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Annual Report

2007

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Swiss Federal Department of Finance FDF
Federal Office of Private Insurance FOPI

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Integrated insurance supervision

On course in a turbulent environment

The ongoing implementation of risk-based supervision and the reorientation toward integrated supervision processes in a turbulent market environment has resulted in numerous positive interactions between supervision and insurance undertakings. The turbulences on the financial markets in 2007, originating from the US market for subprime mortgage loans, did not leave the Swiss insurance market completely untouched. Nevertheless, the industry remains robust overall, since the individual insurance undertakings generally have strengthened their capital base since 2002, have paid attention to the profitable technical business and have reduced their share holdings.

Introduction by Monica Mächler, Director of FOPI

In the first half of 2007, the relatively quiet situation on the financial markets allowed FOPI to advance its conceptual work on implementation of the new Insurance Supervision Act (ISA). A project entitled „Integrated Insurance Supervision" was launched at the beginning of 2007, focusing – in addition to traditional approaches – on economically derived capital requirements based on the Swiss Solvency Test (SST) and on Qualitative Supervision of corporate government, risk management, the internal control system, and other processes such as investment management. The linking and harmonization of the various supervision instruments progressed substantially in the reporting year, in terms of both content and operations.

Robust insurance industry overall, but uncertain market development

The increasingly severe market turbulences in the second half of 2007 have impressively demonstrated how important the additional elements of risk-based qualitative and quantitative supervision enshrined in the new ISA actually are. The insurance undertakings suffered significant losses in their share portfolios and, to a significantly lesser extent, in their bond portfolios. Moreover, several countries – to very different degrees – suffered losses in asset-backed securities and capital market products. Nevertheless, the insurance industry remained robust overall. Insurance undertakings are generally much more strongly endowed than in the crisis years of 2001/2002. Numerous undertakings are also benefiting from the capital increases and profits achieved in recent years, focussing on profitable technical business and the reduction of their share holdings. Thanks to an increase in own funds, the volatilities of the remaining investments have been cushioned more effectively.

A survey of all companies and branches of foreign companies subject to supervision on 22 January 2008 shows that the slump in shares at the beginning of 2008 resulted in differing levels of decreases in the equity capital of insurance undertakings since the end of 2007. Nevertheless, the requirements of Solvency I continue to be met, and the technical provisions are fully covered by assets.

We are pleased that the FOPI investment directives have had the desired effect during the recent turbulences: For instance, direct investments in credit derivatives are not permitted for the tied assets of direct insurers. Insurance undertakings are required to adopt a prudent investment policy and appropriate processes.

Despite the solid constitution of the Swiss insurance industry overall, the current uncertain market situation does not allow predictions whether the development will further worsen and lead to additional write-offs or other consequences for individual insurance undertakings. FOPI is therefore continuously monitoring the situation.

Swiss insurance industry faces further challenges…

The Swiss insurance industry faces challenges for other reasons, due to the economic environment and the uncertainty whether a lower interest rate environment and the economic downturn might have an impact on earning power and premium growth. The sector also continues to face intensified competition. In the reporting year, the extremely competitive trends internationally have again reached Switzerland, such as the takeover of Converium Holding AG by the French SCOR S.A. At the same time, the sector must reorient itself towards evolving client needs both in life and non-life insurance, placing great demands on the innovative capacity and cost optimization potential of the insurance undertakings. The strategy for the future jointly elaborated by the Swiss Bankers Association (SBA), the Swiss Insurance Association (SIA), the Swiss Funds Association (SFA) and the financial centre infrastructure (SWX Group, SIS Group and Telekurs Group) clearly reflects this development.

….as does insurance supervision: Integrated Insurance Supervision

The highly competitive environment also confronts supervision with challenges. The new ISA has paid particular attention to the challenges resulting from liberalization and the associated risks. The shift of emphasis toward risk-based supervision envisages supervision of technical and financial risks through action targets and the implementation of such targets. The FOPI project on „Integrated Insurance Supervision“ launched in January 2007 can be seen in this context.
With the goal of developing a modern total concept of insurance supervision, the focus is on the harmonizing integration of traditional, quantitative, and qualitative elements of insurance supervision. Implementation is carried out on different levels: Improvements at the operational level within FOPI have already been implemented, while substantive harmonization has a project horizon until the end of 2010. Since substantive harmonization is expected to require amendments to ordinances or even laws, the project will likely continue into the second decade of the century.

The most significant event has been the introduction of the Swiss Quality Assessments (SQA) at the end of 2007, which serve to assess the corporate governance, risk management, and internal control system (ICS) of an insurance undertaking. The set of directives will be rounded off in 2008, especially in regard to the Swiss Solvency Test (SST). Insurance undertakings subject to the SST must submit their results to FOPI during the year.

International networking of Swiss insurance supervision

International networking is part of Integrated Insurance Supervision. FOPI cultivated this field intensively in the reporting year. Half-yearly Regulatory Dialogues with the EU and the US National Association of Insurance Commissioners (NAIC) have been instituted. FOPI has also participated actively in the International Association of Insurance Supervisors and the Insurance and Private Pensions Committee of the OECD. FOPI has cultivated numerous bilateral contacts with European, American, Oceanic and Asian supervisory authorities. These contacts have shown that Swiss insurance supervision enjoys one of the most advanced supervisory systems worldwide. In July 2007, the EU published a draft framework directive on Solvency II containing an overall concept committed to elements comparable to those in the Swiss system. Together with the Swiss system, a convergent European approach is emerging, with a positive effect on the development of insurance supervision outside Europe.

Integrated Financial Market Supervisory Authority (FINMA)

Starting 1 January 2009, the supervision of banks, insurance undertakings, and other financial intermediaries in Switzerland will be consolidated into the Swiss Financial Market Supervisory Authority (FINMA). With the partial entry into force of the FINMA Act, the new authority already attained its own legal personality on 1 February 2008. In addition, seven members of the board were elected The supervisory responsibilities will still be met by the existing authorities until the end of 2008. The focus for FOPI will be on further advancing the implementation of integrated insurance supervision and ensuring that professional insurance supervision remains guaranteed throughout the 2008 transition year.

FOPI in brief

Insurance supervision in Switzerland
The Federal Office of Private Insurance (FOPI) is responsible for insurance supervision in Switzerland, with the goal of protecting insured parties from the insolvency risks of insurance undertakings and from abuse. This legistative mandate is implemented by way of a forward-looking, competent, and professional approach that is committed to independent decision-making and proper judgement. Since 1 January 2006, a set of modern supervision instruments has been available for this purpose. All FOPI staff members are committed to supervisory integrity on the basis of an internal code of conduct.

The Federal Office of Private Insurance (FOPI) supervises the insurance undertakings in non-life, life, and reinsurance. It also supervises insurance intermediaries. The focus of FOPI's supervision work is on protecting insured persons from risks of insolvency of the insurance undertakings and from abuses.

FOPI issues licenses for business operations and performs a risk-weighted audit of active business with respect to finances and quality. Where necessary, it intervenes in cases of abuse or takes the appropriate protective measures. FOPI also approves and monitors insurance products in collective life and supplementary health insurance.

FOPI participates in the drafting of legislative foundations and international agreements relating to private insurance. Since 1 July 2003, FOPI has been part of the Swiss Federal Department of Finance (FDF).

Director
Monica Mächler (since 01.01.2007)

General Management (as of 31.12.2007)
Hans-Peter Gschwind, Deputy Director
Manfred Hüsler, Vice Director
Heinz Schweizer, Vice Director
René Schnieper,
Member of the General Management
Michael Mayer,
Member of the General Management

Staff

Total staff members:	89 (1.1.07: 89)
Total full-time positions:	83.95
Temporary staff members:	15 (9 full-time positions)
Exits 2007:	12, including 4 retirements

The staff is composed of a broad range of specialists who work together on an interdisciplinary basis. Staff members include lawyers, mathematicians/physicists/actuaries, economists, business economists, accounting and investment specialists, social scientists, and other experts.

The following special notices apply as of 31.12.2007:
- The former APKK Aerosana Association (health insurance) has not been released from supervision, but the new Aerosana Foundation has received a license (duplication)
- Genevoise Vie no longer has any insured persons (they have been transferred to Zurich Life), but it has not yet been released from supervision
- REC Re will be released from supervision shortly
- The health insurance scheme Lumnezia I was released from supervision on 23.1.08, but is still (correctly) listed in the table as of 31.12.07
- The health insurance schemes Saastal and Malters will be released from supervision shortly.

Supervised undertakings (as of 31.12.2007)

Type of insurance undertaking	Switzerland	Branches of foreign insurance undertakings	Total
Non-life insurers	78	39	117
Life insurers	22	4	26
Reinsurers	25		25
Captives	46		46
Subtotal	**171**	**43**	**214**
Health insurance schemes offering supplementary health insurance	46		46
Total of supervised insurance undertakings and health insurance schemes	**217**	**43**	**260**

Main Issues 2007

Swiss insurance industry

Focus on investment and solvency rules

The insurance companies domiciled in Switzerland were not significantly involved in the direct grant of subprime loans in the reporting year. Exposures varied, however, with respect to indirect investments in the form of investment funds, credit derivatives, asset-backed securities in general, and other structured products – though no direct credit derivatives (other than in investment funds, etc.) are allowed for tied assets. Overall, the FOPI investment directives had the desired effect. The insurance undertakings are required to adopt a prudent investment policy with respect to tied assets.

In the difficult market environment of 2007, numerous insurance undertakings benefited from the capital increases and profits attained in recent years. They were able to build up their own funds further and cushion the volatility of their investments. Moreover, numerous insurance undertakings have reduced their share holdings since 2002. The current uncertainty in the market, however, makes it unclear as to whether the situation could further worsen and, in the case of individual insurance undertakings, might lead to further write-offs or other consequences. FOPI is therefore continuously monitoring the situation.

Principles contained in the investment directives for tied assets

Direct insurers are required to cover their technical provisions with tied assets. The direct insurers must observe the investment directives in this respect, which call for a prudent investment policy. These rules do not apply to the free assets of direct insurers and also not to reinsurers.

Direct insurers in Switzerland have a total of approximately CHF 300 billion in capital investments that are invested in tied assets and therefore serve to directly guarantee the claims of policyholders. Under the protective mechanism of tied assets, 100% of the technical provisions (plus a safety margin) must be covered by assets that comply with the investment directives. With the introduction of the new investment directives in 2006, FOPI intentionally envisaged an opening of the investment universe. The new guidelines allow the risk-aware use of newer, more complex investment instruments. For instance, hedging transactions such as synthetic bonds or swaptions are allowable to reduce risks arising from obligations vis-à-vis insured persons. This makes it easier to manage long-term interest obligations.

The investment directives do not, however, permit direct investments in credit derivatives such as credit default swaps, total return swaps on credit risk, or credit spread options. This rule was adopted because of the limited liquidity of these instruments, their high operational risks, and the difficulty in demonstrating the efficiency of the hedging transaction. It is conceivable that the revision of the investment directives in 2008 may, under carefully defined conditions, permit certain hedging transactions with credit derivatives.

Indirect investments in credit derivatives are possible, as long as they meet certain requirements. According to the provisions contained in the investment directives, structured products must be broken down according to individual risks (look-through). The individual components of the instrument must meet the requirements of the investment directives. This entails that structured products linked to credit derivatives or the like (e.g. collateralized debt obligations) are not allowable. The situation is different in the case of hedge funds. No look-through is conducted here, so that credit derivatives may be contained in such investments. The insurance undertakings may therefore only invest in hedge funds if they meet certain requirements.

Alternative investments such as hedge funds, private equity funds, or commodity certificates and the use of structured products are therefore permissible. Alternative investments qualify for tied assets if they meet certain requirements. These requirements govern reasonable diversification, exit options, calls for additional cover, leverage, and transparency of investments. The investment directives also call for implementation of tailored processes and systems that allow the insurance undertakings to carry out a professional selection, management, and control of the investments made. The insurance undertaking must document its implementation of the abovementioned requirements for alternative investments in a concept to be submitted to the supervisory authority. FOPI then carries out an on-site inspection and discusses the implementation of the submitted concept with the insurance undertaking.

Traditional and risk-based solvency rules

FOPI also regularly reviews the solvency of the insurance undertakings. Traditionally, the requirements under Solvency I are monitored. These formulaic requirements define how much free and unencumbered equity capital an insurance undertaking must maintain relative to its business volume. Although Solvency I does not cover financial market risks, it does allow statements to be made on the available equity capital. In particular, the development of equity capital can be observed. Stress tests also show the dependence of equity capital on the financial markets.

In addition to Solvency I, implementation of the Swiss Solvency Test (SST) has been pursued since entry into force of the new ISA on 1 January 2006. Compared with Solvency I, the SST constitutes a substantially refined methodology for solvency evaluation. The SST is principle-based, relying on an economic analysis of all risks of an insurance undertaking. It is part of a supervision concept that relies on the self-responsibility of the supervised undertakings. The undertaking is required to set up an effective risk management system. It is then the responsibility of the supervisory authority to verify whether such a risk management system exists. The SST is an integral component of the risk management of an insurance undertaking.

Since 1 January 2006, large insurance companies have been required to apply the Swiss Solvency Test (SST) as part of field tests. Other insurance companies voluntarily completed the test. In 2008, the SST will be mandatory for all insurance undertakings, groups, and conglomerates subject to supervision by FOPI. The entities subject to supervision will have a grace period until the end of 2010 to build up the required target capital.

FOPI surveys on asset-backed securities and credit derivatives

In August and November 2007, FOPI assessed the general situation concerning asset-backed securities (ABS) and credit derivates among 17 selected insurance companies and groups. In particular, the respondents had to indicate their exposures to subprime loans and mortgages, especially in the US market; estimated exposures to subprime investments through indirect vehicles such as hedge funds, funds of hedge funds, collective investments, and structured products; and any exposures to US subprime investments via credit insurance, guarantees, and other such instruments. The undertakings were also called upon to indicate the expected effects of the crisis on their earnings situation and liquidity.

The surveys showed that the insurance companies domiciled in Switzerland have not been significantly involved in the direct grant of subprime loans. However, some insurance undertakings have built up different levels of exposure with respect to indirect engagements in the form of investment funds, credit derivatives, asset-backed securities in general, and other structured products. It also goes without saying that insurance undertakings, like other market participants, are affected by the impact of the current turbulences, especially with a view to exchange quotations.

In the reporting year, only one reinsurance group in the circle of insurance undertakings subject to FOPI supervision was immediately affected by the subprime turbulence to a greater extent. The published book losses concern credit default swaps.

Effects of the slump in shares

FOPI carried out a survey as of 22 January 2008 of all companies and branches of foreign companies subject to supervision with respect to equity capital, Solvency I, and tied assets. The survey shows that the development of the financial markets at the beginning of 2008 resulted in differing levels of decreases in the equity capital of insurance undertakings since the end of 2007. Nevertheless, the requirements of Solvency I continued to be met as of 22 January 2008, and the insurance undertakings had fully covered their technical provisions at that time with assets. In particular, with regard to the retirement assets fully reinsured by private life insurers, the guaranteed minimum coverage of 100% continues to be completely guaranteed.

Integrated insurance supervision

First milestones reached

An interdisciplinary project team entitled „Integrated Insurance Supervision" within the Federal Office of Private Insurance (FOPI) is condensing a modern holistic concept for insurance supervision. This concept integrates traditional, quantitative, and qualitative elements in a harmonious way. The project was launched in January 2007. The most significant event so far was the launch of the Swiss Quality Assessment (SQA) for corporate governance, risk management, and the internal control system at the end of 2007.

The new Insurance Supervision Act (ISA) shifts the emphasis toward risk-based supervision, with the goal of monitoring insurance and financial risks in a forward-looking manner. Alongside traditional instruments, new quantitative and qualitative elements will play an important role.

The new instruments

The new ISA has codified the Swiss Solvency Test (SST) developed by FOPI. The SST serves to identify the economic risk exposure and risk capacity of an insurance undertaking, relying on similar principles as Solvency II, the analogous project in the EU. Supplementing this quantitative approach, qualitative supervision instruments are being introduced, such as the provisions on corporate governance, risk management, the internal control system, and various processes such as the asset management.

The traditional instruments

In addition to these new supervision instruments, several traditional and proven supervision mechanisms will continue to be applied. The license to operate an insurance business as such is granted on the basis of business plans that must be updated continuously. Within the scope of the reporting obligations account must be rendered in particular concerning Solvency I and the bound assets. In the course of business operations, several processes relevant to company law, such as portfolio transfers, are subject to approval. If FOPI identifies threats to solvency or abuses, it has several protective measures at its disposal, which are supplemented by defined rules on the bankruptcy of insurance undertakings and specific penalty provisions.

The Integrated Insurance Supervision project

The abovementioned legislative changes also enhance the demands on supervision, its processes, and its staff. A multidisciplinary project team has been commissioned to condense the modern holistic concept. In terms of substance, this means integrating traditional, quantitative, and qualitative supervision. Redundancies will be eliminated and inconsistencies corrected. Processes – especially internal interfaces – will be optimized to improve the efficiency of the supervisory authority. This will create an insurance supervision that is efficient and homogeneous in relation to the supervised companies, taking into account the needs of the market while strengthening the protection of insured parties.

The project was launched in January 2007. The first operational milestones were attained in June 2007 and at the end of 2007. By the end of the 2007, the need for substantive harmonization was also assessed. Substantive harmonization is being implemented on an ongoing and stage-by-stage basis, with a projected time horizon until the end of 2010. Since substantive harmonization is expected to require amendments to ordinances or even laws, the project will likely continue into the second decade of the century.

Important milestone: Swiss Quality Assessment (SQA) as implementation of qualitative supervision
Over the course of the year, FOPI developed two new supervision instruments, which were submitted to companies at the end of 2007. The results must be returned to FOPI by the end of March 2008. These instruments are:

- Self Assessment Tool for Corporate Governance (based on article 14 ISA)
- Self Assessment Tool for Risk Management/ Internal Control System (based on articles 22 and 27 ISA)

These tools are pursuing a new path for implementation of principle-based supervision. The companies are called upon to convey a photographic illustration of their processes in the areas of corporate governance and risk management/ internal control system and to evaluate themselves. This will be followed by an evaluation by FOPI, which will be supplemented where necessary by a risk dialogue with the insurance undertaking in question. This may result in recommendations by FOPI or specific measures.

The legal foundations
The new Federal Law of 17 December 2007 on the Supervision of Insurance Undertakings (Insurance Supervision Act, ISA) and the associated Ordinance of 9 November 2005 on the Supervision of Private Insurance Undertakings (Supervision Ordinance, SO) as well as the FOPI Ordinance of 9 November 2005 on the Supervision of Private Insurance Undertakings (FOPI Supervision Ordinance, FOPI-SO), which entered into force on 1 January 2006, have created the foundations in Switzerland for a modern insurance supervision system.

International insurance supervision

Strengthening of cooperation at the international level

In addition to its activities in international institutions and at the level of bilateral contacts, the Federal Office of Private Insurance was able to establish a Regulatory Dialogue in 2007 with the European Union and with the umbrella organization of US insurance supervisors. The focus of international discussions was on the EU framework directive on Solvency II published in July 2007, which is largely based on the same foundations as the modern Swiss supervision concept implemented in the Swiss Solvency Test (SST).

The Federal Office of Private Insurance intensively cultivated its multilateral and bilateral contacts in 2007. Given the tightly interlocking regulatory developments affecting the worldwide insurance industry, it is indispensable for Switzerland to strengthen its international exchange with foreign countries and international organizations. This allows Switzerland to promote a convergence of developments, especially at the conceptual level.

Regulatory Dialogue

In May 2007, a FOPI delegation and representatives of the European Commission (Internal Market and Services Directorate General) explored the possibility in Brussels of establishing an informal „Regulatory Dialogue“ between the EU and Switzerland. The Regulatory Dialogue was institutionalized in November 2007; it will now take place twice a year. The focus in 2007 was on topics relating to economic solvency models. The exchange concerned the draft Solvency II directive published by the European Commission in July 2007 (see box). Since Switzerland has already gathered some experience with the Swiss Solvency Test (SST), the Swiss predecessor to Solvency II, the representatives of the European Commission were very interested in the know-how from Switzerland.

Another Regulatory Dialogue with a half-yearly meeting rhythm has been established with the National Association of Insurance Supervisors (NAIC). The NAIC is the umbrella organization for the insurance supervision authorities in the individual US States. After a preparatory discussion in May, the first Regulatory Dialogue between the NAIC and Switzerland took place in October 2007. The focus was on the economic foundations underlying the Swiss Solvency Test (SST), in which the American conversation partners showed particular interest.

Both Regulatory Dialogues will continue in spring 2008.

Cooperation with EU and EEA States

Regular contacts are maintained with insurance supervisory authorities of the EU and the EEA concerning the insurance groups and conglomerates operating in Europe (CoCo Meetings). Based on a model text negotiated with the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), FOPI has concluded a Memorandum of Understanding (MoU) with all the insurance supervisory authorities of the EU and EEA states. The MoUs facilitate information exchange and cooperation among the supervisory authorities of individual States, in particular relating to group and conglomerate supervision. Numerous bilateral contacts have also taken place, most of which for the purpose of exchanging views and experiences on conceptual developments. FOPI also achieved an important milestone of success: CEIOPS has now recognised the Swiss supervisory regime, in the area of supervision of financial conglomerates and the related supervision of insurance groups, as an equivalent regulatory structure. CEIOPS not only acknowledges the progress resulting from the new Insurance Supervision Act in the areas of qualitative and quantitative supervision as well as group and conglomerate supervision, but also the improvement of cooperation in the context of the aforementioned MoUs.

Cooperation with States outside Europe

In the reporting year, there was great interest by East Asian, Oceanic and Latin American supervisory authorities in the Swiss Solvency Test and the developments relating to Qualitative Supervision. Several delegations from these States were received in Berne. These contacts serve as important foundations for advancing the international convergence of supervisory systems.

Amendment of the Direct Insurance Agreement with Liechtenstein

Thanks to an amendment of the Agreement of 19 December 1996, insurance intermediaries registered in either of the two countries now enjoy freedom of services and establishment in both countries. The amended Agreement was signed on 20 June 2007 and has been provisionally applied since 1 July 2007. The Federal Council submitted its message to Parliament on 21 November 2001 for approval and definite entry into force.

German- and French-language exchange of experiences

The financial market supervisors of Germany, Austria, the Principality of Liechtenstein, and Switzerland met in September 2007 for a German-language exchange of experiences. A French-language exchange of experiences also took place in September 2007 with the insurance supervisory authorities of France, Luxembourg, Belgium, and Switzerland.

Strengthening of international insurance supervision

The International Association of Insurance Supervisors (IAIS) continued its engagement on behalf of a worldwide convergence of supervision techniques in 2007. FOPI participated actively in numerous committees and subcommittees. The Technical Committee, of which Switzerland is a member, is of particular importance to the further development of the work. In 2007, the Common Structure for the Assessment of Insurance Solvency and the IAIS guidelines on evaluating solvency were adopted. Several further projects were initiated or expanded in 2007, such as the work of the new Governance & Compliance Subcommittee and the Financial Conglomerates Subcommittee. Since April 2007, the Insurance Laws Subcommittee of the IAIS has been chaired by Valérie Staehli of the Federal Office of Private Insurance. The Insurance Laws Subcommittee oversees the Insurance Laws Database, a collection of information on supervisory systems worldwide.

To promote communication and cooperation among supervisory authorities around the world, the IAIS adopted a Multilateral Memorandum of Understanding (MMoU) expected to enter into force in 2008. The MMoU defines the principles and procedures for providing information and evaluating insurers. Several member countries, including Switzerland, have expressed interest in joining the MMoU.

IMF: Assessment of the reinsurance sector

The IAIS standards also serve as the basis for the International Monetary Fund's (IMF) periodic Financial Sector Assessment Program (FSAP).

In 2007, the IMF concluded a detailed assessment of the Swiss reinsurance sector. The IMF also updated its data on the direct insurance sector as part of its FSAP Update. FOPI received high marks for its work. The IMF indicated, however, that resources should be enhanced especially for on-site inspections. The annual Article IV Consultation – the „other" country assessment carried out by the IMF – was also successfully concluded in 2007. Overall, the developments over the course of the FINMA project were deemed positive. However, the IMF noted that the legal foundations relating to budget and policy autonomy and sanction mechanisms could still be strengthened. During the Article IV Consultation, the IMF also noted FOPI's pioneering role in the area of risk-based supervision with the SST, and recommended paying greater attention to the „high-risk" insurers.

Engagement at the OECD

2007 was a year of change for the OECD work of the Federal Office of Private Insurance. With the resignation of Kurt Schneiter, Head of International Affairs at FOPI, in May 2007, Switzerland turned over the chairmanship of the Insurance and Private Pensions Committee (IPPC) to Manuel Aguilera of Mexico. Michael Mayer, the new Head of International Affairs at FOPI, was elected to the bureau of the IPPC in December 2007.

The content of the two conferences in 2007 included regulatory effectiveness and efficiency and the tensions on the American financial market. Also of note is the IPPC Programme of Work for 2009/2010, which will be further elaborated in 2008.

Equivalence of Swiss Solvency Test (SST) and Solvency II

The SST – the economic and risk-based capital model – will become mandatory in 2008 for all insurance undertakings, groups and conglomerates subject to FOPI supervision unless they are exempt as reinsurance captives. The entities subject to the SST have a grace period until the end of 2010 to build up the required target capital. In the EU, the framework directive on Solvency II was published by the EU Commission in July 2007. Provided that the framework directive will be adopted by the European Parliament in 2008 as planned, Solvency II will likely enter into force in the individual European countries by 2012.

Both solvency monitoring approaches are principle-based and considered part of a supervision concept relying on the self-responsibility of the supervised companies. The company is required to institute effective risk management. Therefore the supervisory authority reviews whether such risk management is actually instituted.

The principles constituting the basis for Solvency and the SST are almost entirely identical. Differences exist only in the implementation of the two systems. Solvency II and the SST should therefore be deemed equivalent.

The most important principles of Solvency II and the SST are:

- Both the SST and Solvency II rely on the „total balance sheet" approach. This means that all items on the economic balance sheet must be compiled. They must also be treated consistently.
- The second fundamental principle is that of market-consistent valuation on an economic basis. This requires that financial instruments with a market value must be taken into account at that value (marking-to-market). Instruments without an immediately determinable market value must be valued according to a sound financial mathematical method (marking-to-model).
- The third fundamental principle is the principle of risk-based supervision. The capital needs of an insurance undertaking are based on the risks of the undertaking. The risk categories to be taken into account are the actuarial risk, the market risk, and the credit risk. In addition, Solvency II requires modelling of operational risk. The demand for complete and consistent consideration of all financial instruments is an advantage of the SST and Solvency II in comparison with Basel II.

The introduction of these solvency systems is a quantum leap for the prudential supervision of insurance undertakings. It will generate competitive advantages for the insurance industry.

Mergers & Acquisitions

Participation by Scor in Converium

On 5 April 2007, Scor S.A. (France) presented a public takeover offer to the shareholders of Converium Holding AG (Switzerland). Based on article 21 of the Insurance Supervision Act (ISA), the Federal Office of Public Insurance (FOPI) tied the takeover to conditions with a view to protecting solvency and the interests of the insured persons. The takeover has meanwhile been completed.

Mergers & acquisitions (M&A) entail a major change for the stakeholders of the involved company. In the case of insurance undertakings, policyholders and insured persons are especially affected. Merger & acquisition transactions by or concerning insurance undertakings are therefore also dealt with by insurance supervision. The provisions contained in the ISA on business plan changes also often apply to M&A transactions. The evaluation of the acquisition of stock under insurance supervision law looks at the potential endangerment of the insurance undertaking and the interests of the insured persons. For this reason, the legislative power has mandated FOPI to conduct a thorough prudential audit, which also includes financial resources. Capitalization and technical provisions must be examined, as well as their cover by assets. In addition to past developments, plans and projections for the future as well as the quality of risk management must be taken into account.

Takeover offer by Scor S.A. to Converium shareholders

In accordance with articles 22 et seqq. of the Federal Law on Stock Exchanges and Securities Trading, Scor S.A. (France) submitted a public takeover offer to the shareholders of Converium Holding AG (Switzerland) on 5 April 2007. Scor is the leading French reinsurer. To justify the merger, Scor argued that the takeover would create a multi-line reinsurer in Europe with a multi-hub system covering all markets worldwide. Scor also indicated that significant synergy effects could be achieved, leading to efficiency gains throughout the group.

FOPI decisions on the indirect acquisition of Converium stock by Scor

According to article 21 of the Insurance Supervision Act (ISA), plans to participate directly or indirectly in an insurance undertaking domiciled in Switzerland must be communicated to the supervisory authority if the participation reaches or exceeds 10%, 20%, 33%, or 55% of the capital or voting rights of the other undertaking. The first partial step consisted in the purchase of two share packages. Scor thereby became a 32.9% owner of Converium Holding shares. In its letter dated 24 April 2007, FOPI informed the Scor Group that it did not have any objections to an indirect participation in the capital of Converium Holding AG exceeding 20%. The second partial step consisted in the acquisition of more than 33%/50% of the capital and voting rights of Converium Holding AG.

On 27 June 2007, FOPI tied the indirect acquisition of Converium Holding AG stock by Scor Group to the following conditions:

- Should Converium (now Scor Switzerland AG) intend to carry out transactions resulting in less than 200% solvency under Solvency I, this must be presented to FOPI for approval.
- Scor must notify FOPI of intragroup transactions prior to their execution, should they exceed an amount of USD 100 million or an aggregate total per calendar year of USD 200 million.
- Scor must also notify FOPI, prior to execution, of borrowing or repayment of third-party or own capital, dividends, issuing of guarantees or other hedging instruments, as well as the purchase of own shares, should such transactions exceed an amount of USD 100 million or an aggregate total per calendar year of USD 200 million.
- FOPI will consider the repeal, modification, or continuation of the conditions at the latest by 30 June 2009, on the basis of the audited 2008 annual account statement of Scor Switzerland AG.

Life insurers and occupational pension plans

Focus on calculation of the minimum distribution rate

In 2007 for the second time, the Federal Office of Private Insurance (FOPI) published a market overview of the 2006 financial accounts of the occupational pension plans of private life insurers. It also presented model calculations facilitating an expansion of objective analysis.

The FOPI market overview for 2006 shows that, as of 31 December 2006, 13 (previous year 14) private life insurers offered collective insurance for occupational pension plans for a total of 2.13 million insured persons. One of these insurers is only offering reinsurance of death and disability risks, and two are in run-off, i.e. they are no longer concluding new contracts and are only fulfilling the obligations arising from their existing client base.

Distribution rate 1.65% above minimum distribution rate

Of the total earnings from the savings, risk, and cost process in the 2006 business year, insured persons received 91.65% (PY 92.03%) in the form of insurance benefits, increased and strengthened technical provisions, and surplus participation.

The share allocated to the 13 insurance undertakings after distribution to insured persons was CHF 696 million in 2006, compared with CHF 600 million in the previous year. This corresponds to 0.58% of the reinsured occupational pension assets totaling CHF 120 billion. These 0.58% serve to build up and pay interest on the legally required solvency capital, constituting the risk premium for the equity capital liability of the overall company.

FOPI models for earnings-based and profit-based calculation of the minimum distribution rate

Whether the profit-based method or earnings-based method should be used to calculate the minimum distribution rate was discussed intensively in various forums during the year. The law stipulates the earnings-based method in principle, except in special situations.

To evaluate the two methods, FOPI used model calculations over the years 2000 to 2006 to compare the effective net results obtained with the earnings-based method and the theoretically determined net results obtained with the profit-based method. One important value was the relationship between the net result and the technical provisions, which are covered by reinsured occupational pension assets totalling CHF 120 billion. The earnings-based method derives a margin in good years close to 0.5%, while the profit-based method derives a margin of only about 0.1%.

The FOPI model calculations show that the profit-based method is unable to meet even minimum demands on the injection of solvency capital. This can endanger the solvency of the insurance undertaking in the long term.

Examination of the basis for calculating the minimum distribution rate by the Control Committee of the National Council

The Working Group of the Control Committee of the National Council (CC-NC) on Surplus Participation under the Occupational Pension Act also examined the development of the basis for calculating the minimum distribution rate for occupational pension plans. It investigated whether the earnings-based method for calculating the minimum distribution rate enacted by the Federal Council corresponds to the will of the legislative power. In its report of November 2007, the CC-NC concluded that the ordinances enacted on the minimum rate do not contradict the will of the legislative power.

Fewer life insurers offering occupational pension plans

That the occupational pension business is not particularly attractive even with the earnings-based method is demonstrated by the fact that the number of insurance undertakings offering this line of business is shrinking. In 1985, all of the 22 life insurance undertakings operating in Switzerland at the time offered occupational pension products. In 2007, 25 life insurance undertakings were active in the Swiss market. Of these 25 undertakings, only 12 still offer occupational pension plans. In 2 of these 12 companies, the occupational pension plan business is in run-off, i.e. the companies are no longer concluding new contracts and are only meeting the obligations arising from their existing client base. One other company is only offering reinsurance of death and disability risks.

Law Setting

Total revision of the Insurance Contract Act (ICA)

Preparation of consultation draft

Upon conclusion of the work by the ICA Expert Commission at the beginning of August 2006, resulting in a draft ICA revision and commentary, the work in the Federal Office of Private Insurance (FOPI) in 2007 focused on preparation of a consultation draft.

The Federal Law of Insurance Contracts dated 2 April 1908 (Insurance Contract Act, ICA) governs the relations under private law among insurance undertakings and between insurance undertakings and insured persons. The ICA entered into force nearly 100 years ago and has only been partially revised since then.

Draft by the Expert Commission

The ICA Expert Commission was appointed on 11 February 2003 under the direction of Professor Dr. Anton K. Schnyder and commissioned to draft a total revision of the ICA plus commentary. The ICA Expert Commission delivered the draft proposal and the commentary at the beginning of August 2006, thus concluding its work.

Further steps and consultation procedure

In September 2006, the Federal Department of Finance mandated FOPI to prepare a consultation draft by the end of 2007 based on the expert proposal. The FDF will then decide on further steps and, if appropriate, will request the Federal Council to launch a consultation procedure. The consultation procedure on the total revision of the Insurance Contract Act is included in the Federal Council's annual goals for 2008.

Once the consultation draft has been released, the Federal Chancellery will announce the time of the consultation procedure and make the consultation materials available to the public in electronic form. Only then will interested persons outside the Federal Administration be invited to submit comments.

Aspects of the total revision

The total revision of the ICA will take up political concerns and the aspects of consumer protection that could not already be included in the partial revision carried out in 2004. The new ICA will take into account the parliamentary initiatives submitted at the federal level, the recommendations of the Competition Commission, and the developments of insurance contract law in our neighbouring countries as appropriate. It will also improve coordination with social insurance and liability law.

The questions arising in connection with the total revision of the ICA include the introduction of a rescission right and a general cancellation right, as well as a review of the currently applicable statutes of limitation. Also up for discussion are an expansion of the information duties of the insurance undertakings, new rules for intermediaries, introduction of a substantive review of General Conditions of Insurance, and modification of the current rule on change in ownership.

New and revised directives 2007

The reporting year showed that the directives elaborated by the Federal Office of Private Insurance (FOPI) in 2006, which further specify insurance supervision law, have proven effective in practice. Implementation work was continued in 2007. Several new directives were enacted, and several already existing directives revised.

To illustrate FOPI's implementation work in the field of supervisory law during the reporting year, we would like to mention the Framework Directive on the Activities of Independent Auditors with respect to Insurance Companies (Framework Directive on Auditing), which entered into force on 21 November 2007. This framework directive also integrated revised versions of the Directive on the Audit of Tied Assets by the Independent Auditor and the Directive on the Audit of the Occupational Pension Plan Insurance (OPP) Operating Accounts by the Independent Auditor. The new provisions were published on the FOPI website on 21 November 2007.

Another important cornerstone of supervision in connection with the audit of insurance companies is the Directive on the authorization of audit companies as independent auditors and auditors in charge under specialized insurance legislation, which entered into force on 1 January 2007 and was revised on 1 September 2007 with a view to entry into force of the Federal Law of 16 December 2005 on the Recognition and Supervision of Auditors.

Framework Directive on Auditing
According to the Insurance Supervision Act, insurance companies must mandate an independent auditor to audit their conduct of business (article 28, paragraph 1 ISA). The ISA governs the preconditions for licensing as an independent auditor of an insurance company in general terms (article 28, paragraph 2 ISA), its responsibilities (article 29 ISA), and its notification duties (article 30 ISA).

The Framework Directive on Auditing further specifies the supervisory provisions on the auditing responsibilities of the independent auditor in accordance with article 29, paragraph 1 ISA: In particular, it specifies that the independent auditor shall audit:
whether the form and content of the annual financial statement comply with the legal requirements, the articles of association, and the rules and regulations (financial statement audit), and whether the provisions of the ISA and the insurance supervision ordinances (SO and FOPI-SO) and the directives have been complied with in accordance with the relevant FOPI instructions.

The Framework Directive on Auditing also specifies rules concerning reporting on the financial statement audit and the supervisory audit in accordance with article 29, paragraph 2 ISA.

Supervisory audit of tied assets
Annex 1 of the Framework Directive on Auditing indicates how the supervisory audit of tied assets must be conducted by the independent auditor in accordance with article 17, paragraph 1 ISA. The audit criteria are contained in the FOPI Directive on Investment in Tied Assets (Investment Directive) and the corresponding circular on tied assets. The principles of proper bookkeeping and accounting apply.

Supervisory audit of the occupational pension plan Insurance (OPP) operating accounts
Annex 2 of the Framework Directive on Auditing governs the audit of the OPP account by the independent auditor. The subject of the audit encompasses the OPP account, the accompanying report, and the disclosure proposal. The Directive on the Occupational Pension Plan Insurance (OPP) operating Accounts serves as a basis. The purpose of this directive is to further specify the supervisory provisions on the OPP account.

Directive on the Authorization of Audit Companies as Independent Auditors and Auditors in charge under specialized Insurance Legislation
There was also need for action with respect to the Directive on the Authorization of Audit Companies as Independent Auditors and Auditors in charge under specialized Insurance Legislation, which entered into force on 1 January 2007 and was revised on 1 September 2007. The licensing and recognition of independent auditors in the field of insurance is pursuant to the basic license, which since 1 September 2007 has been governed by the Federal Law of 16 December 2005 on the Recognition and Supervision of Auditors.

The purpose of the FOPI directive is to further specify the preconditions and recognition procedure for independent auditors and head auditors of insurance companies groups and conglomerates. The directive also contains the principle for monitoring these preconditions for recognition.

New business plans pursuant to the ISA
The forms for compiling business plan data published in August 2007 are of equally great importance to the business activities of insurance companies, the supervisory activities of FOPI, and not least of all the implementation of supervision law in practice. Insurance companies already subject to FOPI supervision upon entry into force of the new supervision law on 1 January 2006 had to submit this data to FOPI by 31 December 2007. FOPI started evaluating the data on 1 January 2008. The business plan – i.e. the business plan data – must be submitted to FOPI for approval by insurance companies intending to take up new business activities.

The business plans will continue to constitute an important basis for the business activities of the insurance companies. Should the business plan change, the changes must be communicated to FOPI. The implementation of some business plan changes requires approval by FOPI (article 5, paragraph 1 ISA). All other business plan changes are considered approved if FOPI does not initiate an audit within 4 weeks (article 5, paragraph 2 ISA).

From the Supervisory Areas

Supervision of groups and conglomerates

Developments in Europe and Switzerland

The insurance groups and conglomerates operating in the European Union (EU) will be supervised at the group level by a single supervisory authority and at the subsidiary level by the competent national authority. This rule is contained in the draft directive of the European Commission on Solvency II available since the beginning of July 2007. The final version of this rule will also affect cooperation between the EU/EEA and Switzerland in the area of group supervision.

The draft framework directive of the European Commission on Solvency II, which serves as the foundation for modern insurance supervision, has been available since the beginning of July 2007. The planned supervision system will create a basis for supervision of insurance groups and conglomerates operating within the EU by a supervisory authority at the group level – in cooperation with the supervisory authorities of the local subsidiaries. This will allow cross-group risks, risk concentrations, internal transactions, and risk management to be supervised efficiently. It will also allow groups to manage their multinational diversification potential and their internal financial support instruments allowable on their balance sheets. In addition, important processes such as investment management, risk management, or the internal control system are implemented centrally by the group management for the entire group. This gives groups clear resource advantages if they only have to deal with a single supervisory regime at the group level.

Home-country principle

According to the draft framework directive on Solvency II, each EU country will as a rule be competent where the group head office is approved and located.[1] If this country is outside the European Economic Area, article 272 of the draft directive provides for verification of the equivalence of group supervision for that third country (such as Switzerland). The preconditions for such equivalence are:

- a positive review by the EU supervisory authority that would be responsible for supervising the group in question,
- consultation of the EU insurance supervisory authorities of the affected countries, and
- consultation of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

Future European group supervision

The envisaged responsibilities of group supervision will in particular encompass risk-based group solvency, risk concentration, intragroup transactions, risk management, and the internal control system. These elements are among the most important tools of modern risk-based insurance supervision as applied to groups and will now only be audited by the group supervisory authority. This will significantly enhance the status of the group supervisory authority. Conversely, the national authorities supervising the individual units of the group will, despite mutual information and cooperation duties, only be responsible for a narrow range of activities relating to the respective unit. With this cross-EU supervision, the European Commission aims to accelerate the modernization of insurance supervision. It is following the trend that began with the „lead supervisor approach" to earlier directives as developed by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).[2]

[1] See Proposal for a Directive of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance, article 260, paragraphs 2 et seqq.

[2] See CEIOPS, Statement on the Role of the Lead Supervisor, December 2006

Differing views on group supervision
However, the new distribution of competences has not only been received positively. 14 of 27 EU States explicitly came out against a pure group model (i.e. without any right of national supervisors to intervene) prior to publication of the draft Solvency II directive. Precisely in those countries where the insurance markets are dominated by the subsidiaries of foreign companies, there is a fear that the national supervisor will only have minimal influence on the insurers in its own country and therefore will not be able to effectively implement his responsibilities relating to market and consumer protection. However, there has been some recent movement in these negative positions.

Whether and how the concept of group supervision will be modified by the time the directive enters into force is difficult to assess. For instance, a mediator function of CEIOPS may be considered in the event of conflicts between solo and group supervision.

Swiss insurance groups and conglomerates, for which the European Union represents an important market, are also very interested in a uniform supervisory competence for group aspects within Europe. This will result in equivalence and cooperation efforts between Switzerland and the EU.

Significance for Switzerland
The cooperation currently practised between Switzerland and the EU does not yet rest on the concept of Solvency II, but rather on the three generations of Solvency I directives. The basis for cooperation is primarily the Memorandum of Understanding (MoU) on cooperation signed by the Federal Office of Private Insurance (FOPI) and CEIOPS in February 2006. It has meanwhile been implemented in individual MoUs between Switzerland and all EU Member States. These MoUs provide the foundation for inclusion of FOPI in European group supervision. Together with the national legal foundations, they facilitate not only information exchange, but also cooperation among supervisory authorities.

The cooperation in the field of group supervision that has evolved in recent years within the EEA is coordinated by the CEIOPS Insurance Group Supervision Committee. FOPI is a regular guest at its meetings. Within the framework of this organization, the concepts of „Coordination Committee“ and „Lead Supervisor“ have been created[3], with the call for the member organizations to implement these concepts.

On the basis of the MoU, FOPI has also been included in this process. FOPI has been assigned the responsibilities of lead supervisor for Helvetia Group, Bâloise, and Nationale Suisse by the involved EEA supervisory authorities. For groups operating in Switzerland with group head offices in a country of the European Union such as AXA (France) and Generali (Italy), the respective EEA supervisory authorities are responsible for monitoring the group activities. FOPI is invited to the respective coordination meetings.

Responsibilities of the lead supervisor
The responsibilities of the lead supervisor include supervision responsibilities such as the preparation of a work plan for monitoring of the group and assessment of intragroup transactions, solvency, risk management, and the internal control system. The results of these activities must be passed on to the concerned supervisory authorities as part of regular coordination meetings. These meetings are generally held annually and are organized and chaired by the lead supervisor.

Unlike the planned new group supervision in accordance with Solvency II, the predominant focus of group supervision up to now was on preparing information for the coordination meetings and for the attention of the concerned national supervisory authorities. The national supervisory authorities must also approve the abovementioned work plan for monitoring of the group. It should be emphasized that the lead supervisor concept should in no way limit the supervisory rights of the individual countries.

Influence of the European development on Swiss group supervision
As explained above, the specific design of future European group supervision is still unclear, given the recent consultations on the draft directive and the existing differences of opinion. Considerable time will pass until the directive is adopted. However, it can be assumed that group supervision will become more important and that the lead supervisor concept developed by CEIOPS will be modified and adjusted to the Solvency II framework directive.

[3] See CEIOPS „Guidelines for Coordination Committees“ February 2005 and „Statement on the Role of the Lead Supervisor“ December 2006

Groups operating in Switzerland – whether managed from Switzerland or abroad – are still very much interested in a single supervision for group matters. These groups also generally prefer home-country supervision for reasons of efficiency and communication. For this reason, Switzerland and the EEA should continue to strive for cooperation in group supervision.

The foundation for such cooperation continues to be mutual recognition of the equivalence of the supervisory regimes. This is intended to ensure equal regulatory treatment, and the various supervisory authorities should not differ too much from each other with respect to regulatory density and requirements. In addition to the equivalence of supervision, equivalence of approaches to information exchange is also of great importance. This constitutes the basis for the Memorandum of Understanding.

The path toward group supervision requires a lot of time and resources, due to the large number of involved countries and their differing interests. Nevertheless, the Swiss insurance supervisory authority will continue to pursue this path. Swiss insurance supervision will also make its contribution to European group supervision as part of the Swiss Federal Financial Market Supervisory Authority (FINMA) starting in 2009.

Analysis

Upheaval in the individual life insurance market

An analysis of the years 1985-2006 shows that individual life insurance providers have reacted to interest rate developments and economic factors by offering new types of insurance products. A movement away from classical life insurance with capital protection and guaranteed interest can be observed.

In 2008, most of the individual life insurance contracts will expire that were concluded before 1 April 1998, i.e. before introduction of the federal stamp duty of 2.5% on redeemable, single premium life insurance contracts. This is a good occasion to take a closer look at the development of the Swiss individual life insurance market over the past few years. The starting point of the following analysis, going back to the year 1985, will be the gross premium volume generated in Switzerland.

Market break in classical single-premium individual endowment insurance

Looking first at the breakdown of gross premium volume by insurance contracts with single premiums and insurance contracts with periodic premium payments, it is not difficult to see that the single premium business reached its peak in 1998, and then shrunk in several steps to barely one fifth of that amount in 2006 (see Figure 1).

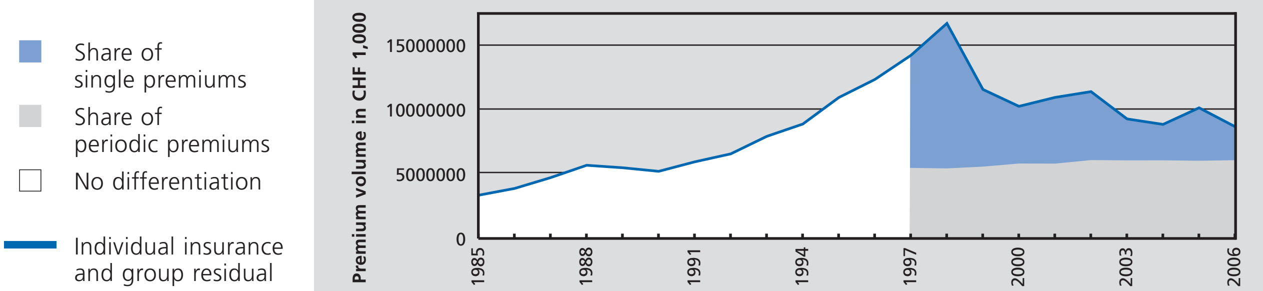
The question arises whether the decrease in the single premium business is solely due to the introduction of the stamp duty. To obtain further data on other influencing factors for this decrease, Figure 2 breaks down the gross premium volume by the key lines of individual life insurance, i.e. individual endowment insurance, individual annuity insurance, unit-linked life insurance, and group insurance other than occupational pensions (mainly residual debt insurance).

The findings are clear: The break after 1998 focused almost entirely on classical single-premium individual endowment insurance. What factors are responsible for this striking break?

Figure 1

Single premiums as a share of the premium volume of individual life insurance

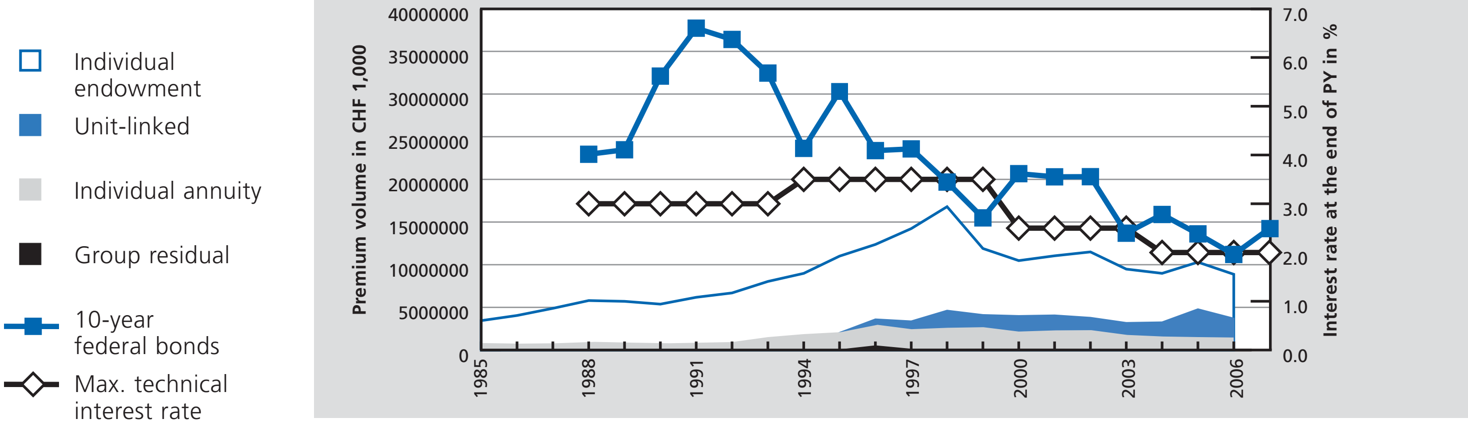
A differentiation according to single premium and periodic premium payment was only introduced in 1997.



Influence of interest rate development
Of central importance is the so-called technical interest rate. The technical interest rate is paid on the part of the premiums received that are not needed to finance risk benefits and costs, i.e. the savings premium. The underlying challenge consists in the fact that private life insurers *must guarantee the technical interest rate for the entire duration of the contract*, without being able to project the interest rate development in advance over such a long time horizon. The technical interest rate must therefore be fixed very carefully. As long as a private life insurance undertaking achieves a high yield with its investment strategy, it can honour its obligations vis-à-vis policyholders and even generate a surplus.
However, a higher investment yield can only be achieved by raising the capital investment risk. Since the benefits must be guaranteed, however, a careful risk analysis tends to recommend keeping the capital investment risk low and aligning the technical interest rate with low-risk capital investments. Important very low-risk investments are federal bonds with a 10-year maturity. Applying the prudence principle which underlies the Supervision Law, FOPI therefore determines a maximum technical interest rate for the guaranteed interest on classical individual endowment insurances, based on the spot interest rate for 10-year federal bonds. To ensure solvency, this maximum technical interest rate may only be exceeded by life insurance undertakings when determining rates and the premium provision if other equivalent guarantees are provided, such as risk-based deposit of own funds.
The high market interest rates of more than 4% in the years before 1998 favoured the growth of individual endowment insurance. When the rate sank below 4%, however, individual endowment insurance became significantly less attractive. This loss of ground could only be compensated to a minor extent by the unit-linked life insurances introduced in 1995. Annuity insurance reacted to a much lesser extent to the same influences and had a stabilizing effect on the individual life insurance business.

Figure 2

Development of gross premium volume 1985-2006 in individual life insurance



Influence of financial market turbulences
Another factor influencing the development of the gross premium volume in individual endowment insurance consisted in the various financial market turbulences. While they hardly had an effect before 1998 on the robust, decade-long upward trend, the situation changed fundamentally after 1998. Because of the decreasing interest rates for fixed-interest investments, life insurers since 1994 had steadily increased their investments in higher-risk investment categories such as shares and foreign currency investments. This development was made possible by the relaxation of capital investment rules for life insurance, as was demanded at the time by politicians and economy alike in light of the positive stock market development. A consequence of this relaxation was a significantly higher vulnerability of life insurers to economic and financial crises.
These consequences were seen for the first time during the Asian crisis in 1998, which triggered a drop in share prices and interest rates and, in combination with the introduction of the stamp duty, resulted in a massive collapse of single premium business.
The bursting of the dot-com bubble in conjunction with the uncertainties in the capital markets following 9/11 in the years 2001 and 2002 led to a further significant setback. The generated gross premium volume collapsed again. At the same time, own funds came under dangerous pressure. The lack of risk-based equity capital resources now became painfully apparent, since life insurers had to use their hidden reserves in the preceding years to sustain surplus participation for policyholders, the financing of growth, and more expensive servicing of equity capital providers.

Risk-based supervision decreases instability
As a consequence, FOPI launched the development of a new solvency regime in 2002 under the name Swiss Solvency Test (SST). The SST serves to determine the economic risk capacity of an insurance undertaking. Solvency II – the equivalent project within the EU – follows an analogous approach. These challenges, especially the monitoring of risks arising from the changed market conditions, were taken into account accordingly by the new Insurance Supervision Act (ISA), which entered into force on 1 January 2006. The associated paradigm shift toward risk-based supervision aims to surmount new types of actuarial and financial risks by ensuring sufficient equity capital.

Innovation with new types of insurance products
Life insurers on their part reacted by turning away from classical life insurance with capital protection and guaranteed interest. They prefer products that provide capital protection only in the event of death and to a limited extent in the event of survival, but that otherwise largely transfer the capital investment risk to the policyholders. In this way, clients can tailor their private prevention to their own risk capacity. These innovations have been made possible by quantum leaps in IT development such as data warehousing, client-server technology, and Internet portals.

Conclusion
By developing complex and flexible new products, Swiss life insurers have undertaken a paradigm shift. This means that clients can better tailor their own risk capacity and that life insurers can better manage and control their risk exposure. Life insurance companies are thus better prepared to handle the current financial and subprime turbulences than in 2002, thanks also to the new supervision tools. The efforts undertaken in recent years to better detect and minimize quantitative and organizational risks, to diversify risks, and to build up a risk-based equity capital basis have paid off.

Health insurance

Solvency supervision of supplementary health insurers

Similarly to collective life insurance, the law calls for preventive product control for supplementary health insurance and individual daily allowance insurance. This product control aims to ensure that rates are neither abusively high nor represent a threat to solvency.

Since the possibility of forecasting risks for supplementary health insurance is only limited, the annual solvency evaluation by the supervisory authority is intended to counter these rating uncertainties.

Providers of supplementary health insurance and daily sickness allowance insurances include health insurance schemes and private insurers. Private insurers have a market share of three quarters of supplementary health insurance and daily allowance insurances, with a premium volume of CHF 8.2 billion (including collective daily sickness allowance insurances under the Insurance Contract Act) in 2006. The private insurers are institutionally supervised by the Federal Office of Private Insurance (FOPI) and, unlike health insurance schemes, must meet the capital adequacy requirements of Solvency I using a volume-based blanket approach and henceforth also the requirements of the Swiss Solvency Test (SST), which employs an economic and risk-based approach. FOPI supervision of supplementary health insurances also extends to approval of new products, reviews and approvals of requested rate adjustments, and monitoring of solvency.

Health insurance schemes have a total market share of approximately one fourth of supplementary health insurance and daily allowance insurance. They are institutionally supervised by the Federal Office of Public Health (FOPH). To the extent that health insurance schemes offer supplementary insurance, they are subject to supervision by FOPI with respect to these products, while supervision of own funds is the responsibility of FOPH.

Review of rates by FOPI

The review of rates carried out by FOPI must take account of the fact that insolvency risks among supplementary health insurances are often due to underrating.

- The object of the licensing review for a new supplementary insurance therefore consists in the significant risks contained within the rate, such as deviations from the expected claims amount, antiselection, the ageing of the insured population, and in general all factors that might lead to more expensive claims payments.
- FOPI must also ensure that already approved products do not trigger a danger of insolvency due to a rate that is too low, and that they are not abusive due to a rate that is too high.

The solvency evaluation

The possibility of forecasting the risks mentioned above is only limited, since no methodological approach is able to measure such risks objectively, reliably, and precisely. The multitude of factors influencing risks cannot be captured statistically over a longer period of time to a sufficient extent. The annual solvency evaluation by the supervisory authority should therefore ensure that these rate uncertainties are countered.

Crucially important for the evaluation of the solvency situation are the current capital resources and the capacity to perform capital increases later on, especially during financially tense situations. All providers offering supplementary health insurance as their core business are as a rule not able to satisfy their capital needs on the organized capital market. This background also influences how solvency supervision is conceived, since securing the requested level of own funds, taking into account the legal own funds requirements, can only be achieved by internal financing. Accordingly, current and future earning power is crucial. The second, equally important criterion is capital adequacy. It is composed of the evaluation of own funds requirements and the evaluation of the allocation to technical provisions, which must cover the significant risks of this insurance business.

The goal of the solvency analysis is to ensure that the legislative rules concerning own funds are fulfilled, that sufficient provisions have been allocated, and that the expected earnings are sufficiently high. A high risk exists when capital adequacy is insufficient and cannot be covered by future cash flows. A medium risk exists when the allocation of technical provisions is too low and the cash flow cover is rather tight.

While the need for provisions can be methodologically calculated quite well over a certain time period, the calculation of an expected cash flow value requires relevant analytic foundations. Only then can bad financial developments be recognized at a time when the insurer still has options to introduce corrective measures. If this time is missed, the last resort consists in supervisory measures such as the deposit or blocking of tied assets, forced portfolio transfers, or even authorization of bankruptcy proceedings.

Possible measures for combating financial problems
The causes leading to financial problems are manifold. Financial difficulties tend to arise when the insured population is affected by antiselection, over-ageing, or inflation. If these factors cannot be compensated by larger client bases generating earnings, this generally leads to a long-term weakening of earning power. In such situations, a thorough analysis of earning power is key. Only then can the potential of reorganization measures be assessed. A simple measure can be a rate increase intended to improve the financial situation while taking into account the vital interests of insured persons. The replacement of outdated products with new products, while granting existing insured persons the right to switch in accordance with article 156 of the Supervision Ordinance (SO), and the transfer of some products or the entire insurance portfolio to a new insurer, which must then offer the insurance contracts at the same conditions, are further possibilities for improving the financial situation over the long term.

Supplementary health insurance products
Within voluntary supplementary health insurance, benefits can be freely chosen subject to the constraints of the Insurance Contract Act, unlike mandatory basic insurance. Approximately 900 different products exist on the market with different benefits and rates. FOPI must fulfil its legislative mandate of ensuring that rates are not abusively high or so low that they endanger solvency. The Insurance Supervision Act (ISA) aims to protect insured persons from the insolvency risks of insurance undertakings and from abuses.
For private and semi-private supplementary hospital insurance, 15 of a total of 61 providers adjusted their premiums as of 1 January 2008. Rate changes were recorded for 42 of a total of 246 products. The adjustments, which included both decreases and increases, led to a slight premium increase per insured person across the entire segment of 0.6% (2007: 0.5%). Looking only at the affected products, the average increase was 1%.
For mass business – i.e. the other benefits insured by supplementary health insurances – the premiums rose by an average of 0.7% as of 1 January 2008. This category of supplementary health insurance includes benefits such as outpatient care, general hospital coverage, and dental and nursing insurance. The premiums of 30 of a total of 583 products were adjusted. Looking only at the affected products, the average increase here was 6.4%.

Reinsurance

Trends in the renewals of the reinsurance treaty business

For the past several years, leading reinsurance companies have reported on the results of their renewals of the treaty business as of 1 January. These reports are important indicators of the profitability development in the insurance business. In the renewals as of 1 January 2008 a reduction in premium rates was recorded, but mainly to a still appealing level.

A major part of the reinsurance treaty business, especially in Europe, is renewed on 1 January of each year. The renewals in January 2007 did not indicate any significant changes relative to the previous year. Overall, the development of the premium rates was slightly negative. In most lines of business and countries, however, they remained at an attractive level. Direct insurers exhibited a trend of raising their deductibles. As a result, the damages arising from the winter storm Kyrill – the largest insured natural disaster event in 2007 – remained largely within these deductible limits. They did not have a major impact on reinsurers. The pressure on lower prices was more noticeable in liability than in property lines.

Smaller price fluctuations expected than in previous price cycles

This trend was partially confirmed and reinforced over the course of the year, especially with respect to renewals on 1 July 2007. This date is of great importance to US business. Overall, the price level was deemed to be attractive, even though the peak of the price cycle had probably passed. In this phase, cycle management is of the utmost important. While the price fluctuated heavily between peaks and troughs in past price cycles, there are now several reasons why the cycle will be less pronounced. These reasons include:
Risk-based capital models are being applied more frequently. They are used by rating agencies and supervisory authorities to assess financial security, and by the companies to manage business according to economic rather than accounting principles.
The companies have substantially improved their transparency. They not only report more frequently and timely, but also – as mentioned above – on renewals. This enhances their exposure to shareholders, which should have a positive effect on discipline.
Capital management is pursued much more actively than in previous phases. Where companies have capital that cannot be employed at attractive conditions, the capital is now often repaid to shareholders. Some reinsurers have launched substantial share repurchase programmes.
Investment returns have been appealing in recent years, but not comparable with the yields at the end of the 1990's. The proportion of shares in portfolios has also fallen. Accordingly, expectations for future returns are lower. This should ensure that the focus on sufficient profitability in the insurance business will continue.

Of the utmost importance overall, of course, is the available and demanded capacity to bear risks in the reinsurance market. The supply side has not changed much, i.e. only insignificant new capital has been acquired. Rather, share repurchase programmes have been launched or concluded. The market for the securitization of insurance risks has also re-established itself.
At the regional level, reinsurance companies domiciled in Bermuda, which were disproportionately affected by the tropical storms in 2005, have tried to improve geographic diversification.

Contract renewals in January 2008
Each year, the reinsurance industry meets in Monte Carlo (September) and Baden-Baden (October). At these meetings, expectations are signalled concerning the upcoming renewals. At the meetings in 2007, additional reductions of the premium rates were suggested, but generally within a relatively narrow range. A further topic was that leading reinsurers increasingly employ differentiated premium rates or conditions and, unlike before, no longer are satisfied with the same conditions as other reinsurers. Disaster losses were also discussed. Insured disaster losses caused by nature or humans were significantly higher in 2007 than in 2006, but lower than the multiyear trend. As expected the renewals of the treaty business as of 1 January 2008 was characterized by lower premium rates, however in general within a limited range, so that going forward attractive technical results will continue to be expected.

Supervision of intermediaries

Establishment of a register – substantive supervision now operational

Since entry into force of the revised Insurance Supervision Act (ISA) on 1 January 2006, more than 12,150 insurance intermediaries have been registered. Approximately 14,000 files have been reviewed. In parallel with supervision of the register, the Intermediary Supervision Division started conducting on-site visits and market inquiries in 2007.

Since 1 January 2006, insurance intermediaries have been under the supervision of the Federal Office of Private Insurance (FOPI). The key instrument of this supervision is the public register, which is accessible via the intermediary portal at www.vermittleraufsicht.ch. FOPI largely completed establishment of the register in 2007. Some files still require in-depth review.

The number of registered insurance intermediaries (more than 12,000) is twice what was expected. Especially dependent intermediaries (agents associated with an insurance company), whose entry in the register is voluntary, have shown great interest in registration. Nearly 60% of the approximately 12,000 published entries are dependent intermediaries. Approximately 1,100 entries are legal entities.

Ongoing supervision with on-site visits

Unlike supervision of insurance undertakings, intermediary supervision does not involve a solvency audit. There is, however, ongoing supervision aimed at protecting insurance customers, for instance with respect to information requirements. Insurance supervision thus extends beyond maintenance of the register.

For this purpose, the supervisory authority conducts on-site visits to insurance intermediaries throughout Switzerland. During these visits, compliance with the intermediaries' obligations is audited, including whether the preconditions for entry in the register are met. Cooperation agreements with insurance undertakings, commissions, and the organizational structure are also reviewed. Finally, the supervisory authority audits whether the insurance intermediaries fully comply with the new information requirements under article 45 ISA. All dependent and independent intermediaries have had to meet these information requirements upon initial personal contact with clients since 2006.

The first visits resulted in the following findings:

- The great heterogeneity of the market was confirmed. In addition to large industry brokers, many small and very small firms operate on the Swiss market. These small firms increasingly are joining together into pooled companies, in order to share infrastructure costs and obtain better conditions from insurance undertakings.
- Many insurance intermediaries welcome the new Insurance Supervision Act, but in some cases are insufficiently informed about their duties, such as the information requirements, and therefore inadequately implement them.
- The classic field staff of insurance undertakings continues to be very important in Switzerland. More and more, insurers are strengthening distribution through vertical integration.

Market supervision
When exercising market supervision, FOPI investigates concrete leads from the market. Broker lists of insurance undertakings are also compared with the register, and non-compliant intermediaries are approached. Increasingly, insurance undertakings verify their broker lists themselves and initiate entries, thereby helping to keep the register updated.

Agreement with the Principality of Liechtenstein on insurance intermediaries
The Agreement of 19 December 1996 on Direct Insurance between Switzerland and the Principality of Liechtenstein grants insurance undertakings from both contracting parties the right to establish registered offices in the other State or conclude cross-border life and non-life insurance contracts. The Agreement was amended in 2007 to include an analogous provision on insurance intermediaries, granting them freedom of establishment and provision of services on the basis of reciprocity (see also 15). The Agreement also provides that insurance intermediaries domiciled in Switzerland or Liechtenstein must only register with one of the two supervisory authorities to be able to work in both countries.

Additional information is available on the intermediary portal: www.vermittleraufsicht.ch

Review and Outlook

The path to modern insurance supervision

By Kurt Schneiter, former Head of the International Affairs Division, FOPI

Insurance supervision and its evolution have been and continue to be reactions to developments on a market in which the self-healing powers of competition are not always efficacious. The first private insurance undertakings in Switzerland were foreign companies established here starting in 1813. The only Swiss insurer in the first half of the 19th century was Mobiliar; it received a license from the cantonal governments of Berne and Aargau in 1826 to cover the risk of fire. Already starting in 1804, cantonal cattle insurance schemes under public law emerged, and between 1805 and 1812 – perhaps benefiting from the return of public peace thanks to the Mediation Act – cantonal building insurance establishments were created in 14 cantons, with more to follow. The boom in private insurance started in the second half of the century. Two life insurers broke the first ground: Rentenanstalt (1857) and La Suisse (1858). The establishment of numerous other private non-life and life insurers and soon also reinsurers in the 1860's and 1870's underscores the importance that risk insurance began to assume with industrialization. By 1885, 157 private insurance undertakings were operating in Switzerland: 13 covered transport risks in the growing commerce sector, 24 insured against accidents in industrial companies, 38 fire insurers and 4 cattle insurers competed with the public cantonal institutes, and 65 life insurers vied for customers.

The steady need for insurance brought movement to the market, with all the risks and opportunities that hopes of profit entail. Nowhere near all of the insurers had the technical skills and financial means to run an insurance business. The cantonal authorities were unable to carry out the necessary controls. This prompted Parliament during the revision of the Constitution in 1874 to transfer legislation and supervision relating to private insurance to the Confederation. On 25 June 1885, Parliament adopted the Insurance Supervision Act, which entered into force on 1 November 1885. On 26 December 1885, Johann Jakob Kummer, Dr. phil. h. c. et Dr. med. h. c., previously Head of the Federal Statistics Office, a former pastor and president of the Berne cantonal government, was appointed the first Director of the Federal Insurance Office (FIO).

The first years of supervision under the new Federal Insurance Office

The appointment of Dr. Kummer turned out to be a stroke of luck. His analysis of the market situation and the problems facing insurers still makes his first official report recommended reading today. It demonstrates how correct the decision was to professionalize insurance supervision. Of the 157 companies operating in 1885, 60 withdrew from business right away in view of the licensing criteria. Of the remaining 101 previous and new companies, the supervisory authority only licensed 83. What is remarkable is the high share of foreign companies, namely about 70% (59 of 83). In life insurance (23 of 30) and fire insurance (14 of 18), the share was even higher. Cattle and glass insurance was only operated by foreign companies. Transport insurance was balanced, with 6 domestic and 6 foreign companies, and only hail insurance (1) and reinsurance (3) were purely Swiss.

The main concern of the FIO was the „solidity" of the companies. Capital resources were one element in this regard, although less helpful in the case of foreign companies for insured persons in Switzerland, as the FIO noted. Another element was the payment of a surety; here again, the FIO noted that the sureties ranging from CHF 8,000 (glass) to CHF 100,000 (life) hardly corresponded to the risk, but could nevertheless not be set higher. For these reasons, the supervisory authority from the very outset focused primarily on supervision of the „formation of reserves" (in today's terminology, the „technical provisions").

The beginnings of the Insurance Statistics

The legal basis for the activities of the supervisory authority consisted of the merely 17 articles of the Insurance Supervision Act. This enviable brevity was not intentional, but rather due to lack of knowledge: The insurers had refused to provide information prior to entry into force of the law on the problem areas that should have been regulated. As the FIO put it, this would have been helpful „in promoting the advantages and correcting the deficits of the insurance undertakings' performance". It is a testimony to the wisdom of the legislative power that it exercised restraint in this situation and deliberately did not formulate any demands „the fulfilment of which might have turned out to be impossible, unnecessary, or even damaging to the insurance industry". Article 9 of the law did contain a general clause, however, authorizing the enactment of any decrees that appeared „necessary in the general interest and the interest of the insured persons" and the revocation of a license at any time if „the situation of an undertaking no longer offered the necessary guarantee for the insured persons" or the undertaking did not carry out the „demanded changes to its organizational structure or business management" within a specified time period.

The first report of the supervisory authority impresses with its precise technical assessment of the insurance business and the clear presentation of the insurance data relevant to the undertakings and lines of insurance. This clarity may be due to the previous capacity of the FIO director as the head of the Statistical Office, even though he expressly denied in the introduction that this was „the result of a love for statistics".

Rather, the legislative power had demanded these statistical analyses as a collection of materials for subsequent legislation. Moreover, Kummer regarded such publication as the „main task of State supervision", without which it would be insufficient. According to Kummer, the grant of operating licenses did not guarantee the solidity of the insurance undertaking; it did not relieve the insured persons of their duty to safeguard their own interests and – as he understood it – to consult the published business results themselves. At the same time, however, the FIO created the foundation for an important, albeit not only supervision tool: the Insurance Statistics. These statistics are the sine qua non of supervision, often uncovering significant changes in the business operations of the undertakings. Without its own detailed statistics, incidentally, no insurance undertakings can be run successfully.

There is insufficient space for a discussion of the regulatory measures undertaken by the FIO in its first decades. As an example, we will simply note the prohibition of passing on commissions and inducements. This was less to protect the insured persons than to strengthen the welfare of agents and the reputation of the insurance market, by curtailing the ruinous competition emerging at the beginning of the 20th century among insurance agents, who promised their clients bonuses paid for out of their own commissions upon concluding a life insurance contract.

Evolution of supervision in the 20th century

The consequences of the First World War mainly hit German insurers, with whom insured persons in Switzerland had also concluded contracts. To improve the protection of insured persons, it appeared appropriate to demand that foreign insurers operating in Switzerland deposit a surety amounting to the total obligations – i.e. the technical provisions – arising from Swiss business. This rule was codified in the Surety Act of 4 February 1919.

Soon thereafter, the global depression at the end of the 1920's showed clearly that Swiss insurers – and, due to their substantial capital investments, especially life insurers – are not immune to crises. Again for the purpose of improving the protection of insured persons, Parliament enacted the Security Fund Act, with which it required all Swiss life insurers to set up a security fund separate from their other assets to cover the claims of insured persons. A restrictive catalogue of investments with quota limits served to protect the security fund from major losses in value.

In the 1950's, the wide range of new insurance forms raised doubts about the unambiguousness of the term „insurance" that had been developed by legal practice. Company constructs had evolved whose exemption from supervision was questionable. Years of expert work resulted in a replacement of the old Insurance Supervision Act with the new version of 23 June 1978, which also clarified exemptions from the supervision requirement.

The creation of the EU Single Market was a challenge for everyone. Harmonization of supervision law in the EU made companies from third countries subject to a special regime. This occurred for the first time with the first directive on direct insurance other than life insurance (First Non-Life Insurance Directive) of 24 July 1973. On the request of the private insurance industry, the Swiss Confederation concluded an insurance agreement with the EEC on 10 October 1989 after a 17-year negotiating marathon. This agreement removed the directive's discriminatory effects on third-country companies with respect to Swiss insurers. The main concerns were the requirement of depositing a surety in the country of business and the latent danger of being excluded from business activities in the EU. This result could not be achieved without reciprocity: The branches of EU non-life insurers may operate business in Switzerland without have to deposit a surety in the amount of the technical provisions.

The Non-Life Insurance Act (NLIA) adopted on 20 March 1992 to implement the insurance agreement – both of which entered into force on 1 January 1993 – therefore requires all non-life insurers, both domestic and foreign, to establish „tied assets" similar to the security fund in the life insurance sector.

Even before entry into force of the new ISA, the Federal Administration was already intensively working on its revision and the enactment of a new law, the Life Insurance Act (LIA). This had become necessary in view of the expected accession to the EEA, for which Swiss law had to be harmonized with the acquis communautaire (EUROLEX). However, the Swiss people rejected EEA accession on 6 December 1992. The Federal Council cobbled together a package of measures (SWISSLEX) the following year out of the prepared legislative drafts to bring about a market-based revitalization of the Swiss market. This package included the parts of EUROLEX likely to promote liberalization in Switzerland even without participation in the EEA. In the insurance sector, this included primarily the abolition of product control in non-life insurance (with the exception of motor vehicle liability insurance, which was released in 1996) and harmonization of the solvency requirements for life insurance with those of the EU (Life Insurance Act of 18 June 1993, LIA).

Unlike Switzerland, the Principality of Liechtenstein did join the EEA. This is relevant because Switzerland became a „third country" for insurance purposes also in relation to Liechtenstein. Swiss insurers would have had to request new supervisory licenses in Liechtenstein, establish a branch, and deposit a surety. This did not happen, thanks to the conclusion of the insurance agreement between Switzerland and Liechtenstein on 19 December 1996, which entered into force provisionally on 1 January 1997 and definitely on 9 July 1998. Unlike the agreement with the EEC, the agreement with Liechtenstein relies on the current version of the third EU insurance directive, which introduced home-country supervision and cross-border freedom of services.

Risk-based insurance in the 21st century

Five laws – the Insurance Supervision Act, the Surety Act, the Security Fund Act, the Non-Life Insurance Act, and the Life Insurance Act – and about a dozen ordinances and Federal Council decisions: supervision law had become messy and self-contradictory and was in need of consolidation. The newly emerging financial conglomerates and insurance groups, corporate governance, global business activities, increasing linkages among insurers, and many other factors also necessitated a total revision of supervision law. The new standards of the International Association of Insurance Supervisors (IAIS), which are used by the IMF to assess a country's insurance sector and supervision, called for a legislative regulation of these problem areas as well as cooperation with foreign insurance supervisors. Moreover, discussions had been initiated worldwide on how risks should be taken into account when determining the required solvency capital of an insurance undertaking. The call for a new calculation of the required equity capital became particularly loud during the financial market turbulences in 2001 and 2002. Already during the deliberations in Parliament, the supervisory authority intensively scrutinized the existing or envisaged methods of risk assessment used abroad. The result is the Swiss Solvency Test, which in the view of domestic and foreign experts is the best possible way to assess all risks to which insurance undertakings are exposed. The new Insurance Supervision Act, which largely takes these new requirements into account, was adopted by Parliament on 17 December 2004 and put into effect by the Federal Council on 1 January 2006.

It is sometimes said in Switzerland and abroad that substantive State supervision is being replaced by solvency supervision due to the new risk-based solvency system. However, substantive State supervision has always also encompassed solvency supervision – in different forms – and as such was sufficient for about 100 years in preserving the solvency of undertakings. The increasingly complex business fields of insurers have, however, resulted in increasing risks that can no longer primarily be assessed by product control alone. The Swiss Solvency Test takes this development into account. The SST though is also only one of several supervision tools. The supervisory authority can, as part of Integrated Insurance Supervision in the area of Qualitative Supervision, continue to intervene directly in the business management and organization of an undertaking, which is precisely the nature of substantive State supervision. Existing intervention options have not been eliminated (where preventive control of insurance products has been dropped, subsequent review and rejection is possible), but rather even enhanced: rejection and dismissal of important officeholders, inspections of linked companies, and so on. After the positive experience with substantive State supervision over 120 years prior to entry into force of the new law, and strengthened by additional insights gained from the risk-based supervisory system as part of Integrated Insurance Supervision, we are now turning to the challenges of the future.

Federal Financial Market Supervisory Authority

On the path to FINMA

As of 1 January 2009, government supervision of banks, insurance undertakings, and other financial intermediaries will be consolidated into a single Swiss Financial Market Supervisory Authority (FINMA). With the partial entry into force of the FINMA Act, the new authority already attained its own legal personality on 1 February 2008 and can now carry out preparations. Until the end of 2008, the participating authorities will continue to autonomously fulfil their supervisory mandates.

With the establishment of an integrated financial market supervisory authority, an organizational reorientation is underway to strengthen Swiss financial market supervision and to give it greater weight as an interlocutor at the international level. FIMNA is being organized as an establishment under public law, with functional, institutional, and financial independence. This is provided by the FINMA Act, which partially entered into force on 1 February 2008.

FINMA Act as the umbrella law

In addition to organizational questions, the FINMA Act also contains fundamentals on financial market regulation, liability rules, and harmonized supervisory instruments and sanctions. The FINMA Act serves as an umbrella law for the other laws governing the content of financial market supervision. These subordinate laws remain unchanged. This arrangement takes account of the special nature of the different areas of supervision. For insurance undertakings, this means that they must continue to meet the requirements under the Insurance Supervision Act (ISA).

Fit for FINMA

With the election of a Board of Directors and partial entry into force of the FINMA Act, FINMA has already attained its own legal personality. Until the authority actually becomes operational on 1 January 2009 and begins functioning as an integrated financial market supervisory authority, however, several months remain. During this time, FOPI has set out the following goals:

- First and foremost, professional and modern supervisory activities will be performed, based on insurance supervision law.
- Additionally, Swiss supervision will – as already in the year before – strengthen its position internationally. A specific goal is to consider the draft of the European Union for a new framework directive on Solvency II. This will significantly influence the European insurance market.
- Finally, the goal will be to significantly advance integrated insurance supervision over the course of this year. The project was launched in January 2007. Initial milestones have been achieved, especially the regulation of competences and the channelling of information flows between the competent supervisory divisions and in the area of qualitative supervision. The next milestones are scheduled for mid-2008. Implementation is ongoing and step-by-step. The time horizon is until the end of 2010.

On 1 January 2009, the staff members of the three merged authorities – the Swiss Federal Banking Commission (SFBC), FOPI, and the Anti-Money Laundering Control Authority (AMLCA) – will take up their work for the new FINMA at a joint location. This will not mark the end of a development, but rather an important intermediate goal on the path toward a supervisory authority that is also recognized internationally.