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To Insurance Institutions Subject to FINMA Supervision

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FINMA Newsletter 5 (2010)

Insurance Institutions – Results of the First Swiss Qualitative Assessment

Ladies and Gentlemen

This communication is to transmit to you the attached report containing FINMA's market-wide observations gathered from the first Swiss Qualitative Assessment (SQA I). The areas reviewed in SQA I were corporate governance, risk management, and internal controls. In summary, the review suggests insurers are generally moving in the right direction in these areas, though this progress is not consistent across all insurers or in all aspects of these areas.

1 Basis for the Observations

FINMA's observations are based on the 2008 SQA I submissions of Swiss insurers. The SQA is based on the Circular on Corporate Governance, Risk Management and the Internal Control System for the Insurance Sector, effective January 1, 2007 (now called FINMA-RS 08/32 of 20.11.08).

FINMA considers the areas of corporate governance, risk management, and internal controls to be of fundamental importance to the sound management of an insurer. They can help influence how decisions are made at the company and which risks are taken. They also determine which mechanisms are in place to promote adherence to internal policies and external obligations and guard against unwise or improper actions.

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2 Evidence of Increasing Efforts and Recognition of Business Value

The SQA I submissions show increasing efforts by many insurers in the areas of corporate governance, risk management, and internal controls. The progress among many insurers seems generally in line with market developments and practices in these areas. At the same time, the submissions suggest that the progress is not even across all insurers or in respect of all elements of corporate governance, risk management, and internal controls. Some insurers show leading practices on several of these aspects, while a number of insurers still appear to be considerably behind.

Within the same insurer too differences can exist. An insurer might show strengths on risk identification but not on risk controls, or on board governance but not on compliance. To ensure proportionality, FINMA's review compared insurers of similar size or risk complexity.

In general, it appears to FINMA that more and more Swiss insurers are recognizing the business value of proper focus on these areas. We believe the recent financial crisis has further brought to the forefront the importance of having the right governance, risk, and control systems in place and the appropriate oversight by the company's board of directors.

3 Potential Improvement Areas

The SQA I submissions reveal examples of good practices, some matching up with what leading companies internationally are pursuing. The submissions also reveal areas of insufficient clarity at some insurers or where more focused attention may be needed. These areas include:

- a) Board of Directors' qualifications, time devotion, oversight of management, and independence
- b) Checks-and-balances as between the Board of Directors and the Management Board and within the Management Board
- c) The positioning, resources, independence, reach and authority of some control functions (such as the risk manager and compliance officer)
- d) Company preparedness overall to manage risks effectively and comply with obligations, including in terms of having in place necessary policies, processes, training and controls.

As the report underscores, the above observations do not reflect progress which insurers have made since their SQA I submissions in 2008. Many insurers indicated then having in place specific plans to advance their efforts, particularly in respect of risk management processes and internal controls.

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4 Benefits of SQA I

The SQA forms an important part of FINMA's integrated supervision approach. It complements both traditional supervisory tools and the quantitative tools of the Swiss Solvency Test by looking at more qualitative elements. It also part of FINMA's efforts to increase the efficiency and effectiveness of its supervision of financial institutions.

The information in the SQA I submissions provide FINMA helpful evidence of the various operational practices insurers are following to implement corporate governance, risk management, and internal control principles. FINMA is using the results to hold with selected insurers more focused discussions on these topics and otherwise to enhance its understanding of a company's risk profile. The results of SQA I are also assisting FINMA in setting supervisory priorities and developing the next qualitative assessment to be known as SQA II.

We believe that the report should also be of utility to insurers in their efforts to further develop or fine-tune their individual approaches in the corporate governance, risk management, and internal control areas in accordance with their particular risk profiles. We encourage the Board of Directors, management, and the control functions of each insurer to review the report also in this context.

Yours sincerely

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Enclosure: Report on First Swiss Qualitative Assessment