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Switzerland: Financial Sector Assessment Program—Factual Update—Insurance Sector Market and Regulatory Developments

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

SWITZERLAND

FACTUAL UPDATE: INSURANCE SECTOR MARKET AND REGULATORY DEVELOPMENTS

MAY 2007

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

Contents Page

ACRONYMS

ALM	Asset-liability-management
AML/CFT	Anti-money laundering, combating the financing of terrorism
BE	Best estimate
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CoC	Cost of capital
EU	European Union
FAOA	Federal Audit Oversight Authority
FINMA Act	Federal Act on Financial Market Supervision
FIU	Financial Intelligence Unit
FOPI	Federal Office of Private Insurance
FOPI-SO	FOPI Ordinance on the Supervision of Private Insurance Companies
FSAP	Financial Sector Assessment Program
IAIS	International Association of Insurance Supervisors
ICL	Insurance Contract Law
ICP	Insurance Core Principle
IRV	Interkantonaler Rückversicherungs-Verband
ISL	Insurance Supervision Law
MLCA	Money Laundering Control Authority
MoU	Memorandum of Understanding
MVM	Market value margin
SAM	Self-Assessment Modules
SFBC	Swiss Federal Banking Commission
SIA	Swiss Insurance Association
SO	Ordinance on the Supervision of Private Insurance Companies
SRO	Self-regulatory organization
SST	Swiss Solvency Test
ULP	Unit-linked policies

EXECUTIVE SUMMARY

Regulatory reforms since 2003 have updated Switzerland's regulatory and supervisory regime for the insurance industry to bring it in line with international best practices. The Insurance Supervision Law (ISL), which came into effect on January 1, 2006, has reoriented the regulatory focus and expanded the regulatory scope to include group/conglomerate supervision, corporate governance, risk management and market conduct of insurance intermediaries. The ISL also provides for a range of corrective and preventive regulatory measures and empowers the Federal Office of Private Insurance (FOPI) to exchange information with both domestic and foreign regulators.

The risk-based and principle-based approach to regulation and supervision is aligned with the structure of the Swiss Insurance Industry. The Swiss insurance market is highly concentrated, dominated by a few large players with a significant international presence. More than 75 percent of Switzerland's premium receipts are from foreign business. The Swiss Solvency Test (SST) is recognized, internationally, to be at the forefront of risk-based solvency regimes. The SST paves the way for risk-based and differentiated supervision of insurers. Active consultations with industry participants have contributed to the overriding policy objective of practical, proportionate and effective regulation.

While the updated regulatory framework has a very high level of observance with the Insurance Core Principles, implementation of the reforms is in transition. The broad legislative framework has been established. The FOPI has recently issued and is drafting a number of implementing decrees and guidelines. These include corporate governance guidelines tailored to the insurance industry, regulatory intervention levels, roles of external auditors and actuaries, intra-group transactions. Going forward, the key challenge is in balancing the objective of the ISL, i.e., to protect the insured from abuses and the insolvency risks of insurers, against the financial market policy of preserving the international competitiveness of Switzerland as a financial center as well as the cost of regulation/supervision.

For effective supervision of the large and internationally diversified Swiss insurance industry, it is critical that the FOPI is equipped with adequate regulatory resources. Retention of experienced key personnel and rapid development of regulatory capacity is key to maintaining the momentum in implementing the regulatory reforms under the ISL. The effective implementation of the SST requires the FOPI to have good insights into company-specific internal models. While self-governance and enhanced external audits are useful complements, there is scope for FOPI to further strengthen direct supervision of (re)insurers. This requires adequate resources for more effective and timely off-site surveillance as well as risk-focused on-site examinations. In addition, there are significant resource implications for the FOPI if it is appointed as the supervisor /lead supervisor for cross-border supervision of insurance groups/conglomerates, in recognition of its regulatory equivalence with the EU.

I. Background

1. **This Technical Note provides a factual update of the regulatory regime for the direct insurance industry in Switzerland.**[1] The Swiss insurance sector was formally assessed in 2001, as part of the Fund's initial Financial Sector Assessment Program (FSAP), against the Insurance Core Principles (ICP) issued by the International Association of Insurance Supervisors (IAIS) in October 2000.

2. **Switzerland undertook a complete revision of its insurance supervisory regime in 2003.** The Parliament adopted the ISL on December 17, 2004, establishing the legal foundation for the Ordinance on the Supervision of Private Insurance Companies (SO) and the FOPI Ordinance on the Supervision of Private Insurance Companies (FOPI-SO). As the ISL replaced preventive product supervision with risk-based supervision and a risk-sensitive solvency regime, consequential amendments were also made to the Insurance Contract Law (ICL) to strengthen disclosure requirements. Prior to this, the Swiss insurance legislative framework had been fragmented into five federal statutes, 11 Federal Council ordinances and decisions, and several unpublished directives.

3. **This update focuses on significant market and regulatory developments since the previous FSAP conducted in 2001.** Implementation of the regulatory reforms pursuant to the ISL and other developments are reviewed, and benchmarked against the revised ICP issued by the IAIS in October 2003.

II. Market Structure and Industry Performance

A. Market Structure

4. **Switzerland is an established insurance center, well served by large and sophisticated insurers.** As at August 31, 2006, there were 214 (re)insurers—23 Swiss life insurers, 4 foreign life insurers, 78 Swiss non-life insurers, 40 foreign non-life insurers, and 69 reinsurers. The majority of the insurers are joint stock companies, as insurance cooperatives have been declining due to difficulties in raising capital. Switzerland has the highest per capita expenditures for insurance in the world—about SwF 7,000 (excluding social security contributions).

5. **Swiss insurers are significant international players, with more than 70 percent of their global premiums sourced from abroad.** Of the total global premiums of SwF 187

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[1] Prepared by Su Hoong Chang (Monetary and Capital Markets Department). A formal assessment of the Swiss reinsurance industry is reported in a separate Detailed Assessment Report.

billion recorded in 2004, SwF 133.5 billion was in respect of foreign business. While more than half of direct life premiums stems from Swiss business, about three quarters of non-life business were written abroad and more than 95 percent of reinsurance premiums came from foreign business. In 2005, Swiss insurers employed about 42,186 staff in Switzerland and 92,774 staff abroad.[2] With the acquisition of GE Insurance Solution, to be completed by end-2006, Swiss Re becomes the largest reinsurer in the world, with an estimated 25 percent of global life and 14 percent of global non-life reinsurance premiums.[3]

Table 1. Balance Sheet of Top Four Direct Insurance Groups by Region, 2005

In SwF Mn	**Baloise**	**Swiss Life**	**Winterthur**	**Zurich Fin'l Services**	**Total (%)**	
Switzerland	33,607	88,971	84,619	42,125	249,322	28.8
Europe	28,501	88,626	93,799	253,619	464,545	53.7
North America	0	0	5,753	89,884	95,637	11.1
Asia	0	0	5,897	N.A	5,897	0.7
Rest of world	0	0	-11,340	60,419	49,079	5.7
Total	**62,108**	**177,597**	**178,728**	**446,047**	**864,480**	**100.0**

Source: 2005 Annual Report of the Federal Office of Private Insurance.

6. **Even though the Swiss insurance market is highly concentrated, the market structure has remained stable.** In 2005, the five largest non-life insurers accounted for 72 percent of gross premiums written while the five largest life insurers accounted for 82 percent of the premiums earned. Swiss Re, European Re and Converium consistently maintain about 79 percent share of the Swiss reinsurance market. Exits from the market have been orderly and new niche players have been attracted to enter the market, in the absence of restrictive entry barriers.

7. **Some insurers have reviewed their business strategies to focus on their core businesses.** Traditionally, Swiss insurers operate life and non-life as well as reinsurance businesses as part of their diversification strategies. There is an emerging trend for insurers to specialize in their traditional core business.[4] Almost all direct insurers have withdrawn from active reinsurance operations. The number of insurers offering one-stop financial services via collaborative ventures with banks fell significantly.

[2] Data extracted from the Swiss Insurance Association, with its 80 members accounting for more than 95 percent of the premiums written in the Swiss market.

[3] Standard & Poor's Global Reinsurance Highlights 2006 Edition.

[4] As an example, Swiss Life has refocused on life insurance while Mobiliar specializes in non-life products.

8. **Insurance for buildings is mandatory in 19 cantons, provided by monopolistic cantonal insurers that are not regulated by the FOPI.** The total sum insured for buildings in 26 cantons amounted to more than SwF 2,000 billion and content cover is about SwF 700 billion. These cantonal insurers cover fire, lightning, explosion, aircraft and elemental perils only.[5] Potential economic losses from earthquakes are estimated at approximately SwF 80 billion in the region of Basle. Earthquake insurance is mandatory in Zurich while the other 18 cantons maintain a voluntary earthquake pool with the sum insured totaling SwF 1,200 billion. The Swiss Insurance Association (SIA) and the Interkantonaler Rückversicherungs-Verband (IRV), an inter cantonal pool of insurers, have launched a joint initiative to implement a mandatory earthquake insurance solution with appropriate reinsurance protection by January 1, 2008.[6]

B. Industry Performance

9. **The insurance industry has recovered from the stock market crash in 2001/2002.** Restructuring investment allocation strategies and more stable capital market performance led to improved earnings and capitalization of direct insurers. Investments in shares and mutual funds have been brought down to less than 8 percent (SwF 43 billion) of capital investment at end-2005. The direct insurance industry has been profitable, even after sustaining SwF 1.3 billion payouts caused by a severe storm in August 2005.

10. **Stabilized premium receipts and declining losses for direct Swiss business have strengthened capital and reserves of the direct insurers over the last three years.** Gross premiums of direct Swiss insurers totaled SwF 50.5 billion for 2005. For non-life insurance, motor insurance is the largest line of domestic business, accounting for 23 percent of market share, followed by fire and natural hazards insurance (15 percent). The latter suffered the highest loss ratio of 140 percent for 2005. A massive growth of 83 percent was registered in the unit-linked life insurance, boosted by good investment performance in 2005 and the introduction of new products that offer capital protection or a guaranteed minimum return at contract expiry. Occupational pension insurance declined 8.2 percent due mainly to the withdrawal of a number of insurers and guaranteed products. Health insurance has been hovering at the current level.

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[5] Elemental perils are defined by law and include flood, storm, hail, avalanche, snow pressure, snow slide, landslide, falling rock and rockslide.

[6] Source: Data quoted in this paragraph is from Guy Carpenter, *The World Catastrophe Reinsurance Market – Steep Peaks Overshadow Plateaus*, September 2006

11. **Total assets held by direct insurers amounted to SwF 450.3 billion as at end-2005, with significant shifts in asset allocations since 2002.** About 50 percent was invested in fixed income securities while investments in shares had been reduced significantly to only 8 percent of total assets at end-2005. Significantly, intra-group loans and investments in related companies amounted to SwF 55.7 billion or 12.4 percent of total assets. The current asset allocation strategy implies that insurers are unlikely to enjoy high, albeit volatile, investment returns as in the past. Future profitability will hinge on disciplined underwriting performance.

12. **The industry has been building up its equity base for the past three years, with combined life and non-life equity totaling SwF 26.5 billion at end-2005.** The surplus of the direct industry rose by SwF 1.7 billion in 2005 to reach SwF 4.1 billion while equity increased marginally by SwF 0.8 billion. Total reserves held by the direct insurance industry amounted to SwF 596.1 billion, of which life reserves accounted for SwF 513 billion.

III. INSTITUTIONAL FRAMEWORK AND ARRANGEMENTS

13. **Pursuant to the ISL, the FOPI regulates and supervises all private (re)insurance entities, groups and conglomerates as well as intermediaries domiciled in Switzerland**. Exempt from the scope of the ISL are: (i) insurance companies with their registered office outside Switzerland if they only operate insurance in Switzerland; and (ii) insurance companies subject to special supervision pursuant to Swiss Federal Law, in respect of activities covered by such special supervision, including those registered in the register of occupational pension plans and insurance intermediaries dependent on an insurance policy holder, where they pursue exclusively the interests of the policy-holder and the companies the policy holder controls. Old age and survivors' insurance, Swiss National Accident Insurance Fund and military insurance are not subject to supervision by the FOPI.

14. **The health insurance sector is subject to dual supervision**. Basic health insurance is mandatory, mainly offered by health insurance associations regulated by the Federal Office of Public Health (FOPH). While private insurers are allowed to write basic health insurance, their level of interest is low as premium rates are fixed by the FOPH. The FOPI is responsible for supplementary private health insurance sold by private insurers and health insurance associations. The insolvencies of three health insurance associations (KBV; Accorda; and Zurzach) in recent years were attributable to their basic health insurance portfolios.

15. **The FOPI was restructured in mid-2004 to facilitate specialization according to the type of insurance operation.** Separate supervisory sections are responsible for non-life insurance, life insurance, intermediary, group and conglomerate and health insurance and reinsurance. With its current established headcount of 90 staff, the FOPI monitors over

200 insurers, about 60 supplementary health insurance funds and more than 8,000 registered intermediaries. The supervisory sections are supported by the Supervisory Development, Legal Services, Financial Accounting, Financial Investments and International Affairs departments.

16. **A new integrated financial market authority (FINMA) is expected to be operational by 2009.** The draft Federal Act on Financial Market Supervision (FINMA Act), endorsed by the Federal Council on 1 February 2006, aims to integrate the Swiss Federal Banking Commission (SFBC), the FOPI and the Money Laundering Control Authority (MLCA) into FINMA. The current roles of the supervisory authorities for the respective sectors are retained. Each sector continues to be regulated and supervised under the existing sectoral legislation. The draft FINMA Act also provides for a streamlined and harmonized sanctions regime, which comprises revisions to the existing criminal law provisions and new administrative sanctions.

17. **Self-regulation is a critical component of the Swiss regulatory regime.** A number of professional bodies and self-regulatory organizations (SRO) complement the FOPI in promoting professional market conduct and sound industry practices. These include the Swiss Institute of Certified Accountants, the Swiss Insurance Association (SIA), the Swiss Actuarial Association and the Swiss Insurance Brokers Association. The SIA has also established a distinct SRO to administer AML/CFT regulations approved by the FOPI.

IV. Implementation of IAIS Insurance Core Principles

A. Conditions for Effective Insurance Supervision

18. **The Swiss authorities articulated Switzerland's Financial Centre and Financial Market Policy in September 2006**. Predictability of macroeconomic, legal and institutional frameworks is viewed as a traditional strength and the essential foundation for Switzerland's long-term success as an international financial center. The key objectives are to (a) facilitate international competitiveness, (b) ensure functionality, efficiency and stability; and (c) maintain integrity. The guiding principle is to achieve practical, proportionate and effective regulations. At the same time, "opportunities and options should also be utilized as part of a deliberate practice of regulatory differentiation" to preserve Switzerland's competitiveness and reputation as a stable and integrated financial center.

19. **The Audit Oversight Act, enacted in December 2005, established the Federal Audit Oversight Authority (FAOA) responsible for licensing and supervising auditors carrying out statutory audits.** Audits of public companies are subject to this special

regime.[7] The FAOA is expected to be operational by end-2007. The law specifies the qualifications and duties of auditors. It regulates auditors' professional conduct, including independence, quality assurance, documentation and the scope of audits.

20. The **Swiss Ombudsman of Insurance, established by the SIA, deals with complaints and facilitates the resolution of disputes.** Parties involved are not bound by the Ombudsman's findings and they are free to take further legal steps.

B. The Supervisory System

21. **The ISL, which came into effect in January 2006, is designed to protect the insured from abuses and the insolvency risks of insurers.[8]** The Federal Council is charged with the execution of the ISL and appoints the FOPI.[9] In the past, the supervisory focus was on the approval of premiums; i.e., a premium that was neither abusive nor a threat to solvency. The ISL replaces preventive product approval/monitoring with a risk-based solvency framework. However, product approval is retained in the socially sensitive areas of occupational pensions and supplemental health insurance.

22. **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,** as provided under the draft FINMA Act; and the guidelines on regulation issued by the Federal Department of Finance, the Swiss Federal Banking Commission, and FOPI.[10] The objective is to achieve more effective, practical and cost-conscious regulation—regulatory processes should be transparent, the parties affected should be involved to a greater extent and the economic impact of regulation should be taken into account at an early stage. Consideration should be given to clarifying the authority, circumstances and processes in addressing potential conflicts in objectives and preserving the operational autonomy of the FOPI.

23. **The new supervisory approach includes self-governance and self-assessment.** The FOPI's supervision philosophy is risk-based, principle-based, and competition-oriented. The onus is on the Board of directors and senior management of insurers to ensure robust risk

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[7] Include all companies listed on the Swiss stock exchange, foreign companies with bonds outstanding in Switzerland (whether listed or not) and companies that account for at least 20 percent of the assets or revenues in the consolidated financial statements of any aforementioned company.

[8] Article 1 of ISL.

[9] Article 88 of ISL.

[10] These considerations are included in Article 7 of the draft FINMA Act and the Joint Guidelines for Effective Financial Market Regulation in September 2005, which set out uniform criteria for evaluating regulatory proposals across the financial sector.

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. This is intended to assist the FOPI in focusing on insurers with material deviations from industry benchmarks.

24. **In February 2006, FOPI concluded a Memorandum of Understanding (MoU) with the Members and Observers of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).**[11] Pursuant to this MOU and the EU equivalence recognition for the Swiss insurance regulatory regime, the FOPI may be appointed as a lead supervisor or co-supervisor for cross-border supervision of insurance groups and financial conglomerates domiciled in Switzerland. This recognition reduces the regulatory burden of Swiss insurance groups and conglomerates operating in the EU.

25. **It is critical that the FOPI has adequate regulatory resources to effectively implement the regulatory reforms under the ISL.** The FOPI has an expanded mandate under the ISL in corporate governance, risk management, solvency controls, group/conglomerate supervision and direct supervision of intermediaries. While self-governance, as well as an enhanced role for auditors and actuaries, complements regulation and supervision, the FOPI has to strengthen its direct supervision of insurers. The FOPI also has to build regulatory resources to fulfill its responsibilities as the lead supervisor/co-supervisor for supervising cross-border conglomerates and groups.

C. The Supervised Entities

26. **The ISL strengthened the legal basis for the FOPI in licensing insurers.** The FOPI is empowered to require applicants to submit comprehensive business plans that should include details regarding the identity of beneficial owners as well as information on the fitness and propriety of directors, auditors and key management staff. A license will only be granted if the legal requirements are met and the interests of the insured are safeguarded. In addition, insurers are required to inform the FOPI of any changes in their business plans.[12]

27. **Changes in control and portfolio transfers are subject to approval by the FOPI**. Insurers are required to notify the FOPI of changes in or acquisitions of share ownership 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

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[11] CEIOPS includes member states of the European Union (EU) and the European Economic Area.

[12] Article 4 and 6 of ISL.

endanger the insurer or the interests of the insured.[13] Prior approval from the FOPI is required for transfers of insurance portfolios in full or in part to another insurer. If the FOPI orders a portfolio to be transferred, it shall specify the conditions. The insurer acquiring the portfolio shall inform each of the insured parties individually within 30 days of the transfer that they have a right to terminate their contracts.[14]

28. **Direct captives are regulated the same way as direct insurers while reinsurance captives are exempted from the SST.**[15] However, where a reinsurance captive has complex group structures or substantial financial risks, the FOPI may require the application of the SST.

29. **The ISL also empowers the FOPI to establish rules on corporate governance and internal controls.** To this end, the SO sets out the requirements for the fitness and propriety of board members and management. [16] In particular, the chairman of the Board of Directors should not also serve as chief executive officer. Insurers are also required to set up an effective internal audit function that is independent of management. External auditors have whistle blowing obligations to the FOPI.[17]

D. Ongoing Supervision

30. **To facilitate off-site surveillance, the FOPI should implement more timely and comprehensive regulatory reporting as a priority.** While insurance entities furnish annual reports in respect of Solvency I requirements and semi-annual reports of consolidated/group accounts, insurance groups/conglomerates submit quarterly financial and asset-liability management reports. In addition, the information submitted is insufficient for effective regulatory assessment. For example, the FOPI does not have new business premiums written by life insurers, which is a basic financial indicator. The FOPI should consider implementing more timely, e.g., quarterly, reports of selected key regulatory data such as solvency, and asset-liability management to allow for ongoing monitoring and timely intervention. Such interim reports could be based on insurers' internal management and risk control reports to

[13] Article 21 of ISL

[14] Article 62 of ISL does not apply to reinsurers.

[15] Article 2 of SO.

[16] Article 12 to 14 of SO.

[17] Article 30 of ISL.

minimize cost and effort. This will also pave the way for the eventual implementation of the IAIS standards on public disclosures.[18]

31. **Due consideration should be given to reviewing the scope and intensity of on-site visits.** Currently, such visits typically last for two to three days involving mainly meetings with insurers' management as well as with experts in the investigated fields. Additional discussions could also be held on validating the internal models used for the SST. Besides discussions on the management presentation and review of management and internal/external audit reports, an appropriate supervisory program should include an independent assessment of the risk management and corporate governance practices of insurers e.g., to check that control measures are operating as conveyed to the FOPI. The completion of the SAM project will provide useful inputs to the FOPI on implementing a risk-based approach to on-site inspections.

32. **Group and conglomerate supervision under the ISL is recognized as equivalent to the relevant EU Directives** and with the Principality of Liechtenstein.The FOPI has the discretion to exercise conglomerate and group supervision. The FOPI's consolidated supervision encompasses all entities within Swiss-based groups. Conglomerate supervision is applicable if there are "significant" bank or securities operations along with insurance activities. The five largest insurance-based conglomerates as at end-2005 are: Baloise-Holdings, Swiss Life, Swiss Re, Winterthur Group and Zurich Financial Services Group. The criteria adopted for group supervision include the geographical scope of operations and the complexity of group structures. Currently, nine Swiss groups are placed under group supervision. Double gearing is addressed under both the Solvency I and group SST.

33. **The SO empowers the FOPI to require reports on significant intra-group transactions and establishes minimum values, taking account of the size and complexity of the insurance group.[19]** The intra-group transactions include: loans; guarantees and off-balance sheet operations; hybrid instruments qualifying as capital resources; capital investments; reinsurance; cost allocation agreements; and other risk transfer operations. Intra-group transactions which exceed the minimum values set by the FOPI are deemed to be significant. However, there are no explicit provisions within the FOPI's power to address undesirable intra-group transactions specifically. The FOPI's legal authority to take action to address such a concern is provided under Article 51 of the ISL.

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[18] *Disclosures Concerning Technical Performance and Risks for Non-Life Insurers and Reinsurers*, October 2004; *Disclosures Concerning Investment Risks and Performance for Insurers and Reinsurers*, October 2005; and *Disclosures Concerning Technical Risks And Performance For Life Insurers*, October 2006.

[19] Article 194 of SO.

34. **While the ISL empowers the FOPI to enforce a range of corrective and preventive measures, the FOPI may be limited by its regulatory resources in taking enforcement actions.** Consideration should be given to allocating adequate and trained personnel to administer the streamlined and harmonized sanctions ordinance, including the proposed administrative sanctions (e.g., confiscation or occupational ban) provided under the draft FINMA Act.

E. Prudential Requirements

35. **The ISL empowers the FOPI to establish risk management standards and supervise insurers' risk-management practices**. Insurers are required to identify and manage all relevant risks. Initiatives are underway to fine tune the methodologies and parameters for risk-based supervision, underpinned by the SST.

36. **All insurance companies are required to designate accountable actuaries, responsible for assessing insurers' risk management** as well as the appropriateness of premium rates and investments. The role of an accountable actuary is formalized under Solvency I. The FOPI will define the role of the appointed actuary under the SST more precisely in its forthcoming statement: "The appointed actuary is responsible to the extent of his training and experience, and based on the size and risk structure of the insurance company."

37. **The SST adopts a principle-based solvency regulation and facilitates risk-based supervision.** However, this implies that the FOPI needs to have good insights into company-specific models 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 1 requirements. As of January 1, 2006, the SST is mandatory for large insurance companies. Business in foreign branches must be taken into account. Small insurers, reinsurers as well as insurance groups/conglomerates are expected to fully implement SST in 2008. The target capital requirement is expected to come into force as of 2010.

38. **The SST aims to strengthen effective risk management by insurers, especially asset-liability-management (ALM)**. It establishes target capital as a pillar two requirement, 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.

39. **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 FOPI has issued guidelines for calculating technical reserves for life insurance and is drafting the guidelines for non-life insurance. The use of an internal model is the default option and standard models can only be used if they adequately quantify an insurer's risks. The use of internal models is mandated for reinsurers, captives, insurance groups and conglomerates, insurers with substantial business written by foreign branches and life insurers writing substantial financial options and guarantees. Going forward, the verification of the internal models used will be a challenge for supervision.

40. **Premiums in respect of natural hazard covered under fire insurance are based on industry tariff rates.** The scope of cover and the premium rates are uniform and binding on all insurers. The Federal Council shall issue detailed rules on the basis for calculating premiums, the scope of cover, limits on liability and statistics to be compiled by insurers. The FOPI checks that the premium rates are fair in terms of risks and costs. The intention is to pool the risks on a national basis, allowing the insured living in exposed zones to have basic insurance coverage at affordable premiums.

41. **The separation of the safety fund for life insurance and occupational pension insurance earmarked SwF 118.7 billion as technical provisions for pension policies.** On April 30, 2004, the FOPI issued a directive that set out the principles and the process for separating the safety funds. Each insurer would present its concept for the separation for approval. The concept must satisfy four principles: (i) equal partition of risks, (ii) equal partition of expected returns, (iii) partition of hidden reserves in the same proportion as the proportion of the amounts of the separated funds, and (iv) consideration of future cash flows. The objective is to ensure that the separation is undertaken in a way that does not compromise the interests of the insured persons for occupational pensions or life policyholders. An insurer's explicit proposition to split each category of asset would be checked by the FOPI and an external expert, and subject to external audit.

42. **Policyholders and beneficiaries insured by insurers in Switzerland have priority in respect of claims against the tied assets of insurers, which are segregated from the insurers' other assets.**[20] If an insurer intends to operate third party motor vehicle insurance, it shall become a member of the Swiss National Bureau of Insurance and the National Guarantee Fund. This guarantee fund covers third party injuries caused by unknown drivers.

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[20] However, the tied assets requirement does not apply to reinsurers.

F. Markets and Consumers

43. **To enhance consumer protection, the ISL empowers the FOPI to supervise insurance intermediaries**. The FOPI is empowered to inspect intermediaries. However, the FOPI has no plan to conduct routine inspection of intermediaries. The FOPI manages a public register of intermediaries and more than 8,000 have been registered since January 2006. Intermediaries can only be registered if they demonstrate relevant professional qualifications and adequate professional liability insurance. Rules on the relevant professional qualifications, including training and examination have been established in collaboration with the insurance industry.

44. **The ISL and the amended ICL regulate disclosure requirements of insurance intermediaries vis-à-vis the insured.** In particular, the ISL holds intermediaries liable for negligence, errors, or incorrect information. However, enhanced disclosure requirements under the ICL have been deferred till January 1, 2007 in response to industry feedback that the provisions require a high degree of standardization of information.

45. **The FOPI is advised to introduce enhanced disclosure and market conduct requirements for unit-linked policies (ULPs).** Policyholders of ULPs bear the investment risks of assets attributable to the policies and some ULPs may offer minimal or no life insurance coverage. As such, it is important that the policyholders are aware of the investment risks. Intermediaries should also ascertain that ULPs meet the financial/protection needs and risk appetite of policyholders. In view of the significant growth of ULPs in 2005, it is pertinent that the FOPI introduces regulatory rules that would provide relevant and adequate information to policyholders for informed decisions and monitoring. Intermediaries should also be trained adequately to provide professional advice.

46. **The FOPI has authority to require insurers to report insurance fraud to law enforcement authorities**. Claims fraud is punishable under the Criminal Code, which obliges insurers to report fraud to relevant authorities and take preventive measures. The mandatory internal control systems, as defined in the FOPI guideline, contribute to fraud prevention. The FOPI also does not promote the exchange of information between insurers on fraud but leaves this to the SIA.

47. **The FOPI cooperates with other competent authorities in countering fraud**. Direct cooperation with foreign authorities focuses on fit and proper requirements. In criminal cases, the Department of Justice is the appropriate channel of communication, notably under agreements on legal assistance concluded with other jurisdictions.

G. Anti-Money Laundering, Combating the Financing of Terrorism (AML/CFT)

48. **The FOPI Ordinance on AML/CFT, which will come into effect on 1 January 2007, brings the Swiss AML/CFT regime in line with standards established by the Financial Action Task Force.** The ISL also empowers the FOPI to approve changes in control and beneficial ownership. Self-regulation is the preferred approach and the SRO established by the SIA administers the regulation issued pursuant to the FOPI Ordinance on AML/CFT. The FOPI also cooperates closely with the domestic Financial Intelligence Unit (FIU) and other domestic AML/CFT supervisory authorities such as the SFBC and the MLCA. The Swiss FIU in turn cooperates with domestic enforcement authorities and with foreign FIU. Cooperation with foreign supervisors is only possible on an informal basis, unless MOUs have been executed.

49. **The transitional provision under the ISL, transferring the supervisory responsibility for insurance brokers in respect of AML/CFT to the FOPI, has yet to be implemented.** However, many brokers will still be subject to supervision by MLCA as they often engage in other non-insurance businesses regulated under the AML/CFT regime. AML/CFT will be integrated under the FINMA.

V. Recommended Action Plan

Insurance Core Principles (ICP)	Recommended Action
The Supervisory System ICPs 2-5	Consider greater clarity regarding the authority, circumstances and processes in addressing potential conflicts in supervisory objectives. 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. Push ahead with the regulatory reforms under the ISL. Strengthen regulatory resources to effectively supervise a sophisticated and globally diversified reinsurance industry and implement the regulatory reforms. Consider formal regulatory cooperation and information exchanges with foreign regulators outside the EU/EEA.
Ongoing Supervision ICPs 11-17	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 measure; (d) conduct group/conglomerate supervision; and (e) conduct direct supervision of intermediaries. Consider quarterly reports on selected key financial indicators, particularly on solvency and asset-liability-management, to facilitate ongoing off-site surveillance and timely intervention. Allocate adequate and skilled resources to enforce preventive and corrective measures under the ISL.
Prudential Requirements ICPs 18-23	Maintain the momentum in implementing the SST as planned.
Markets and Consumers ICPs 24-27	Introduce enhanced disclosure and market conduct requirements for ULPs. Plan for the effective implementation of the IAIS standards on public disclosures to facilitate market discipline.