 1) Disclosures Concerning Technical Performance and Risks for Nonlife Insurers and Reinsurers, October 2004; 2) Disclosures Concerning Investment Risks and Performance for Insurers and Reinsurers, October 2005; and 3) Disclosures Concerning Technical Risks And Performance For Life Insurers, October 2006. |
| Assessment | **Largely observed** |
| Comments | Significant progress has been made in promoting the transparency of reinsurers. To facilitate market discipline, the FOPI is advised to plan for the effective implementation of the IAIS standards on public disclosures. |