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Federal Office of Private Insurance FOPI

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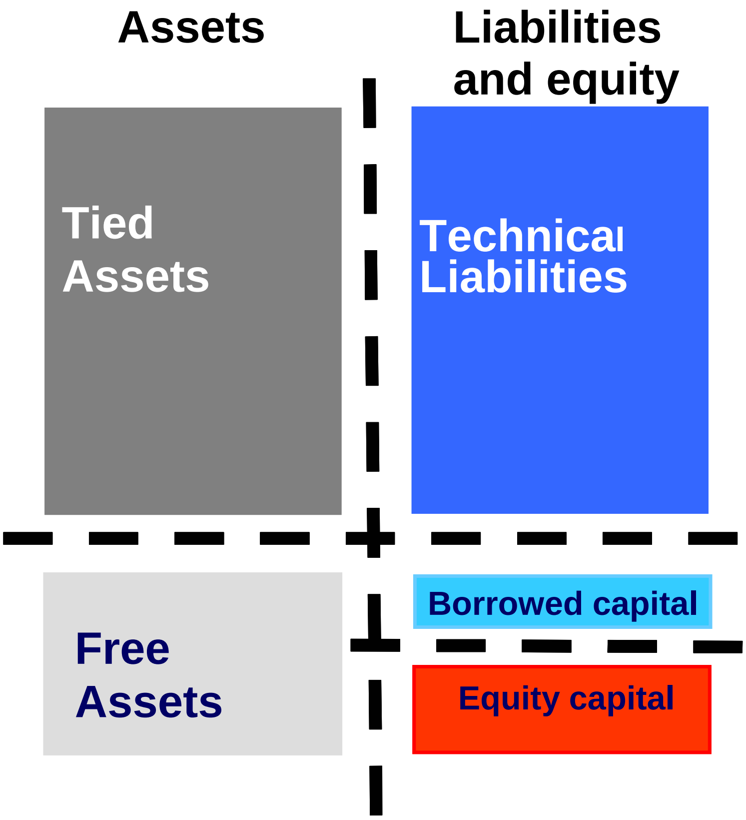
Securing claims of insured parties

1. Introduction

The central task of insurance supervision is to secure the claims of insured parities, i.e. solvency protection, which means protecting insured parties from the consequences of insolvency of insurance undertakings. To secure the claims of insured parties, an insurance undertaking must establish sufficient technical provisions in accordance with actuarial principles. These technical provisions must be covered at all times by so-called "tied assets".



Strict rules apply to investments of the tied assets with respect to risk spreading, permissible investment categories, risk and investment management.

Article 54 of the Insurance Contract Act (ICA) states that in the case of bankruptcy, the proceeds from the tied assets are first used for secured claims arising from insurance contracts. In other words: claimants enjoy a preferential status in that they are to be satisfied first from the proceeds of the tied assets, before other creditors, in the case of bankruptcy.

2. Claims of insured parties enjoy special legal protection

The claims of insured parties are evaluated by the insurance company on the basis of actuarial principles and reported as so-called technical provisions (liabilities vis-à-vis insured parties). Pursuant to prudential rules, each direct insurer is required to establish tied assets to secure these claims arising from insurance contracts. The tied assets thus constitute liability reserves for the policyholders, ensuring that their claims arising from insurance contracts will be satisfied before the claims of all other creditors.

Investments of tied assets must at all times cover the total amount of these technical provisions, including a safety margin of 1% for life insurance and 4% for non-life insurance. If the technical provisions and the safety margin are no longer fully covered, this is considered underfunding. In this case, the insurance undertaking is required to remedy the underfunding immediately.

3. Impact of market movements is observed continuously

The massive upheaval on the international financial markets has not left insurance companies and groups under Swiss supervision untouched. Since mid-2007, FOPI has thus been continuously and intensively analyzing the impact of these market movements.

Strict rules apply to the investment of tied assets with respect to risk spreading, permissible investment categories, risk and investment management. While the investments of tied assets have also lost value, the scope of this loss has been substantially limited thanks to the security-focused FOPI investment directives.

3.1 Only 6% invested in stocks

All investments of tied assets must be made according to the principle of diversification. Overweighting of a single asset category is not permissible. Alternative investments (hedge funds, private equity, commodities) may only be used for diversification purposes subject to very restrictive conditions. Overall, this investment category is limited to a maximum of 10% of tied assets.

Looking at the overall market, insurance undertakings currently invested, as of 31 december 2007, only 6% in stocks, 5% in alternative investments, and 1% in structured products. The investment directives also demand broad spreading of counterparties with whom the assets are placed. Insurance undertakings may only invest a maximum of 5% of tied assets with the same counterparty, counting all investment forms such as stocks, bonds, open derivative transactions, and time deposits. Special security measures apply to derivative and securities lending transactions, such as a prohibition on unsecured transactions.

3.2 Change in value of fixed-interest investments

Since life insurance has a long-term investment horizon, the legislative power requires the amortized cost method as an upper threshold for the valuation of fixed-interest investments, which for the overall market represent an average of 55% of investments of tied assets. This valuation method entails that price gains on bonds cannot be reported during low-interest phases. Conversely, during phases of interest rate increases or increases of the credit spread (as is currently the case), the resulting value fluctuations need not be considered. This leads to a stable valuation of fixed-interest investments. Where actual defaults occur – such as in the Lehman Brothers case –, the write-downs must be taken into account immediately. The counterparty risk is limited by the abovementioned 5% counterparty limit.

4. Monitoring of tied assets

Each year, tied assets are audited by the supervisory authority using a standardized process as well as by an independent auditor employing specifically defined audit methods. In special situations, such as during the financial crises over the past few months, FOPI also carries out additional inspections of solvency requirements during the business year. These include stress tests, which indicate to what extent the tied assets are exposed to market changes.

5. Outlook

Tied assets are fully available to cover the claims of insured parties. Despite the massive upheaval on the financial markets, this cover continued to be guaranteed by insurance undertakings as of 30 September 2008. The extraordinary nature and depth of the current crisis, and especially the ongoing uncertainty about how to overcome it, make clear that the tied asset investments, which so far have continued to be recoverable overall, might be touched more strongly. Nevertheless, over the course of the crisis so far, the FOPI investment directives have proven themselves as a useful orientation aid for preserving the value of the insured party claims deposited in the tied assets.

The demands on Solvency I formulaically define how much free and unencumbered equity capital an insurance undertaking must hold relative to its business volume.

Direct insurers are required to cover their technical provisions with **tied assets**; investment rules must be observed in this regard, which require the insurance undertaking to pursue a prudent investment policy. These rules do not apply to free assets.

Unlike direct insurers, **reinsurers** need not establish tied assets or observe investment directives in this regard, but they of course must also meet the regulatory solvency requirements.