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**Final Report**  
**on**  
**Public Consultation No. 14/041**

**EIOPA Advice to the European  
Commission**

**Equivalence assessment of the Swiss  
supervisory system in relation to articles  
172, 227 and 260 of the Solvency II  
Directive**

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# 1. **Executive summary**

## **Introduction**

By letter of 25 February 2014, the European Commission requested EIOPA to update the equivalence advices for Switzerland and Bermuda (under articles 172, 227 and 260 of the Solvency II Directive) and Japan (under Article 172 of the Solvency II Directive) that EIOPA provided in October 2011.

As in 2011, EIOPA publicly consulted on the three reports. On 19 December 2014, EIOPA launched a Public Consultation on the draft 'EIOPA Advice to the European Commission - Equivalence assessment of the Swiss supervisory system in relation to articles 172, 227 and 260 of the Solvency II Directive'.

## **Content**

This Final Report includes the EIOPA Advice and a feedback statement to the consultation paper (EIOPA-CP-14/041). It has been adopted by the Board of Supervisors of EIOPA and was subsequently submitted to the European Commission.

## **2. Feedback statement**

EIOPA would like to thank all the participants to the Public Consultation for their comments. All the comments received were of general nature; welcoming and supporting EIOPA's work and stressing the importance of an Equivalence determination in respect of Switzerland.

The comments received have not led to a redrafting of the 'EIOPA Advice to the European Commission - Equivalence assessment of the Swiss supervisory system in relation to articles 172, 227 and 260 of the Solvency II Directive'.

### **3. EIOPA Advice to the European Commission - Equivalence assessment of the Swiss supervisory system in relation to articles 172, 227 and 260 of the Solvency II Directive**

#### **Chapter I: Introduction**

##### **Section 1 - Equivalence assessments under Solvency II:**

1. Under the Solvency II directive the European Commission may determine whether the solvency regime of a third country is equivalent to that laid down in Solvency II in relation to three areas of focus. Article 172 relates to equivalence of the solvency regime applied to the reinsurance activities of insurers<sup>1</sup> with their head office in the third country concerned, where a positive determination would allow reinsurance contracts with insurers in that third country to be treated in the same way as reinsurance contracts with EEA insurers. Article 227 relates to third-country insurers which are part of EEA groups, where equivalence would allow groups to take into account the local calculation of capital requirements and available capital rather than calculating on a Solvency II basis for the purposes of the deduction and aggregation method. Article 260 relates to group supervision of EEA insurers with parents outside the EEA, where equivalence would mean EEA supervisors would rely on the group supervision of that third country.
2. The European Commission's Call for Advice of 11th June 2010 asked CEIOPS (EIOPA's predecessor organisation) to provide advice on whether the supervisory regimes of certain third countries satisfy the general criteria for assessing third country equivalence. In its letter of 29th October 2010 the European Commission indicated that Switzerland should be assessed for equivalence under articles 172, 227 and 260. Following full consultation, EIOPA provided its advice to the European Commission in October 2011.
3. By letter of 25th of February 2014 the European Commission requested EIOPA to update the equivalence advice for Switzerland. The updated report is intended to allow the European Commission to take fully-informed decisions in relation to the equivalence of Switzerland under each of the three articles.
4. In revising its report EIOPA has again consulted FINMA (the Swiss Financial Market Supervisory Authority) who provided an update on relevant legislative changes that have taken place since 2011, and on developments in their supervisory approach. Following receipt of FINMA's input, EIOPA commenced a desk-based review of its previous advice, and following some further written queries which FINMA cooperated fully in answering, completed its deliberations.
5. Equivalence assessments are expected to take into account the principles contained in the Solvency II Directive, as well as the general criteria for assessing third country equivalence to be found in articles 378, 379 and 380 of Implementing Measures (in the form of a Delegated Act). The assessment against the principles and objectives set out in this report reflect these provisions
6. EIOPA's advice on equivalence refers only to the regulatory regime applying to those insurers which would, by virtue of their size and the nature of their activities, fall within the scope of the Solvency II Directive.

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<sup>1</sup> Please note that throughout this report, where reference is made to "insurers" this includes insurers and reinsurers, unless otherwise specified.

## Section 2 - EIOPA Methodology:

7. There are a number of over-arching principles under-pinning the assessment:

- Equivalence assessments aim to determine whether the third country supervisory system provides a similar level of **policyholder and beneficiary protection**.
- Supervisory cooperation under conditions of **professional secrecy** is a key, determinative element of a positive equivalence finding. When assessing the criteria relating to professional secrecy, the principle of proportionality will not apply.
- The equivalence assessment is a **flexible process** based on principles and objectives (embedded in the general criteria for assessing third country equivalence). All the applicable criteria (the principles and objectives) need to be met for a positive equivalence assessment; there are a number of indicators associated with these principles to help to guide the assessment, but a positive equivalence assessment does not require that every indicator be fulfilled.
- When pursuing an equivalence assessment, proper consideration should be given to the adequacy of third country practice in applying the **proportionality** principle. This is further developed below.
- An equivalence judgement can only be made in respect of the **regime in existence** and applied by a third country supervisory authority at the time of the assessment. Plans and on-going initiatives for changing the national supervisory regime should not be considered an adequate support for a positive equivalence finding until the day of their actual implementation. Nevertheless, these initiatives should be taken into account, with due consideration given to their expected timing and the degree of commitment to them, when performing an equivalence assessment and providing advice to the Commission.
- Assessments will be **kept under review** and take into account any developments that might lead to relevant changes in the third country supervisory regime. EIOPA will review its advice at least every 3 years or upon learning of significant developments within jurisdictions already found equivalent.

8. For a criterion to be considered equivalent, the third country supervisory authority must provide evidence that the relevant national provisions exist and are applied in practice. The process of assessing each principle and objective requires a judgmental weighting of numerous factors.

### *Proportionality*

9. The proportionality principle is embedded in the Solvency II Directive, Article 29 (4) of which states that: “[...] Implementing measures [should ensure] the proportionate application of this Directive, in particular to small insurance undertakings”. Consistently with this, the Directive:

- Recognises that the principle of proportionality should apply to captives, given that they only cover risks associated with the group to which they belong (Article 13 (2) and Recital 21 Solvency II Directive);
- Introduces a requirement for the system of governance to be proportionate to the nature, scale and complexity of the (re)insurance undertaking’s operations (Article 41 (2) Solvency II Directive);

- Allows, where necessary, for simplified methods and techniques to be developed to calculate technical provisions in order to ensure that methods are proportionate to the nature, scale and complexity of the risk supported by the (re)insurance undertaking, including captive (re)insurance undertakings. (Article 86 (2) (b) Solvency II Directive);
  - Allows for simplified calculations for specific risk modules and sub-modules where this is justified taking into account the nature, scale and complexity of the risks faced by insurers, including captives (Articles 109 and 111 (1) (l) Solvency II Directive);
  - Establishes an absolute floor for the MCR (Minimum Capital Requirement) of €1.2m for captive reinsurers, as opposed to €3.6m for other reinsurers (Article 129 (1d) (iii) Solvency II Directive); and
  - Introduces a requirement for supervisory powers in deteriorating financial conditions to be proportionate and reflect the level and duration of the deterioration of the solvency position of the (re)insurance undertaking concerned.
10. In line with this, in its 1st April 2010 cover letter to the EC, EIOPA stated that equivalence was “a proportionate process. [...] As such, under each of the Chapters, [EIOPA] has advised that the existence of a proportionality principle in the application of regulatory provisions in 3rd country jurisdictions (contingent upon the nature, scale and complexity of the risks inherent in the business) should not be in itself an obstacle [...] to the recognition of equivalence.”
11. EIOPA has taken the principle of proportionality into account in its equivalence assessments in a manner consistent with the above. Under this approach application of the proportionality principle could include discretion for the supervisory authority to apply the requirements in different ways as proportionate, but would not include discretion for the supervisory authority to exempt insurers from certain requirements. For instance, a proportionate application of a requirement for all insurers to have certain function holders could include the supervisory authority being comfortable with a small insurer having one person who holds for example the risk management function and actuarial function at the same time; it would not include a small insurer not having one or other of these functions at all.

*EIOPA’s advice*

12. In undertaking the assessment, the finding for each Principle will be given using five categories: equivalent, largely equivalent, partly equivalent, not equivalent and not applicable.
13. EIOPA’s overall advice to the European Commission on the country’s equivalence for each article will be given as one of the following:
- Country A meets the criteria set out by the Commission.
  - Country A meets the criteria but with certain caveats.
  - Country A needs to undertake changes in the following areas (...) in order to meet the Commission criteria for equivalence.

### Section 3 - The Swiss insurance sector – an overview:

#### Overview of the Swiss (re)insurance market

14. Figures for 2013 show that Switzerland had the 16<sup>th</sup> largest domestic insurance market in the world, with written premiums estimated to be the equivalent of US\$ 62,597 million, equating to a 1.35 % share of the world market.<sup>2</sup> Life insurance business represented 54.7% of the total premium income.

|                      | Premium volume in millions of US dollars (estimated) | Change over 2013 (inflation adjusted) | Share of world market |
|----------------------|--|---------------------------------------|-----------------------|
| Total premium volume | 62,597   | 1.99%                                 | 1.35%                 |
| Life                 | 34,227   | 2.2%                                  | 1.31%                 |
| Non-Life             | 28,370   | 1.8%                                  | 1.4%                  |

15. Premiums per capita in 2013 were estimated to be the equivalent of US\$ 7,701, ranking Switzerland first globally by this measure (EU average US\$ 2,680). The figure for insurance penetration (premiums as a % of GDP), estimated at 9.6%, ranked Switzerland 10<sup>th</sup><sup>3</sup> (EU average 7.82%).
16. These figures do not properly reflect the importance of the Swiss insurance industry globally. The financial sector forms an important part of the Swiss economy, making a major contribution to value creation and employment. Second only to the banking sector, the Swiss insurance sector accounts for a contribution to value creation of around 3% of GDP, with over 48,000 employees in Switzerland and 74,000 abroad working at subsidiaries and branches of Swiss groups (January 2013 figures) It is home to some of the biggest insurance groups in the world, and around two thirds of the premium volume of the Swiss private insurance industry in 2012 was from business abroad<sup>4</sup>.
17. The insurance sector offers a wide range of products, in direct insurance and reinsurance. In 2013 the gross premiums of insurers domiciled in Switzerland (including their foreign operations) amounted to CHF 123.3 billion (CHF 35.1 billion for life insurers, CHF 51.3 billion for non-life insurers, and CHF 36.8 billion for reinsurers)<sup>5</sup>.
18. Number of supervised entities by type of business as of December 2013

|               | Insurers domiciled in Switzerland       | Branches of foreign insurers | Total   |
|---------------|---|------------------------------|---------|
|               | At the end of 2013 (at the end of 2012) |                              |         |
| Life insurers | 19 (19)                                 | 4 (4)                        | 23 (23) |
| Supplementary | 20 (21)                                 | 1 (1)                        | 21 (22) |

<sup>2</sup> Figures taken from Swiss Re Sigma No 3/2014, *World Insurance in 2013*.

<sup>3</sup> Swiss Re Sigma No 3/2014.

Population: 8.1 million

GDP: US 651billion

<sup>4</sup> Swiss Insurance Association: Facts and Figures 2014

<sup>5</sup> FINMA Report on the insurance market in 2013



|                                     |           |         |           |
|-------------------------------------|-----------|---------|-----------|
| health insurers                     |           |         |           |
| Non-life insurers                   | 60 (60)   | 43 (41) | 103 (101) |
| Reinsurers                          | 28 (27)   | 0 (0)   | 28 (27)   |
| Reinsurance captives                | 34 (34)   | 0 (-)   | 34 (34)   |
| Total number of insurers supervised | 161 (161) | 48 (46) | 209 (207) |

Not included in the above table are general health insurers of which there were 14 on 31 December 2013, supervised primarily by the Swiss Federal Office of Public Health (FOPH), but also subject to FINMA supervision in relation to their supplementary health insurance cover based on private contractual agreements.

19. As of end 2013 there were eight insurance groups subject to group supervision by FINMA.
20. Over the period 2009-13 the number of insurers under supervision has remained relatively stable, a fall in the total from 168 to 161 over the five year period being primarily due to a fall in the number of reinsurance captives in 2010.

*Overview of the institutional and legal framework for the financial sector of Switzerland*

21. The Federal Constitution of the Swiss Confederation of 18 April 1999 (FC) establishes a free market economic system in which own property and economic freedom are guaranteed (Articles 26, 27 and 94 FC). Economic freedom includes in particular the freedom to pursue private economic activities, including financial services.
22. Articles 95 and 98 of the FC lay down the constitutional basis for the regulation of professional activities in the private sector, and the financial sector in particular. The Confederation is empowered to legislate on the banking and stock exchange system, and on private insurance. It may also legislate on other financial services (Article 98 FC). However, regulatory activities undertaken by the state must always pursue a legitimate aim (i.e. they must be conducted in the public interest), and are bound by the constitutional principle of the rule of law including proportionality (Article 5 FC).
23. The Financial Market Supervisory Act of 22 June 2007 (FINMASA) serves as an umbrella law for sector-specific laws governing financial market regulation and supervision. It entered into full force on 1 January 2009.
24. In addition to setting the organisational parameters for FINMA as an institution, including its liability, the FINMASA defines principles for the regulation of financial markets, as well as a set of harmonised supervisory instruments and sanctions. Seven sector-specific Federal Acts issued by the Federal Parliament (referred to as the "Financial Market Acts") complement the FINMASA: the Banking Act (BA), the Stock Exchange and Securities Trading Act (SESTA), the Collective Investment Schemes Act (CISA), the Insurance Supervision Act (ISA), parts of the Insurance Contract Act (ICA), the Anti-Money Laundering Act (AMLA), and the Mortgage Bond Act (MBA).
25. Statutory ordinances issued by the Federal Council (Insurance Supervisory Ordinance, Ordinance on the Levying of Fees and Duties; Financial Market Audit Ordinance) and by FINMA implement the Financial Market Acts on a second and

third level.

26. Circulars (Rundschreiben) and other pronouncements (newsletters, discussion papers, FAQs) issued and published by FINMA provide further guidance on FINMA's interpretation and practical implementation of relevant financial market legislation. They provide substance to the intention of the legislator as conveyed in acts and ordinances. Switzerland has a partial system of self-regulation in place. Self-regulation is practically non-existent in insurance regulation, except for anti-money laundering.

## Chapter II: Overall assessment

### **EIOPA advice on Switzerland's equivalence under Article 172**

27. EIOPA's advice is that Switzerland meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II, but with certain caveats set out below. These caveats would be mainly addressed by a pending revision of the Insurance Supervisory Ordinance (ISO) assuming the current draft is implemented and enters into force in 2015. The Federal Council is expected to adopt the amended ISO in February 2015 which would then enter into force before July 2015.
28. We find FINMA equivalent with regard to its powers and responsibilities as a supervisory authority.
29. We find FINMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2.
30. We find FINMA equivalent with regard to its authorisation of reinsurance business.
31. We find FINMA largely equivalent with regard to Principle 4, taking into account the current differences around public disclosure, internal audit and compliance requirements for solo undertakings. These caveats would be mainly addressed by a pending revision of the Insurance Supervisory Ordinance (ISO) assuming the current draft is implemented and enters into force in 2015. EIOPA notes that the details of the public disclosure regime are not yet known.
32. We find FINMA equivalent with regard to its requirements around changes in business, management and qualifying holdings.
33. We find FINMA equivalent with regard to its solvency regime for insurers and reinsurers subject to the SST.

### **EIOPA advice on Switzerland's equivalence under Article 227**

34. EIOPA's advice is that Switzerland meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II.
35. We find FINMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2.
36. We find FINMA equivalent with regard to its solvency regime for insurers.

### **EIOPA advice on Switzerland's equivalence under Article 260**

37. EIOPA's advice is that Switzerland meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II, but with certain caveats set out below. These caveats would be mainly addressed by a pending revision of the Insurance Supervisory Ordinance (ISO) assuming the current draft is implemented and enters into force in 2015. The Federal Council is expected to adopt the amended ISO in February 2015 which would then enter into force before July 2015.
38. We find FINMA equivalent with regard to its powers and responsibilities as a supervisory authority.
39. We find FINMA equivalent with regard to its professional secrecy and information

exchange obligations under Principle 2.

40. We find FINMA equivalent with regard to the scope of its group supervision.
41. We find FINMA equivalent with regard to its co-operation and exchange of information with other supervisory authorities under Principle 9.
42. We find FINMA largely equivalent with regard to its governance and public disclosure requirements, because we note that its public disclosure requirements are not as extensive as those under Solvency II (although for some undertakings this may be supplemented by the requirements of the Swiss Stock Exchange or the Swiss Code of Best Practice for Corporate Governance). These caveats would be mainly addressed by a pending revision of the Insurance Supervisory Ordinance (ISO) assuming the current draft is implemented and enters into force in 2015. EIOPA notes that the details of the public disclosure regime are not yet known.
43. We find FINMA equivalent with regard to its requirements around changes in business, management and qualifying holdings.
44. We find FINMA equivalent with regard to its solvency regime for insurance groups.

## Chapter III: Assessment of each principle

### **Principle 1 - Powers and responsibilities of third country supervisory authorities**

**Objective** - *The supervisory authorities of the third country have the necessary means, and the relevant expertise, capacity, and mandate to achieve the main objective of supervision, namely the protection of policyholders and beneficiaries regardless of their nationality or place of residence. In particular, the supervisory authorities in that third country shall have the necessary capacities, including financial and human resources.*

#### **For reinsurance assessments:**

*The supervisory authorities of the third country are empowered by law or regulation to effectively supervise domestic insurance or reinsurance undertakings carrying out reinsurance activities and to undertake a range of actions, including the ability to impose sanctions or take enforcement action in relation to the domestic insurance or reinsurance undertakings carrying out reinsurance activities that it supervises.*

#### **For group supervision assessments:**

*The supervisory authorities of the third country shall be empowered by law or regulation to supervise insurance and reinsurance undertakings which are part of a group.*

*The supervision of insurance and reinsurance undertakings which are part of a group shall be carried out effectively and the supervisory authorities of the third country shall be empowered by law or regulation to undertake a range of actions, including the ability to impose sanctions or to take enforcement action in relation to the group that it supervises.*

*The supervisory authorities of insurance and reinsurance undertakings which are part of a group shall be able to assess the risk profile and solvency and financial position of that group as well as its business strategy.*

### **The supervisory authority**

#### *FINMA's responsibilities and enforcement powers*

45. According to Articles 1 (1), 3 (a) and 6 (1) FINMASA, together with Articles 2 (1) and 46 (1) ISA, FINMA is, inter alia, responsible for the supervision of Swiss insurers and branches of foreign insurers that operate direct insurance business, of Swiss insurers that operate reinsurance business, and of insurance groups as well as insurance intermediaries.
46. However, branches of reinsurers with their head office outside Switzerland are not supervised by FINMA.
47. Where a supervised person or entity violates the provisions of the FINMASA or of a Financial Market Act or if there are any other irregularities, FINMA is empowered to ensure the restoration of compliance with the law (Article 31 FINMASA).

#### *Freedom from undue political, governmental and industry interference in the performance of supervisory responsibilities*

48. FINMA is an independent institution under public law (Article 4 FINMASA). FINMA can carry out its tasks objectively and efficiently without influences from other

bodies (Article 21 FINMASA: "FINMA carries out its supervisory activity autonomously and independently"). Institutional independence allows FINMA to organise itself as it determines to be most practical, and consistent with the legal provisions. Furthermore FINMA is responsible for its own budget.

#### *Transparency of supervisory processes/procedures*

49. FINMA acts as a transparent and informative supervisory authority. For example, the website of FINMA is used as an information hub enabling supervised entities to access the rules that apply to them and keeping all stakeholders informed.

#### *Adequate financial and non-financial (e.g. sufficient numbers of appropriately skilled staff) resources*

50. FINMA is equipped with adequate financial and non-financial resources. FINMA is responsible for its own budget financed by supervised entities. FINMA also has a sufficient number of appropriately skilled staff (468 full-time equivalents as at end December 2013).

#### *Appropriate protection from being liable for actions taken in good faith*

51. FINMA is only liable if its management bodies or its staff have committed a breach of fundamental duties, and the loss or damage is not due to a breach of duty by a supervised person or entity (Article 19 FINMASA). In this way FINMA benefits from appropriate protection from being held liable for actions taken in good faith.

### **Powers to take preventative and corrective measures**

52. FINMA has evidenced its powers to take preventative and corrective measures to ensure that insurers comply with the applicable laws, regulations and administrative provisions. This includes in particular the ability:

- to obtain all information necessary to conduct the supervision of the insurer or insurance group (for example under Article 29 (1) FINMASA and Article 47 (1) ISA);
- to ensure compliance on a continuous basis with laws, regulations and administrative provisions (including through on-site inspections) including measures to prevent or penalise further infringements (including preventing the conclusion of new contracts) (for example under Article 31 FINMASA and Articles 47 (1) and 51 ISA);
- to communicate concerns, including those relating to the insurer or insurance group's financial position (for example under Article 46 (1d) ISA); and
- to oblige the insurer to respond to concerns raised by the supervisor (for example under Article 31 FINMASA).

### **Financial supervision**

53. FINMA has also demonstrated the existence and extent of its powers in respect of financial supervision. In the area of governance its regulations, supported by circulars and other pronouncements, require insurers to meet requirements in various areas of governance including the assessment of the financial condition of the insurer or insurance group. FINMA regulations and circulars also include requirements for risk management, internal controls, internal and external audit and the actuarial function. These areas are also included in the supervisory review that is done under the Swiss Qualitative Assessment (SQA).

54. The solvency of an insurer is measured by the Swiss Solvency Test (SST), (Article

9 ISA and Article 22 (1b) ISO). A total balance sheet approach is used to determine own funds. Assets and liabilities are valued market consistently. The reference date for the SST is typically 1 January for individual insurers and both 1 January and 1 July for insurance groups.

#### *Accounting standards*

55. Insurance groups which are listed on the SIX Swiss Exchange according to the main standard must apply IFRS or US GAAP as their accounting standard, whereas groups which are listed according to the domestic standard are additionally permitted to use Swiss GAAP FER.
56. The statutory accounting of the legal entities is based on the requirements of the Swiss Code of Obligation - which now includes a new standard approach for financial reporting for all legal entities governed by private law - supplemented by specific accounting requirements from FINMA. The governance requirements for internal controls also apply to accounting. It should be also mentioned that the Federal Council may issue deviating regulations from the Accounting Law, if this is justified by the specific characteristics of the insurance business or the protection of the policy holders (articles 25, 26 and 28 ISA).

#### **Qualifying holdings**

57. Qualified interests in an insurer are defined as 10% of the capital or the votes or other means of exercising significant influence (Article 4 (2f) ISA). FINMA monitors such interests as part of the business plan. If the business plan requirements are not met, FINMA could ultimately withdraw the licence. In the context of acquisitions and disposals, FINMA may prohibit a transaction or impose conditions if the nature or extent of the holding might endanger the insurer or the interests of the insured (Article 21 (4) ISA).

#### **Supervisory powers available to the authority in respect of undertakings in difficulties**

58. FINMA is empowered to take actions to protect the interests of the insured (Article 51 (1) ISA). Such actions include FINMA's competence to assign assets of the insurance companies to tied assets up to the amount<sup>6</sup> required in accordance with Article 18 ISA (Article 51 (2)(h) ISA). Similarly, if there is a risk of insolvency, FINMA can order deferral and extend the due date for payments (Article 51 (2)(i) ISA).
59. Where solvency requirements are not met, measures such as a reduction of valuations of assets or a prohibition against reducing own funds through dividend payments or share repurchases are possible. The insurer or insurance group may also be requested to build up capital or de-risk its activities, for example by selling particularly risky assets. The writing of new business could be restricted. Finally, FINMA may suspend or withdraw the approval to operate as an insurer for one or all insurance classes (Article 37 FINMASA). In the event that an insurer's licence is withdrawn, FINMA orders liquidation (Article 52 ISA).
60. FINMA has the competence to institute and conduct insurance bankruptcies (articles 53-56 ISA, and FINMA Insurance Bankruptcy Ordinance that sets out the procedure), but not for key non-regulated companies (e.g. the holding company) within insurance groups and conglomerates domiciled in Switzerland.

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<sup>6</sup> The insurance company shall guarantee claims arising from its insurance contracts by means of tied assets (Art. 17 ISA). In case of insolvency of the insurance company, according to Art. 54a (2) ISA, first call on the proceeds from the tied assets shall be the claims arising from insurance contracts covered by the sureties according to Art. 17 ISA (i.e. the tied assets). In case the amount of tied assets falls below the minimum requirements, FINMA has under Art. 51 (2)(h) ISA the legal power to increase the tied assets by way of assigning an insurer's untied assets directly to the pool of tied assets up to the minimum amount of tied assets (as defined under Art. 18 ISA).

It is foreseen that this gap will be closed in the context of the new Financial Market Infrastructure Act<sup>7</sup> through the enactment of two new provisions in the ISA. The scope for appeals in bankruptcy proceedings will also be limited. The relevant amendment is expected to enter into force in the first half of 2015.

61. The ISA describes a recovery process which takes place before bankruptcy proceedings are instituted (Article 53 (1) ISA). FINMA's material recovery powers are essentially defined in Article 51 ISA, however, the law does not provide detailed procedural provisions. FINMA has mentioned that it plans to incorporate a formal recovery process into the ISA, by taking due account of the requirements of the Financial Stability Board ("Key Attributes of Effective Resolution Regimes for Financial Institutions" of October 2011). In particular, FINMA has expressed its intention to submit to the Federal Department of Finance (FDF) the following proposals amending the ISA:

- Extension of the scope of restructuring legislation with regard to holding and group companies;
- Encroachment upon shareholder's rights;
- Compulsory participation of creditors in the insurer's debts ("bail in");
- Intervention in insurance contracts;
- Continuance of insurance benefits / transitional insurance;
- Revocation of rights of the annual general meeting;
- Exercise of rescission and responsibility claims.

#### **Enforcement actions available to the authority**

62. FINMA has a toolkit of various measures. In particular:

- Where the supervised entity has seriously violated supervisory provisions, FINMA may issue a declaratory ruling (Article 32 FINMASA) (i.e. a form of public censure).
- Where there has been a serious violation of supervisory provisions, it may prohibit the person responsible from acting in a management capacity at any entity subject to its supervision (Article 33 FINMASA).
- Where there has been a serious violation of supervisory provisions, FINMA may publish in electronic or printed form its final ruling once it takes full legal effect, and disclose the relevant personal data (Article 34 FINMASA).
- FINMA may confiscate any profit that a supervised entity or a responsible person in a management position has made through a serious violation of the supervisory provisions (Article 35 (1) FINMASA).
- FINMA may appoint an independent and suitably-qualified person to investigate circumstances relevant for supervisory purposes (Article 36 (1) FINMASA).
- FINMA will revoke the licence of a supervised entity, or withdraw its recognition or cancel its registration, if it no longer fulfils the requirements for its activity (Article 37 FINMASA).

#### *Cooperation with other authorities/bodies*

63. FINMA has the ability to cooperate with domestic authorities (Article 39

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<sup>7</sup> The Act is still going through the legislative process, a draft version is published on <https://www.news.admin.ch/message/index.html?lang=en&msg-id=54305>



FINMASA), in particular with prosecution authorities (Article 38 FINMASA). FINMA has the power to cooperate with foreign supervisory authorities to ensure compliance with financial market regulation (Articles 42 and 43 FINMASA).

### **Specificities for 172**

*Type and frequency of accounting, prudential, statistical information obtainable by the supervisory authority from an undertaking*

64. Individual insurers:

- An annual management report as of 31 December of each year, consisting of the annual accounts, annual report and, if required by corporate law or if the insurer is part of an insurance group or conglomerate, the consolidated accounts for the group.
- An annual supervisory report (Aufsichtsbericht) including details on solvency margins, technical provisions (gross and net), lines of business, type of reinsurance treaties, geographical information, details on investments categories and other information.
- A report on the regulatory audit by the external auditors including specific audit programmes initiated by FINMA if applicable and the detailed report of the statutory report to the Board of Directors as well as a risk analysis (Circular 2013/3).
- An annual Swiss Solvency Test report on “the calculation of target capital and risk-bearing capital”. Entities which are part of a group subject to FINMA group supervision have to report on a biannual basis.
- An annual report “to control the available solvency margin” under Solvency I (Article 40 (1) ISO).
- An annual update on “transactions in derivative financial instruments”.
- A report on liquidity risks and liquidity situation for insurance companies in supervisory category 28. Insurance companies in supervisory category 3 submit a report to their executive boards. FINMA has the right to request this report at any time (Circular 2013/5).
- Statistical reporting through FINMA’s web-based Insurance Reporting and Supervising Tool (FIRST)

65. In addition, FINMA is empowered to request further information at any time.

### **Specificities for 260**

*Type and frequency of accounting, prudential, statistical information obtainable by the supervisory authority from the parent undertaking*

66. Groups:

- Consolidated financial statements (biannually).
- Interim supervisory report that is less detailed than the annual supervisory report, and includes reporting on solvency, on investments in general, bond exposures, ABS portfolio positions, financing structure and liquidity. Currently the frequency of the interim report is quarterly.

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<sup>8</sup> FINMA adopts a risk-based approach to supervision. Supervised entities are assigned to one of six categories according to their risk impact on consumers (creditors, investors, and insurance policyholders), the financial system as a whole, and the reputation of the Swiss financial sector: Category 2 – Very important, complex market participants/high risk (5 insurers: 2.4% of total); Category 3 – Large and complex market participants/significant risk (36 insurers: 17.4% of total). There are no insurers in category 1 (extremely large and important and complex institutions). (Source: IMF Country Report No. 14/265).

- Swiss Solvency Test report (biannually).
- Solvency I report (biannually).
- Risk management documentation (annually).
- Risk report (annually).
- Information on risk management, governance and internal controls under the Swiss Qualitative Assessment (periodic).
- Further information on the group (Article 194 (1) ISO):
  - Organisational details (including structure charts, committee structures, organisational processes and details of management personnel) (annually, material changes to be reported within 14 days of their taking effect).
  - Group structure (in terms of legal entities) (annually, important changes to be reported ad hoc).
  - Intra-group transactions (annually, material changes to be reported ad-hoc) (Circular 2008/29).
  - Key figures, statistics (bi-annually) through FINMA's web-based Insurance Reporting and Supervising Tool (FIRST-GRE).

67. In addition, FINMA is empowered to request any further information at group level at any time.

#### **EIOPA advice**

*Articles 172/260*

68. FINMA has the necessary means, and the relevant expertise, capacities, and mandate to effectively protect policyholders and beneficiaries regardless of their nationality or place of residence. FINMA has the power to effectively supervise insurers carrying out reinsurance activities and groups, and impose sanctions or take enforcement action where necessary. FINMA is able to effectively assess the risk profile, solvency and financial position and business strategy of groups subject to its supervision. As a result Principle 1 is, in respect of the Solvency II Directive, considered to be equivalent.

## **Principle 2 - Professional secrecy, exchange of information and promotion of supervisory convergence**

**Objective** – *The supervisory authorities of the third country and supervisory authorities of Member States involved in the supervision of domestic insurance and reinsurance undertakings shall cooperate and, where relevant, ensure the effective exchange of information.*

*The supervisory authorities of the third country shall provide that all persons who are working or who have worked for the supervisory authorities, as well as auditors and experts acting on behalf of those authorities, are bound by obligations of professional secrecy.*

*The above mentioned obligations of professional secrecy shall extend to information received from the supervisory authorities of Member States.*

### **General Remarks**

69. Articles 42 (2) and (3) FINMASA serve as a general basis for the exchange of information in an international context, according to which FINMA can provide foreign financial markets supervisory authorities with non-public information and documentation if strict requirements regarding confidentiality and professional secrecy are met. These requirements also apply to all forms of informal cooperation. Confidential information is understood as any information that is not disclosed to the public. Internal rules limit the access to classified information through special access requirements.
70. Based on Article 43 (2) FINMASA, FINMA may authorise foreign authorities responsible for financial market supervision to carry out on-site inspections at Swiss establishments of foreign institutions, to the extent warranted for the purposes of group supervision and under the conditions set out for information requests (Article 42 (2) FINMASA). In turn, FINMA may also request to conduct on-site inspections of Swiss institutions in foreign locations for the purposes of group supervision (Article 43 (1) FINMASA).

### **Ability and willingness to cooperate**

71. FINMA has shown on the basis of the above mentioned provisions its willingness to cooperate in information sharing for suitability assessments and in crisis situations under the legal provisions of Article 42 FINMASA. As well as the practical proof given during the on-site-visit, FINMA has concluded an Agreement with the European Economic Community on direct insurance other than life assurance (1 January 1993), and with the Principality of Liechtenstein on direct insurance and insurance intermediaries (9 July 1998), which are an explicit legal basis for information exchange regarding suitability assessments.

### **Cooperation agreements**

72. According to Articles 6 (2), 42 and 43 FINMASA, FINMA is legally authorised to cooperate with foreign supervisory authorities responsible for financial market supervision even in the absence of a formal arrangement such as a Memorandum of Understanding (MoU). FINMA may enter into administrative arrangements for international cooperation if deemed necessary. FINMA has entered into bilateral and Multilateral Memoranda of Understanding with all the individual members of the EEA and other authorities, has exchanged letters with the Bermuda Monetary Authority (2010) and has exchanged confidentiality agreements regarding supervisory colleges. The decision on whether to conclude

cooperation agreements which do not qualify as international public law treaties is within FINMA's discretion. Where no MoU is signed, FINMA may exchange confidentiality agreements in order to coordinate information exchange.

### **Exchange of information**

73. Articles 38 et seq. FINMASA form the general basis for the exchange of confidential information. Domestically FINMA may cooperate with other Swiss authorities subject to Articles 38 and 39 in conjunction with Articles 40 and 41 FINMASA, and other relevant provisions in the Financial Market Acts.
74. In the international context, based on Articles 42 (2) and (3) FINMASA, FINMA may provide foreign authorities responsible for financial market supervision with non-public information and documentation provided the recipient is subject to official or professional secrecy obligations and the information and documentation provided are only used for the direct supervision of foreign institutions. Such information and documentation provided may only be passed on to other authorities and bodies tasked with acting in the public interest if there is a general authority to do so in a bilateral agreement or if FINMA specifically consents. The information may also be passed on to criminal prosecution authorities if the requirements under the applicable criminal legal assistance regime are met (treaties or Federal Act on International Legal Assistance in Criminal Matters). FINMA makes decisions in this regard jointly with the Federal Office of Justice (FOJ).

### **Regime with regard to the professional secrecy obligations the authority must observe**

75. FINMA management bodies, staff and mandated third parties as well as mandated persons of FINMA are bound by official secrecy, meaning that they must observe secrecy on official matters (Article 14 FINMASA). The duty of secrecy continues to apply after termination of employment or membership of a governance body of FINMA. When these persons are participating in evidentiary hearings and in court proceedings as parties, witnesses or expert witnesses, they are allowed to disclose matters that have come to their knowledge in the course of their duties and that relate to their official tasks only with FINMA's authorisation.
76. The official secrecy obligation (Article 14 FINMASA) mandates that the sharing of confidential information is only possible under the strict and precise conditions set out in Articles 38 to 43 FINMASA, regarding cooperation with domestic and foreign authorities. FINMA will only consent to handing over information if the principles of Article 42 FINMASA are met (specific purpose, confidentiality, handing over to third party only with the prior consent of FINMA).
77. Furthermore, it is FINMA's established policy to hand over information to other domestic or foreign authorities only if the authority from which the information was received confidentially has given prior explicit consent. This policy is based on Article 42 (2b) FINMASA. According to this provision FINMA may hand over information to foreign authorities if it is guaranteed that the shared information would be passed on to another authority only on the basis of a general authorisation in an applicable international treaty or with FINMA's consent. By way of reciprocity and equal treatment, FINMA applies this principle of prior consent in the same way where it is the recipient rather than the provider of information.
78. To implement the relevant statutory requirements regarding confidentiality, FINMA has issued a policy note for internal use (Policy Note on Information

Protection and Procedure). This policy note summarizes, inter alia, the rules covering official secrecy and the practical process on how to handle the information received from foreign authorities.

#### *Exceptions to the professional secrecy obligations*

79. FINMA may cooperate with other Swiss supervisors and authorities and such cooperation may also include the transfer of confidential information (Articles 38 et seq. FINMASA). However, FINMA may refuse to transfer information or materials even to public prosecutors and other national authorities if “their disclosure or handover would prejudice on-going proceedings or the fulfilment of [FINMA’s] supervisory activity” or if “it is not compatible with the aims of financial market supervision or with [FINMA’s] purpose” (Article 40 FINMASA). FINMA has demonstrated that this legal provision is understood to the effect that requested information should only be disclosed when necessary for supervisory purposes. In all other cases, where such information would be intended to be used for other purposes (e.g. as proof in a private civil procedure) FINMA refuses disclosure.
80. FINMA commits itself not to disclose information received from foreign supervisors to third parties without the consent of the foreign supervisor and (in the absence of their consent) to make best efforts to oppose possible disclosure orders with all legal means.

#### *Breach of professional secrecy obligations*

81. A breach of professional secrecy by FINMA management bodies, staff and all mandated persons of FINMA (investigating agents, restructuring agents, liquidators, administrators in bankruptcy and other mandated persons) constitutes a criminal offence under Article 320 of the Swiss Penal Code. It is subject to monetary sanctions or imprisonment.

#### **EIOPA advice**

##### *Articles 172/227/260*

82. FINMA’s professional secrecy framework provides for a high level of protection for confidential information. The relevant legal provisions provide for the confidentiality of all information that becomes available to FINMA, be it collected as part of its own supervisory activities or received from third country supervisory authorities. The Swiss legal framework – and the policy applied by FINMA – allows FINMA to obtain information classified as confidential and to share it with other supervisors and with other administrative bodies only under strict criteria. FINMA therefore applies the principle of prior consent, whereby information may only be passed on with the prior consent of the authority which provided it (in the case of information provided to FINMA by foreign supervisors and vice versa). A breach of secrecy requirements is punishable under Swiss law. On the basis of this legal framework FINMA has the necessary ability – and it has provided proof that it has the necessary willingness – to cooperate with other authorities in the field of information sharing by means of bilateral and multilateral agreements, Memoranda of Understanding and confidentiality agreements as well as in the framework of international agreements and national legal provisions as to cooperation in criminal cases (cooperation with the FOJ). As a result Principle 2 is in respect of the Solvency II Directive considered to be equivalent.

### **Principle 3 - Taking-up of business**

**Objective** – *The taking-up of the business of reinsurance in the third country shall be subject to prior authorisation. Authorisation for the taking-up of business shall be conditional on the undertaking meeting a clear, objective and publicly available set of written standards on a continuous basis.*

83. Prior authorisation is a formal process, with requirements set out under Article 4 ISA. As well as the legal requirements for licensing, FINMA has published on its website a guide with details on the licensing process and templates for each legal requirement. Furthermore FINMA has internal guidelines on the licensing process.

#### **Legal entity**

84. According to Article 7 ISA insurers can adopt the legal form of a stock company or a cooperative society. The scope of FINMA's supervision is set out in Article 2 ISA and covers all kinds of reinsurance activities carried out by domestic insurers and reinsurers. Branches of foreign direct insurance companies are also subject to Swiss supervision. However reinsurance companies that have their registered office outside Switzerland and that only conduct reinsurance business in Switzerland with or without a branch office in Switzerland are not in the scope of Swiss regulation.

#### **Undertaking's operations**

85. Since all insurance activities are within the scope of FINMA supervision, they are subject to prior authorisation. After the initial contact, where the applicant explains the objectives of the proposed insurer, the applicant submits the application and the business plan. The business plan must contain inter alia the financial resources, technical provisions, investment policy, opening balance, planned lines of business and type of risks to be insured, retrocession plan and estimated set-up costs of the insurer, as well as the names of the directors and management board, responsible actuary, and important shareholders. These set-up costs (called the organisational fund) have to be at least 20% of the minimum capital requirements. For insurance activities abroad, a permit from the responsible foreign supervisory authority or a comparable certification is essential. At the end of the licensing process an official notification is issued to the applicant by FINMA. Any changes to the business plan must be approved by FINMA. The business plan has to be updated constantly and FINMA has a remit to monitor compliance with it (Article 46 (1c) ISA). These legal requirements and the parameters for approval are set out in Article 4 (2), Article 5, and Article 6 ISA. According to Article 8 ISA and Articles 8 and 9 ISO, the minimum capital requirements vary according to the different types of insurance authorisation. In addition to its insurance activities, an insurer may only operate business directly associated with insurance activities, and, in any case, provided that the interest of the policyholders are not endangered.

#### **Information on shareholders/members**

86. In the business plan, details of shareholders have to be disclosed and submitted for approval, whether natural persons (name, place of residence and profession) or legal entities (undertaking, headquarters and business scope).

87. Swiss supervisory law defines a threshold for "qualified investors". According to Article 4 (2) ISA a "qualified investor" is one who holds directly or indirectly at least 10% of the capital or the voting rights in an insurer, or who otherwise exerts significant influence on its commercial activities. For this purpose a

register of shareholders containing details on the shareholdings must be submitted.

88. If such qualified positions are acquired after the licence has been obtained, FINMA has to be notified of the change in the business plan.
89. FINMA will review, among other things, the suitability (fitness and propriety) of the qualified investors as well as of the board of directors and the general management.

### **Close links**

90. FINMA's Circular 2008/32 (corporate governance, risk management and internal controls) obliges members of the board of directors and executive management to avoid conflicts of interest. Furthermore with regard to insurance groups there is required reporting to FINMA on intra-group transactions.

### **Withdrawal of authorisation**

91. According to Article 6 ISA, prior authorisation for taking-up of business has to be granted by FINMA, if the legal requirements are met and the interests of the insured are safeguarded. In contrast to this, FINMA withdraws its approval of authorisation if the insurer no longer satisfies those requirements, in accordance with Article 37 FINMASA and Article 61 (1a) ISA. Moreover FINMA has the power to withdraw authorisation if the insurer suspends its commercial activity for more than six months (Article 61 (1b) ISA).

### **EIOPA advice**

#### *Article 172*

92. FINMA has a sound and prudent process for prior authorisation. Swiss supervisory law enables FINMA to obtain a comprehensive overview of the insurer's business processes and financial resources. Moreover FINMA's approach to monitoring the fitness and propriety of shareholders and members is adequate. As a result Principle 3 is in respect of the Solvency II Directive considered to be equivalent.

## **Principles 4 and 10 - System of Governance and Public Disclosure**

**Objective** - *The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings carrying out reinsurance activities to have in place an effective system of governance which provides for sound and prudent management of the business, and require groups to have in place such a system at the level of the group. That system shall at least include an adequate transparent organisational structure with a clear allocation and appropriate segregation of responsibilities, requirements for ensuring that persons managing the undertaking are fit and proper and effective processes to ensure the timely transmission of information both within the undertaking or group and to the relevant supervisory authorities.*

*The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings carrying out reinsurance activities to have in place an effective risk-management system comprising the strategies, processes and internal and supervisory reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis and at an individual and an aggregated level, the risks to which the undertaking is or could be exposed, and their interdependencies, as well as an effective internal control system. It shall require groups to have in place such a system at the level of the group.*

*The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings carrying out reinsurance activities to establish and maintain risk-management, compliance, internal audit and actuarial functions. Groups shall be required to establish and maintain these functions at group level.*

*The solvency/prudential regime of the third country shall require groups and domestic insurance and reinsurance undertakings carrying out reinsurance activities to disclose publicly, on at least an annual basis, a report on their solvency and financial condition.*

### **For group supervision assessments:**

*The prudential regime of the third country shall require the group to have sound reporting and accounting procedures to monitor and manage its intra-group transactions and risk concentrations and to report at least annually significant risk concentration at the level of the group and significant intra-group transactions.*

## **General Governance Requirements**

93. There are rules within the ISA, ISO and Circulars, in particular Circular 2008/32, which apply to insurers and groups and set out the general requirements as to a system of governance.

### **Fit & Proper**

94. Article 14 ISA and Articles 12 to 14 ISO in conjunction with Circular 2008/32 specify the fit and proper requirements for the board of directors (Verwaltungsrat) and the management board (Geschäftsleitung).

### **Risk Management/Effective Internal Control Mechanisms**

95. Articles 22, 68 and 76 ISA, Articles 96 et seq., 195 et seq. and 204 ISO and Circular 2008/32 set out FINMA's risk management requirements. Article 27 ISA in conjunction with Circular 2008/32 does the same for the internal control system. Accounting procedures have to be submitted to FINMA together with the external audit report.

96. In addition, Circular 2008/44 sets out FINMA's risk management requirements



under the SST. FINMA requires insurers to include in their SST report all relevant information required to assess their risk situation. In line with this, the SST report template provides for a chapter covering "other risks" not forming part of the target capital calculation, requiring insurers to consider their wider risk situation; this section of the report would also be expected to include information on risk management. Insurers are also required to consider the applicability of the standard model to their own risk profile. In addition, the Swiss Quality Assessment (SQA) would also serve to review and assess the insurers' qualitative risk management practices, including in respect of the risk management function.

97. Through the revision of the ISO, an ORSA shall become a formal separate requirement in the ISO for solo companies and for insurance groups and conglomerates. Details with regard to definition and goals, scope, forward-looking perspective, overall risk profile, overall capital needs, internal reporting and reporting to FINMA that are mainly comparable to the requirements for the ORSA under Solvency II will be set out in a FINMA circular.

### **Internal Audit Function**

98. Article 47 Solvency II Directive requires that insurers falling under the scope of the Directive shall provide for an effective internal audit function. This internal audit function must be objective and independent from the operational functions (except in certain circumstances described in Article 271 (2) of the Solvency II Delegated Acts). The independence of the internal audit function is ensured by Article 27 (1) ISA. However, pursuant to Article 27 (2) ISA, FINMA is able to exempt an insurer from the requirement to establish an internal audit function. According to Circular 2008/35 an exemption can be made if the insurance company does not have a complex risk structure (e.g. if no material operational, market, credit or insurance risks are present). This is the Swiss interpretation of the proportionality principle in this respect. However, FINMA states that this exemption has always been granted sparingly and the exemption practice has been further tightened in the aftermath of a 2011 EIOPA assessment. Where such exemption is granted, FINMA states it expects external auditors to look even closer at the operational capability of internal audit. FINMA plans to amend the exemption options to mirror the scope of the provisions that will be embedded in Solvency II by way of amendment of its Circular 2008/35 in middle of 2015.
99. The companies which are not exempted have to fulfil very specific requirements as to the contents of the report they have to produce. The internal auditor has to submit a summary of this comprehensive and detailed report to FINMA as an annex to the external audit report. In addition, under SQA II the adequacy of the internal audit function as a function was assessed. We also note that in the context of the group internal audit function, reported practice indicates that all groups need to have an internal audit function, although the Swiss law is not explicit on this point.

### **Contingency plans**

100. According to FINMA every insurer and insurance group must have a contingency plan as part of effective risk management pursuant to Article 22 ISA, Articles 96 and 98 ISO (and for groups Articles 195 and 204 ISO in conjunction with Articles 96 and 98 ISO). Although a contingency plan is not explicitly required under any laws, regulations or circulars, the actual practice seems to provide for this as FINMA states that it considers contingency planning to be part of good risk management.

## **Actuarial function**

101. At solo level an accountable actuary is required under Articles 23 and 24 ISA, Article 99 ISO, Articles 2-4 FINMA-ISO, and Circular 2008/16. Although at group level an accountable actuary is not a legal requirement, appropriate and state of the art actuarial processes must be implemented throughout the group (Articles 67 and 75 ISA in conjunction with Article 22 ISA, Article 198 ISO in conjunction with Article 22 ISO).

## **Outsourced functions**

102. FINMA is of the view that while insurers may outsource certain functions they cannot outsource responsibility. According to Article 47 (4) ISA in conjunction with Article 47 (2) ISA natural or legal persons to which important functions of an insurer are outsourced are obliged to provide FINMA with the information and documents that it requires to carry out its tasks, and, in conjunction with Article 47 (1) ISA, FINMA can perform inspections of them at any time. In addition, they have to report to FINMA any incidents that are of substantial importance to their supervision (Article 29 (2) FINMASA). Changes to outsourcing agreements, like any changes to the business plan, are required to be notified to FINMA under Article 4 (2j) ISA in conjunction with Article 5 (2) ISA.

## **Compliance function**

103. The compliance function is not directly referred to in the ISA or in the ISO, however it is mentioned in Circular 2008/32. In its Circular FINMA has taken the approach that a compliance function only needs to be established if it is appropriate and proportionate taking into account the size and complexity of the company. In practice we also understand that all Swiss groups need to provide for a compliance function, although the Swiss law is not explicit on this point. The Swiss Federal Council intends to introduce a broader compliance function requirement for solo companies in the revised ISO.

104. We note that aside from the supervisory rules and regulations there is a compliance function requirement for the Board of Directors for stock companies ("Aktiengesellschaften") under Article 716a (1) Nr. 5 Code of Obligations and with the administrative body ("Verwaltung") for mutual companies ("Genossenschaften") under Article 902 (2) Nr. 2 Code of Obligations. In accordance with these provisions the board of directors or the directors have the non-transferable and inalienable duty of the overall supervision of the persons entrusted with managing the company or the cooperative's business, in particular with regard to compliance with the law, articles of association, operational regulations and directives. Thus every insurer in Switzerland has to have at least some sort of compliance function. However, the characteristics of the Swiss Compliance function are only to a certain extent comparable to those of Article 46 in conjunction with Recitals 30 to 33 of the Solvency II Directive. Through the revision of the ISO, a compliance function shall become mandatory for all insurers.

## **Ensuring identification of deteriorating financial conditions**

105. In accordance with Article 22 ISA, Articles 96 to 98 ISO and Circular 2008/32, insurers as well as groups are expected to have the means to regularly monitor, report on, and address changing financial conditions. One of FINMA's tools to check this is the SQA, which looks in detail into various elements of governance, risk management and internal controls relevant, among other things, to the effective monitoring of financial conditions and the remediation thereof. Deteriorating financial conditions will be notified to FINMA in particular through

the SST regime, whereby insurers must report significant losses or material changes to their risk profile to FINMA on an ad hoc basis.

### **Auditor's duty**

106. External auditors are required to notify FINMA without undue delay if they have identified any criminal offences, serious irregularities, breaches of good business principles or circumstances likely to endanger the solvency of the insurer or the interests of the insured (Article 30 ISA). Although a direct reference to Article 30 ISA is missing in Article 70 ISA (External audit for groups), FINMA were able to show that they nevertheless require the external auditors of groups to notify FINMA of any of the circumstances mentioned in Article 30 ISA.

### **Public disclosure**

107. Currently all Swiss insurers are required to publicly disclose their financial statements through FINMA's website. In addition, insurance groups listed on the Swiss Stock Exchange are subject to the exchange's additional disclosure requirements, particularly in terms of information relating to corporate governance. Furthermore, insurers may adhere to the Swiss Code of Best Practice for Corporate Governance in their reporting. However, FINMA currently have no public disclosure requirements for Swiss insurers or insurance groups under the SST regime.

108. Articles 51 and 256 of the Solvency II Directive detail the public disclosure requirements for insurers and insurance groups respectively. Specifically, insurers and insurance groups are required to disclose publicly, on an annual basis, a report on their solvency and financial condition. This report should include, but is not limited to, information on the insurer's business, external environment and performance, system of governance, risk profile, valuation for solvency purposes and capital management.

109. This is an important difference between the two regimes and affects not only principles 4 and 10 but also principles 6, 7 and 12. The competent Swiss authorities intend, via the ISO revision, to introduce annual disclosure requirements for insurance companies and insurance groups and conglomerates including the following quantitative and qualitative information:

- Business activities
- Performance
- Risk management and its appropriateness
- Risk profile
- Basis of assessment and methods used, particularly as regards provisions
- Capital management
- Solvency

The full details of the public disclosure regime have still to be elaborated.

## **EIOPA advice**

### *Articles 172/260*

110. FINMA requires insurers and insurance groups to have in place an effective system of governance which provides for sound and prudent management of the business and an effective risk management system. In general its requirements in relation to governance, the actuarial function, outsourced functions and the auditor's duty are equivalent to the Solvency II requirements. However the characteristics of the compliance function under the current Swiss supervisory regime is only in some aspects comparable to the requirements of those of the Solvency II Directive. Insurers are required to establish an internal audit function, however a dispensation for solo entities from this requirement in exceptional cases is possible with FINMA's approval (although it does not seem to be intensely used in practice), particularly for non complex carriers, whereas we note that the Solvency II Directive requires without any exception an internal audit function that, however, does not necessarily have to be performed on a standalone basis, but could be performed by one person or unit along with other tasks (Article 271 (2) of the Solvency II Delegated Acts).
111. On disclosure, some Swiss insurers are subject to the requirements of the Swiss Stock Exchange or adhere to the Swiss Code of Best Practice in Corporate Governance, and financial statements for all firms are published by FINMA. However there is no public disclosure required for any insurers in the areas covered by the Solvency II solvency and financial condition report. FINMA is currently reviewing the issue of public disclosure.
112. Taking the overall picture into account, but acknowledging these current differences around public disclosure, internal audit and compliance requirements for solo undertakings, Principle 4 in respect of the Solvency II Directive is considered to be largely equivalent. In respect of Principle 10, the Swiss regime is considered to be largely equivalent in respect of the Solvency II Directive in light of these differences around public disclosure. These caveats would be mainly addressed by a pending revision of the Insurance Supervisory Ordinance (ISO) assuming the current draft is implemented and enters into force in 2015. EIOPA notes that the details of the public disclosure regime are not yet known.

## **Principles 5 and 11 - Changes in business, management or qualifying holdings**

**Objective** – *The solvency/prudential regime of the third country shall require that proposed changes to the business or management of domestic insurance or reinsurance undertakings carrying out reinsurance activities or of groups, or to qualifying holdings in such undertakings and groups are consistent with maintaining the sound and prudent management of the domestic insurance or reinsurance undertaking or group.*

### **Acquisitions of insurance and reinsurers**

#### *Notification of intention to hold or increase directly or indirectly a qualifying holding*

113. According to Article 21 (2) ISA anyone intending to take a direct or indirect equity holding in an insurer with its registered office in Switzerland must notify FINMA in advance. The thresholds are 10%, 20%, 33% or 50% of the capital or voting rights.
114. Articles 192 (2) and (3) ISO and Circular 2008/28 provide for detailed notification to FINMA by insurance groups and insurance conglomerates about the creation, acquisition or sale of a significant holding. FINMA defines what constitutes a significant holding. FINMA is authorised to assess the acquisition from the perspective of the financial condition of the group and of risk management. If it has any concerns they are communicated to the group and the necessary follow-up actions or sanctions are pursued according to Article 31 et seq. FINMASA.
115. Articles 192 (2) and (3) ISO and Circular 2008/28 also cover notification of a change in the group or conglomerate's shareholder base. FINMA is to be notified if a direct or indirect interest of natural or legal persons in the parent undertaking of the group or conglomerate would result in a change of 3%, 5%, 10%, 20%, 33 1/3%, 50% or 66 2/3% of the voting rights of the parent undertaking, or if a contractual agreement would empower a natural or legal person to exert significant influence over the parent undertaking of the group or conglomerate.

#### *Assessment of acquisition*

116. In this process FINMA will assess the financial soundness and reputation of the new qualified shareholder. This may include, inter alia, the motivation and background of the acquirer, pricing and financing of the transaction, proposed restructuring, organisational changes, due diligence reports, reports on insurance, market, credit and operational risks, solvency and, if applicable, rating agencies' reports.
117. FINMA may prohibit an acquisition or disposal or impose conditions on it if the nature or extent of the holding may endanger the insurer or the interests of the insured (Article 21 (4) ISA). Prior consultation, including advance rulings under Article 31 FINMASA, is possible.
118. In the sphere of group supervision changes are only notified (there is no approval process). In the absence of an explicit ability to assess transactions prior to their announcement, FINMA may nevertheless prohibit transactions or impose conditions on them in respect of individual insurers, or in respect of groups from the perspective of their financial condition and risk management. In effect FINMA is often consulted by the supervised (parent) undertakings prior to the announcement of any material transaction. Although there is no formal

approval process, FINMA is empowered by law to impose sanctions in order to restore compliance with the law (Article 31 FINMASA).

### **Existence of provisions in relation to disposals**

119. Article 21 (3) ISA requires that anyone who intends to reduce its equity holding in an insurer with its registered office in Switzerland to below 10%, 20%, 33% or 50% of the capital or voting rights, or to change its holding such that the insurer is no longer a subsidiary company, has to notify FINMA to that effect.

### **Information obtainable from an undertaking regarding acquisitions and disposals**

120. Article 21 ISA relates to acquisitions or disposals both in terms of an insurer with its registered office in Switzerland intending to acquire an equity holding in another company, and in terms of an investor intending to purchase or sell directly or indirectly equity positions in a Swiss insurer. Under Article 21 (1) ISA an insurer with its registered office in Switzerland that intends to acquire an equity holding in another company must notify FINMA if the holding in the other company equals or exceeds 10%, 20%, 33% or 50% of the capital or voting rights. Under Article 21 (2) ISA anyone who intends to take a direct or indirect equity holding in an insurer with its registered office in Switzerland must notify FINMA in advance if the proposed holding in that insurance company will equal or exceed 10%, 20%, 33% or 50% of the capital or voting rights. In this context it is also of relevance to note that anyone who acquires or disposes of securities that are at least partially listed in Switzerland, must notify in writing the stock exchange and the company concerned when their holding exceeds (or falls below) the thresholds of 3%, 5%, 10%, 15%, 20%, 25%, 33<sup>1</sup>/<sub>3</sub>%, 50% or 66<sup>2</sup>/<sub>3</sub>% of the voting rights in that company (Article 20 SESTA). This applies indirectly to insurers insofar as they may be either the listed company or the shareholder, or if they belong to groups with a listed company (e.g. for providing information to the stock exchange).

121. As for other changes in the business plan, changes regarding qualifying holdings must be reported to FINMA and are subject to supervisory approval (Article 5 ISA).

122. In addition to the requirements outlined above, insurers have to report in their annual returns all material positions in their equity and their holdings. Each year within three months of the annual financial statements being produced, or more frequently if FINMA require it, the insurance group is to provide FINMA with a full structure chart showing all companies in the group (Article 192 ISO). According to Circular 2008/28 the minimum reporting requirements include a group organisational chart (in the form of a graph as well as a list) as well as detailed information on the creation, purchase and disposal of all holdings. Conglomerates also have to indicate if entities belong to the insurance block or the finance block of the conglomerate (Article 205 ISO). The detailed information to be provided on the creation, purchase and disposal of all relevant holdings includes the name of the entity, its address including country, the holding company within the group or conglomerate, the entity's function, its supervisory authority if supervised, and the holding in percentage terms as well as the net asset value.

123. According to Article 29 FINMASA and 47 (2) ISA FINMA may require any additional information it needs on acquisitions and disposals in a group context to be provided.

### **Existence of provisions in relation to outsourcing**

124. Contracts or other agreements that indicate under what terms functions or

activities of the insurer are outsourced, are part of the business plan (Article 4 (2j) ISA). Changes to such contracts or agreements must be reported to FINMA and are subject to FINMA's approval under Article 4 (2j) ISA in conjunction with Article 5 (2) ISA. The changes are deemed approved unless FINMA starts an examination of the changes within four weeks of receiving notification. The supervisory authority is tasked with monitoring compliance with the business plan (Article 46 ISA).

125. In general, insurers may not outsource functions to the extent that the insurer ceases to carry out any of its own functions. Under FINMA's established practice, insurers may outsource a maximum of two of the following significant functions:
- Production (product development, distribution and risk description)
  - Administration of insurance contracts
  - Settlement of claims
126. The outsourcing agreement has to be in writing and has to specify, inter alia, the following:
- duration and terms of termination of the contract;
  - precise description of the outsourced function;
  - reasons for and intended benefit from the outsourcing;
  - financial obligation for the insurance company;
  - data protection and security considerations; and
  - liability of the third party to whom functions are outsourced.
127. Operational risk resulting from outsourcing in a group context has to be addressed in line with Article 68 ISA in conjunction with Article 22 ISA. Furthermore, on a group-wide level, cost-sharing agreements are one element of the intra-group transactions (IGTs) which have to be reported to FINMA (Article 194 ISO, and Circular 2008/29).

**Ongoing assessment, approval and disclosure of relevant information (including portfolio transfers, changes to board and senior management and scheme of operation)**

128. Under Article 62 ISA all portfolio transfers from a Swiss direct insurer to another insurer must be approved by FINMA. This is not applicable to reinsurers, however the transfer of reinsurance contracts does require the consent of the ceding company.
129. From a group perspective, FINMA has to be notified if such a transfer represents a material transaction, or if it results in substantial changes to organisation, structure, risk management and solvency (Article 192 (2) ISO, Circular 2008/28).
130. Changes to the board of directors and executive management represent changes to the business plan (Article 4 (2g) ISA in conjunction with Article 5 (2) ISA). Such changes have to be reported to FINMA within 14 days of their being made. The changes are deemed approved unless FINMA starts an examination of the changes within four weeks of receiving notification. FINMA is responsible for monitoring compliance with the business plan (Article 46 (1c) ISA).
131. At group level changes to the board and senior management have to be reported to FINMA according to Article 191 (2) and (4) ISO, Art. 204 ISO respectively, and Circular 2008/27. Contrary to solo supervision criminal record checks on

managing board members are not required. Information on the structure of operation has to be reported to FINMA according to Article 191 (2) ISO, and Circular 2008/27.

### **Specificities for 172**

*Details as to existence and content of standards in respect of the undertaking's obligation to provide information on the assessment of the reputation and financial soundness of the acquirer*

132. According to Article 5 (2) ISA insurers have to notify FINMA of any changes in a qualifying holding (as defined under Article 4 (2f) ISA). This may include information on, inter alia, the motivation and background of the acquirer, pricing and financing of the transaction, proposed restructuring, organisational changes, due diligence reports, reports on insurance, market, credit and operational risks, solvency and, if applicable, rating agencies' reports. The changes are deemed approved unless FINMA starts an examination of them within four weeks of receiving notification. FINMA monitors insurers' compliance with their business plan (Article 5 (2) ISA).

### **EIOPA advice**

*Articles 172/260*

133. FINMA's processes around changes in business, management and qualified holdings provides for adequate ongoing supervision of the sound and prudent management of insurers and insurance groups. Swiss supervisory law enables FINMA to obtain a comprehensive overview of insurers and insurance groups' business plan changes. Moreover FINMA's approach to monitoring the fitness and propriety of shareholders with a qualifying holding is adequate. As a result Principles 5 and 11 in respect of the Solvency II Directive considered to be equivalent.



## **Principles 6, 7 and 12 – Solvency Assessment**

**Objective** - *The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings and groups to hold adequate financial resources.*

*The assessment of the financial position of domestic insurance and reinsurance undertakings and groups in the third country shall rely on sound economic principles and solvency requirements shall be based on an economic valuation of all assets and liabilities.*

*The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings and groups to establish technical provisions with respect to all of their insurance and reinsurance obligations towards policyholders and beneficiaries of insurance and reinsurance contracts.*

*The solvency/prudential regime of the third country shall require that assets held to cover technical provisions are invested in the best interests of all policyholders and beneficiaries taking into account any disclosed policy objective and that domestic insurance and reinsurance undertakings and groups only invest in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report.*

*The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings and groups to meet capital requirements that are set at a level which ensures that in the event of significant losses policyholders and beneficiaries are adequately protected and continue to receive payments as they fall due to a level of confidence at least equivalent to that achieved by Article 101 of Directive 2009/138/EC. Those capital requirements shall be risk-based with the objective of capturing quantifiable risks. Where a significant risk is not quantifiable and cannot be captured in the capital requirements, then that risk shall be addressed through another supervisory mechanism. The solvency regime of the third country calculation of capital requirements shall ensure accurate and timely intervention by supervisory authorities of the third country in the event that those capital requirements are not complied with.*

*The solvency regime of the third country shall require domestic insurance and reinsurance undertakings and those which are part of a group to maintain a minimum level of capital, non-compliance with which shall trigger immediate and ultimate supervisory intervention.*

*The solvency regime of the third country shall require domestic insurance and reinsurance undertakings carrying out reinsurance activities to meet the capital requirements referred to in paragraphs 5 and 6 above with own funds that are of a sufficient quality and which are able to absorb significant losses. Own-fund items considered by the supervisory authorities to be of the highest quality shall absorb losses both in a going concern and in case of a winding up.*

### **For group supervision assessments:**

*The calculation of group solvency in the third country's prudential regime shall produce a result that is at least equivalent to the result achieved by either one of the calculation methods set out in Articles 230 and 233 of Directive 2009/138/EC. The calculation shall ensure that there is no double use of own funds to meet the group*

*capital requirement and that the intra-group creation of capital through reciprocal financing is eliminated.*

## **Financial supervision**

134. There is constant interaction between FINMA and the entities it supervises, including regular or ad hoc discussions with the board of directors and the management board on all necessary supervisory topics, as necessary.
135. FINMA is an independent institution under public law and has the power to ensure that breaches of its provisions are rectified (Article 31 FINMASA). FINMA is authorised to issue binding rulings and to take specific measures in relation to supervised entities (such as the replacement of all or part of their management by an investigating agent or even the revocation of their business licence). FINMA can also trigger criminal prosecution and is authorised to carry out investigations itself or through a third party at any time.
136. Supervised entities are legally bound to submit thematic, ad hoc and periodic reporting. The most important reporting requirements for Swiss insurers are:
- An annual management report (31 December of each year), which includes the annual accounts, annual report and (if required) the consolidated accounts.
  - An annual supervisory report which includes further detailed information on the results (e.g. technical provisions, solvency margins) (Article 25 (2) ISA).
  - An annual detailed report by the external auditors to the board of directors and to FINMA (Circular 2008/41).
  - An annual Swiss Solvency Test (SST) report on "the calculation of target capital and risk-bearing capital" (Article 53 (1) ISO). Under the current regulation, insurance groups and insurance based conglomerates have to report twice a year (Articles 202 and 204 ISO). According to the proposed revision of the ISO, it is foreseen that insurance groups and conglomerates will have to report only once a year in the future, in line with requirements for solo entities. Material changes to the internal or standard model have to be reported. The SST report is subject to the principle of proportionality. The minimum level of information required includes detailed data about the target capital and the risk bearing capital. Apart from the periodic SST report, insurance companies using an internal model for the SST have to submit the methodology of the model and a full (internal) model description. Material changes to the model require a new report to be submitted.
  - An annual tied assets report together with an inventory of the assets (Article 72 (1) ISO) (not applicable to reinsurers).
  - Annual report on transactions in derivative financial instruments (Article 109 ISO).
137. Besides the periodic reporting requirements, FINMA also asks for ad hoc information in relation to particular events (such as amendments to the business plan, acquisition or disposal, merger or liquidation, intra-group transactions, departure of the actuary).
138. Furthermore FINMA also obtains information from specific examinations and on-site inspections that it conducts itself or through third parties (e.g. information about violations and irregularities, information if solvency is endangered, reports

from investigating agents).

139. Significant incidents, as defined and explained in Circular 2008/25, have to be reported immediately (from the entity and/or the auditor) to FINMA.
140. In addition, FINMA is empowered to request any further information it requires from solo or group level at any time. FINMA is also empowered to ask for information from the insurer's auditor and qualified investors. Parties carrying out significant outsourced functions for insurers also have to fulfil information and reporting obligations towards FINMA.
141. FINMA requests information which reflects the nature, scale and complexity of the business of the insurer concerned and the risks inherent in that business.

## **Valuation**

142. The SST uses a total balance sheet approach to determine own funds. Assets and liabilities are valued market consistently. The valuation has to be in line with information obtainable from liquid markets. Market-consistent values are either equal to prices directly observable in markets, or they are determined by using generally acceptable models based on well-founded financial mathematics. Assets and liabilities are valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction. The overall and fundamental principle of the SST is the market-consistent valuation combined with risk measurement. This is not based on international accounting standards where these deviate from the market-consistent valuation basis. Nonetheless it is consistent with the IAIS Core Principle 17 on Capital Adequacy<sup>9</sup>.
143. Due to its risk sensitivity and effective implementation, the SST outperforms the static and purely volume-based Swiss Solvency I rules which are of limited use for risk-management and supervisory purposes from FINMA's perspective. Therefore, Swiss Solvency I is to be retained only to the extent necessary under international agreements, namely under the Agreement between the European Economic Community and the Swiss Confederation concerning direct insurance other than the life insurance of 10 October 1989. Discussions between the EU and Switzerland are under way to adapt the Direct Insurance Agreement to Solvency II.

## **Technical provisions**

144. Insurers are required to determine technical provisions (TP) for all of their insurance and reinsurance obligations since the market-consistent SST balance sheet has to include all economically relevant liabilities. The calculation of TP has to be comprehensive, objective and based on the most recent information. Best estimate TP have to equal the expected value of discounted cash flows. Objectivity is required in terms of transparent input data for their determination. TP have to be determined on the basis of generally acceptable, recognised actuarial principles. Insurers have to document and disclose the methods applied for each TP class as well as the main results.
145. The market valuation of TP has to be based on the arm's length principle such that independent and knowledgeable partners would be willing to acquire the insurance obligations at that price. TP have to be market-consistent and consist of a best estimate and a market value margin for capital costs. This implicitly includes the requirement for an appropriate segmentation of risks as well as sound calculation processes. FINMA reviews the appropriateness of TP

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<sup>9</sup> "The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention."

calculations through a variety of different approaches including reports, on-site reviews and the model approval itself.

146. FINMA has the legal power to require insurers to increase their technical provisions and can also pursue further actions in cases of non-compliance in order to protect the interests of policyholders.
147. FINMA has implemented a circular (Circular 2011/3) which specifies technical provisions of world wide reinsurance business by Swiss entities, from a statutory and market-consistent basis. It determines principles and minimum requirements for the valuation, documentation and control of technical provisions in the reinsurance business.
148. During a period of extraordinary low interest rates and according to ISO Annex 3 para. 3, Section 3, FINMA has the power to allow other than risk-free interest rate curves for the discounting of existing commitments in the Swiss Solvency Test (SST). This is only possible for current, not for new business.
149. Due to the current difficult economic situation with continuing extraordinarily low interest rates, FINMA is using this competence at the time of this report. In the beginning of 2013, FINMA published Circular 2013/2 which allows discounting with counterparty-risk yield curves. This provides a relief within the SST calculation mainly for life insurers. Non-life insurers, insurance groups and insurance-based conglomerates are less affected. Moreover, the FINMA temporarily loosens the intervention threshold concept (see p.11 of this report: Ladder of supervisory intervention). FINMA's use of this extraordinary power is due to expire at the end of 2015.
150. In the course of these temporary adjustments, insurance undertakings have the option to discount their technical provisions either with the risk-free curve based on Government Bond yields or with the potentially more risky curve based on swap rates. There is no change in the calibration of the capital requirement or the valuation of assets.
151. FINMA is carefully monitoring the effect of the temporary adjustments and their impact on the different types of insurers. To this end, FINMA is requesting insurers to perform and submit shadow calculations without the temporary adjustments. This allows a better comparison of developments with and without the adjustments.
152. According to the FINMA Circular 2013/2 the adjustments are aimed at mitigating the valuation only of current business, not new business. The regular SST provisions in respect of new business are left unchanged.
153. Under Solvency II, the determination of the risk-free yield curve for the determination of the technical provisions is already based on the swap curve. An additional relief for undertakings is to be provided by measures of the SII LTG package. Therefore, the temporarily changes regarding the valuation of TP are acceptable from an Equivalence perspective.

### **Own funds**

154. In the SST, "Risk Bearing Capital" (RBC) (corresponding to the "own funds" in Solvency II) comprises two layers called core capital and complementary capital.
155. Core capital is defined as market value of assets (A) minus market value of liabilities (L) minus corrections plus the market value margin (MVM), which is comparable to the Solvency II risk margin:

Core Capital = A - (L - MVM) - corrections

156. "Corrections" in the above formula refers to deductions of:
- foreseen dividend payments to shareholders;
  - own shares;
  - potential immaterial funds; and
  - latent taxes for real estate in Switzerland.
157. The insurer's own credit risk cannot be taken into account in the valuation of its own liabilities.
158. In order to facilitate the calculation of the MVM, under FINMA's approach it is deducted from the market value of liabilities and is included in the target capital instead.
159. As subordinated debt is deducted as a liability in the formula above, it is not part of core capital (although it may form part of complementary capital if it meets the criteria set out below). Therefore core capital is considered to be of the highest quality with the ability to absorb losses in a going concern as well as in a winding up situation.
160. Complementary capital consists of risk-absorbing instruments (e.g. hybrid instruments) that have to be approved by FINMA on a case-by-case basis and meet strict requirements:
- a) instruments are paid-in;
  - b) instruments cannot be offset against other obligations;
  - c) subordination is contractually fixed and irrevocable;
  - d) the insurer has the right to suspend interest payments;
  - e) the notional debt and interest bear losses without triggering the cessation of the insurer;
  - f) the notional debt is not callable by the investor before the date of redemption, except in case of the liquidation of the insurer; and
  - g) redemption prior to maturity needs approval by FINMA.
161. Complementary capital is eligible to cover capital requirements subject to the following limits: the eligible amount cannot be larger than core capital for hybrid instruments with no fixed redemption date. The eligible amount of subordinated debt/hybrid instruments with fixed redemption date cannot be larger than 50% of core capital.
162. Contingent capital (referred to as "ancillary own funds" under Solvency II) is included in the complementary capital. The SST is based on a total balance sheet approach and does not distinguish between off- and on-balance positions. Any asset or liability, whether on or off-balance-sheet in accounting terms, has to be included in the SST calculations and valued market consistently either through observable market prices or a valuation model. Under normal conditions the market consistent value of a contingent position (e.g. a guarantee) is much lower than the notional amount, as the contingent position would usually be "out of the money". This is why including this amount on the SST balance sheet does not usually lead to a large impact on the RBC at the measurement date. However, in distressed situations, the market consistent value of a contingent position would increase according to the trigger conditions. This means that the market consistent value of the contingent position and thus the RBC can change substantially over the course of the following twelve months. Therefore, the main

effect of contingent positions in the SST is seen in the target capital (i.e. the "SCR") and not the RBC.

## Capital requirements

### *Calibrations of SST*

163. Under the SST, the capital requirement which is more commonly referred to as the Target Capital (TC) under the SST, is calculated to cover unexpected losses arising from existing business that correspond to the Tail Value-at Risk (Tail-VaR) of the Risk Bearing Capital (RBC) subject to a confidence level of 99% over a one-year period.
164. Specifically, the TC is defined as the sum of the discounted market value margin plus the expected shortfall resulting from the change in RBC over a one-year period at a confidence level of 99% Tail VaR.
165. Mathematically, the TC at time zero (TC<sub>0</sub>) can be expressed as:

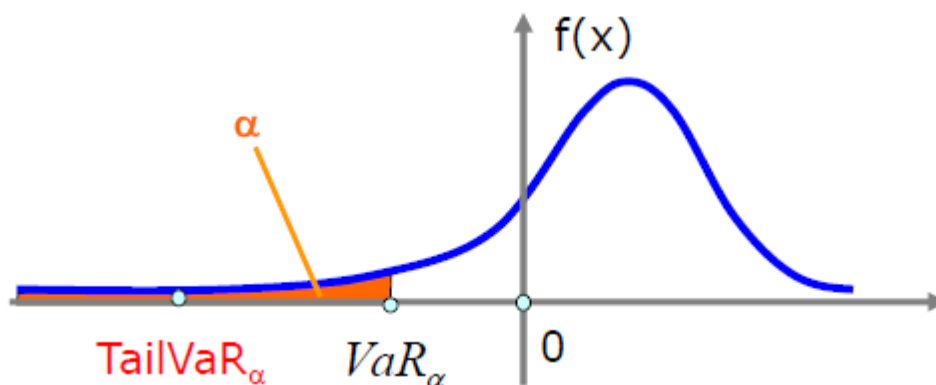
$$TC_0 = \frac{MVM_1}{1 + r_0} - ES_\alpha \left[ \frac{RBC_1}{1 + r_0} - RBC_0 \right]$$

where

- $MVM_t$  is the cost of capital at time  $t$  to cover the RBC over the lifetime of insurance liabilities.
  - $r_0$  denotes the one-year risk-free interest rate at time 0.
  - $ES_\alpha$  (Expected Shortfall) is a synonym for Tail-VaR at  $\alpha$  (i.e.  $\alpha = 1\%$  for SST) and the confidence level of  $(1 - \alpha)$  (i.e. 99% for SST) for the change in RBC.
  - RBC refers to Risk Bearing Capital which is the sum of the core capital and complementary capital to the extent that the complementary capital is eligible.
166. The SST requires the (re)insurer to have RBC at least equal to the TC. This ensures that there is enough capital at the beginning of the year such that the market value of assets is equal to or larger than the market value of liabilities over a one-year period in all situations corresponding to a 99% Tail-VaR confidence level.

### *99% Tail-VaR as opposed to 99.5% VaR*

167. A 99% Tail-VaR confidence level represents the probability-weighted average amount of all losses in the 1% tail of the probability distribution function of changes in RBC (illustrated by the orange area in the diagram below) which could be greater than (or, if there is no probability mass beyond the 1% quantile, equal to) a 1% VaR of the profit and loss distribution. Assuming the changes in RBC have a normal distribution, then a Tail-VaR subject to a confidence level of 99% over a one-year period is at least as strong as a VaR subject to a confidence level of 99.5% over a one-year period and as such, provides equivalent policyholder and beneficiary protection to the Solvency II Directive requirement.



where  $\alpha$  : equal to 1% (i.e. at a confidence level of 99%)  
 $f(x)$  : probability distribution function of changes in RBC

#### *SST risk sub-modules*

168. The SST requires the modelling of "all significant items of the market-consistent balance sheet and all relevant risks in terms of this Circular" (Circular 2008/44 Section IV), in particular market, credit and insurance risks, similar to Solvency II requirements.
169. Unlike under the Solvency II Directive, there is no "standard formula" under the SST. Instead, the SST is carried out using either the FINMA standard model or a company-specific internal model ("internal model"). The same SST requirements, in particular capital requirements calibrated to a confidence level of 99% Tail-VaR, and the modelling of market, credit and insurance risks, apply to both the FINMA standard model and internal models.

#### *Standard model: overview*

170. The standard model is a stochastic model for each of market, credit and insurance risk sub-modules. The calibrations mainly consist of:
- Distributions assumed in the modelling; and
  - Parameter estimations for the distributions.
171. The dependency structures between the different risk sub-modules as well as between risk factors for a risk sub-module are generally based on past experience and expert judgement.
172. The output of the standard model is the RBC at the reference date, a probability distribution of the change in RBC, and the resulting target capital.

#### *Standard model: modelling of risk sub-modules*

173. For market risks, the RBC is expressed as a quadratic function of 82 risk factors and the change in RBC is modelled as a function of these risk factor changes.
174. The 82 market risk factors are:
- Interest rates for CHF, EUR, USD, GBP (13 maturities) [4 x 13 risk factors]
  - Implied interest rate volatility [1 risk factor];
  - Credit spreads Europe (AAA, AA, A, BBB) [4 risk factors]
  - Credit spread US (AAA, AA, A, BBB) [4 risk factors];
  - Credit spread BB [1 risk factor];
  - Swap-Government spread [1 risk factor];

- Foreign exchange rates (EUR/CHF, USD/CHF, GBP/CHF, JPY/CHF) [4 risk factors];
- Implied FX-volatility [1 risk factor];
- Equity indices (CHF, EMU, USA, Great Britain, Japan, Pacific ex. Japan, EMU Small Cap) [7 risk factors];
- Implied equity volatility [1 risk factor];
- Hedge fund [1 risk factor];
- Private equity [1 risk factor];
- Real estate CHF (Residential, Commercial, Real estate funds) [3 risk factors];
- Participations [1 risk factor].

175. The parameters for market risk factors are estimated based on monthly returns over the most recent 10-year observation period. For interest rates and credit spreads, the absolute returns are used. For other market risk factors such as equity, real estate and exchange rates risks, logarithmic (i.e. relative) returns are used.

176. Implied volatilities are also considered. Some examples of annual volatilities used in the standard model for some of the market risk factors are set out in the tables below (Source: SST-Template as of 1 July 2014).

| Term [years] | Volatility [bps] |
|--------------|------------------|
| 1            | 66.8             |
| 2            | 72.4             |
| 3            | 73.5             |
| 4            | 75.0             |
| 5            | 75.6             |
| 6            | 75.3             |
| 7            | 74.4             |
| 8            | 72.8             |
| 9            | 72.4             |
| 10 – 12      | 72.2             |
| 13 – 17      | 75.1             |
| 18 – 24      | 73.4             |
| 25 – 50      | 74.7             |

**Table 1: EUR interest rates volatilities (as of 30 June 2014)**

| Economy           | Volatility |
|-------------------|------------|
| MSCI CHF          | 12.9 %     |
| MSCI EMU          | 17.1 %     |
| MSCI US           | 15.0 %     |
| MSCI UK           | 13.8 %     |
| MSCI JP           | 19.4 %     |
| Pacific ex. Japan | 22.7 %     |
| Small cap EMU     | 26.0 %     |

**Table 2: Equity volatilities (as of 30 June 2014)**

177. Credit risks are modelled using the Basel III standard approach which involves a factor model.

178. Life insurance risks are modelled using the same approach as for market risks. Parameters for biometric risks are based on past experience and expert judgment.

179. Non-life insurance risks are modelled using a stochastic risk model. Parameters for stochastic and parameter risks per line of business are determined based on



experience from large portfolios of business. In addition, the parameters for parameter risks also involve expert judgement.

180. Health insurance risks are modelled using a simplified version of the stochastic risk model for non-life insurance risks. Parameter estimations are determined in the same way as for non-life insurance risks.

#### *Undertaking specific parameters*

181. FINMA may allow an insurer to use undertaking specific parameters in the standard model where their use is justified in relation to the statistics and experience of the insurer, as well as in comparison with other similar portfolios of business.

#### *Additional scenario testing*

182. The modelling of market, credit and insurance risks outlined above (the analytical model) is complemented by scenario testing in accordance with Article 42 ISO. These scenarios consist of "what if" analysis of defined situations and their impacts on the market consistent balance sheet of the insurer concerned.
183. If the analytical model producing the probability distribution is considered to have inadequately or miss modelling some elements of risk, then the determined losses (subject to a minimum value of zero) arising from these scenario tests are taken into account when determining the TC by aggregating the scenario impacts to the probability distribution function resulting from the analytical model to arrive at the ultimate probability distribution function of the change in RBC. The final TC is derived by applying the risk measure (i.e. Tail-VaR 1%) to the ultimate probability distribution function.
184. The scenarios that are tested include scenarios prescribed by FINMA as well as insurer-specific scenarios which the insurer is required to define taking into account its own risk profile.
185. The FINMA prescribed scenarios include 10 financial market scenarios and twelve synthetic scenarios such as a pandemic.
186. For the insurer-specific scenarios, an insurer is required to analyse whether and to what extent the assumptions underlying its SST calculations might understate the probability of extreme events or the impact of risk concentrations on capital requirements, for example, where the credit risk is based solely on the probability of default suggested by the counterparty's rating. Where there is a risk of understatement, the insurer is required to define and evaluate additional specific scenarios for these risks.
187. In contrast, the Solvency II Directive requires an insurer to take into account scenario and stress testing in its Own Risk and Solvency Assessment – the capital requirements from these scenario and stress tests do not automatically form part of its Solvency Capital Requirement (SCR).

#### *Other risks*

188. Other main differences between the SST and the Solvency II Directive are:
189. New business risk

There is no **explicit** requirement under the SST for insurers to take into account "new business expected to be written over the following 12 months"<sup>10</sup> when calculating the TC.

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<sup>10</sup> Article 101(3) of Solvency II Directive.

However the SST explicitly requires insurers to take into account “*all significant items of the market-consistent balance sheet and all relevant risks in terms of this Circular*” (Circular 2008/44 Section IV).

An insurer will need to consider any material risks arising from new business that is expected to be written when conducting the SST. Where there is a material risk, the insurance company is required to define and undertake additional scenario testing specific to its new business risk.

To this end, we conclude there is a similar requirement under the SST for insurers to take into account “*new business expected to be written over the following 12 months*” in their SST calculations.

#### 190. Operational risk

There is no explicit requirement under the SST for insurers to take into account the quantification of capital requirements for operational risks.

Operational risks are generally addressed qualitatively in the risk management processes of the insurer, including its corporate governance and internal control systems. For example in an outsourcing agreement, an insurance company is required not only to assess the service reliability of the potential service provider but also the corporate governance and risk management system of the service provider to ensure that the service provider will be able to fulfil its obligations, including contingency planning for unexpected events.

Where a material operational risk is identified, FINMA will require the insurer to define and undertake additional scenario testing specific to that operational risk and/or impose a capital add-on on the insurer.

The launch of the SQAII Risk Management modules which started in the second quarter of 2011, has probed into issues such as:

- How the insurer addresses operational risk organisationally and the performance goals that are set, with a focus on the work of the board of directors and each of the key control functions.
- The specific strategies and systems the insurer pursues to ensure effectiveness in its corporate governance, risk management and internal control systems.
- The kinds of risks that are monitored, assessed and reported as part of operational risk.
- The methodologies used for the identification and assessment of operational risk and whether the insurer quantifies operational risk. This also includes looking into how past loss events are taken into account and in the modelling. Insurers are also asked to indicate how operational risk is taken into account in stress testing and scenario planning.
- The kind of reporting made to management and to the board of directors on operational risk, including the statistical data that is collected and reported.
- How an insurer operationalises business continuity and crisis management and how it addresses various compliance topics, such as internal fraud, money laundering, insider trading and employee reporting (whistle-blowing).

Operational risk was a main component of the SQAII, which was designed to provide a 360<sup>o</sup> assessment of the risk management of an insurer from different risk functions including the risk manager, the compliance officer, the internal

auditor and a board member, who are each required to provide and certify their respective assessment and views. The SQA in general is expected to be a perpetual but evolving supervisory tool.

SQAII was a "risk-based" exercise and as such, did not cover all insurers. The selection of insurers for SQAII was based on FINMA's internal risk rankings for insurers as well as other considerations including, particular corporate governance structures, risk management practices, internal control systems or other concerns that FINMA may have about an insurer. In addition, a number of additional insurers was selected at random, which included reinsurance captives.

The fact that an insurer was not selected initially in 2011 for SQAII does not mean that it may not be selected later. FINMA may also request from an insurer at any time, information regarding matters involving corporate governance, risk management and/or internal control system. In addition, FINMA may ask the board of directors of an insurer to provide FINMA with a certification of the insurer's corporate governance, risk management and internal control systems and strategies, and in some cases, FINMA may require independent verification of that, whether in general or on specific issues.

A report<sup>11</sup> containing FINMA's observations gathered from SQA II was published last year. FINMA observed evidence of greater awareness among many insurers of the need to pursue a more pro-active and systematic approach to operational risk and a more disciplined approach to operational risk as a distinct risk category.

#### *Risk mitigation techniques*

191. An insurer is required to take into account all legally binding and enforceable risk transfer instruments in its SST balance sheet.
192. In particular, capital and risk transfer instruments such as loans, guarantees and reinsurance contracts are frequently used among legal entities of a group. As such, the correct modelling of these instruments, and their impacts on the RBC and TC of the individual legal entities in line with the valuation and risk modelling principles of the SST, are of particular significance to FINMA. All relevant risks such as counterparty default risk (e.g. in the case of a legally binding and enforceable guarantee from another legal entity of the group) and increased risk to policyholders (e.g. in the case of a legal entity of a group that acts as the reinsurer for an internal reinsurance arrangement) are to be taken into account in line with the SST principles.
193. Where a risk transfer instrument leads to a risk concentration, such as an 80% quota share reinsurance agreement with a single reinsurer, FINMA is likely to restrict the eligibility of the risk transfer instrument.
194. Management actions may also be taken into account in the SST calculations where appropriate. Management actions used in the SST calculations must be signed off by the senior management of the insurer as being realistic, and disclosed in its SST report. FINMA may ask an insurer to justify the management actions assumed in its SST calculations using tools such as supplementary scenario/stress tests to assess their reasonableness and impact.

#### *Frequency of SST calculations and reporting*

195. An insurer must determine and report its TC and RBC at least once a year (Circular 2008/44 Section VIII §71). For an insurer belonging to a group, the TC and RBC must currently be calculated and reported at least once every 6 months

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<sup>11</sup> <https://www.finma.ch/e/finma/publikationen/Lists/ListMitteilungen/Attachments/56/finma-mitteilung-46-2013-e.pdf>

at the beginning of each half year (Circular 2008/44 Section VIII §72). With the revision of the ISO, it is foreseen that insurance groups and conglomerates will have to report only once a year in future, in line with requirements for solo entities. FINMA may also require insurers to calculate and report the SST more frequently under certain circumstances, for example where there is a material change to the risk profile of the insurer.

#### *Monitoring of SST compliance*

196. FINMA requires insurers to monitor their compliance with the SST requirements on an on-going basis. This is set out in Article 46 ISA which states that FINMA “may call upon third parties at any time to check compliance with the law” by the insurer.
197. An insurer is required to report significant losses to FINMA in accordance with Circular 2008/44 Section XIV(A).
198. Where there is a material change to its risk profile, an insurer is required to submit an interim SST as required under Circular 2008/44 Section XIV(B) and Article 51(2) ISO.

#### *Ladder of supervisory intervention*

199. Under the SST, the SST ratio<sup>12</sup> is used by FINMA as a monitoring tool to identify deteriorating financial conditions in an insurer (Circular 2008/44 Appendix 4).
200. The SST ratio of an insurer determines its supervisory zone (green, yellow, amber or red) and the corresponding degree of supervisory intervention:
- If the SST ratio is 100% or more, there will be no supervisory intervention – i.e. the insurer will be subject to normal supervisory monitoring.
  - If the SST ratio falls below 100%, the intensity of supervisory intervention and the intrusiveness of supervisory actions will increase as the SST ratio decreases.
  - If the SST ratio falls below 33%, the insurer will be required to take immediate actions to restore the SST ratio, the failure of which will trigger FINMA to revoke its licence.

The ladder of supervisory intervention for the different zones, as determined by specific thresholds based on the SST ratio, is summarised in the table below.

| <b>Threshold (SST ratio)</b> | <b>Zone</b> | <b>Supervisory Intervention</b>   |
|------------------------------|-------------|---|
| ≥ 100%                       | Green       | None<br><i>Note all transactions directly resulting in the SST ratio falling below the thresholds are subject to approval.</i>  |
| 80% ≤ T < 100%               | Yellow      | FINMA will intensify risk dialogue with the insurer with the objective of mitigating the increased risk. Possible actions include:<br><br>a. Causal analysis and action plan to be submitted by the insurer. The action plan, to be based on realistic assumptions, is subject to approval by FINMA and shall establish in a binding manner the content and |

<sup>12</sup> SST ratio calculated as RBC divided by TC expressed in percentage (i.e. SST Ratio = RBC / TC)

|               |       |  |
|---------------|-------|--|
|               |       | <p>timing of the actions to improve solvency – the Green Zone is generally to be achieved within one year. The action plan to be submitted within 2 months of the underfunding being detected.</p> <p>b. Approval requirement pertaining to certain transactions that will reduce the RBC in general such as dividend payments, capital repayments, voluntary repayments of the company’s own loans, intra-group transactions including the issuing of guarantees and distribution of with-profit bonuses to policyholders.</p> <p>According to Circular 2013/2 (“Temporary adjustments to the Swiss Solvency Test”) FINMA decided not to prohibit paying dividends or surpluses for a yellow-zone-insurer when there is an action plan which is already approved by FINMA. This exception is valid until the end of 2015.</p> <p>c. Other further measures taking the insurer’s situation into account such as audits conducted by external experts to verify the valuation in terms of the market-consistent balance sheet or the appropriateness of the procedure followed in determining the TC, additional reporting and supplementary stress/scenario tests.</p>   |
| 33% ≤ T < 80% | Amber | <p>FINMA may tighten the Yellow Zone measures where applicable and/or initiate further actions including:</p> <p>a. Restructuring plan to be submitted by the insurer that will return the insurer to the Yellow Zone within 2 years and the Green Zone within 3 years. The restructuring plan must also show which of the insurer’s risks will be immediately reduced by which methods, as well as the impact of various scenarios (including negative scenarios) on its effectiveness.</p> <p>b. Other further measures may include:</p> <ul style="list-style-type: none"> <li>• Ordering an extraordinary liquidity plan to be prepared.</li> <li>• Making particularly risky new business and renewals subject to approval. Prohibiting new and renewal business.</li> </ul> <p>According to FINMA-Circular 2013/2 (“Temporary adjustments to the Swiss Solvency Test”) FINMA decided not to prohibit new and renewal business for an amber-zone-insurer when there is an action plan which is already approved by FINMA. This exception is valid until the end of 2015.</p> <ul style="list-style-type: none"> <li>• Prohibiting risky and complex transactions where it is not ensured that they serve to improve the SST ratio.</li> </ul> |

|           |     |  |
|-----------|-----|--|
|           |     | <ul style="list-style-type: none"> <li>• Having an insurer carry out organisational changes and having more in-depth controls, monitoring, reporting and audits performed by internal audit.</li> </ul>  |
| Below 33% | Red | <p>An insurer must take immediate actions to protect the interests of the policyholders. It has to be apparent to FINMA within a short period of time whether the actions initiated by the insurer are likely to lead to success.</p> <p>Such immediate actions include:</p> <ul style="list-style-type: none"> <li>• Immediate increase of the RBC or reduction of the TC.</li> <li>• Voluntary transfer of the entire insurance portfolio.</li> <li>• Partial transfer of the insurance portfolio, resulting in the SST ratio being out of the red zone subsequent to the transaction.</li> </ul> <p>Where it is not possible for an insurer to initiate suitable measures and where the measures ordered by FINMA do not lead to success in the short term either, FINMA will revoke the insurer's licence.</p> |

The ladder of supervisory intervention based on the risk-based SST ratio thresholds ensures appropriate and timely action by FINMA to protect the interests of policyholders. In particular, the risk-based SST ratio thresholds of 100% and 33% are equivalent to the SCR and Minimum Capital Requirement (MCR) thresholds under the Solvency II Directive.

201. As a second measure of the temporary adjustments to the SST, FINMA is relaxing the supervisory intervention ladders (cf. FINMA-Circular 2013/2). FINMA alleviates measures in place to counteract the undershooting of defined threshold

values under the SST Circular and will grant the companies longer deadlines to again reach the target threshold values. For instance under certain conditions, FINMA will refrain from banning an insurance company from making dividend payments and distributing surplus participation to policy holders if its SST ratio is between 80% und 100%. Moreover, companies with an SST ratio of over 60% may, as prescribed in the Circular 2013/2, continue to write new business if they adhere to certain conditions.

202. As indicated in the table above, FINMA as well as the SII regime tolerates some situations when an undertaking temporarily falls below the prescribed capital requirement (SII: SCR, SST: TC) as there is no automatic prohibition of dividends or surplus payments to policyholders. The measures below the minimum capital requirement will remain unaffected.

#### *Absolute minimum capital requirement*

203. The absolute minimum capital requirements (minimum capital) for insurers are set out in Articles 7-9 ISO and vary according to the lines of business conducted: between CHF 5 million and CHF 12 million for life insurers, CHF 3 million and CHF 8 million for non-life insurers, CHF 3 million for insurance captives and CHF 10 million for professional reinsurers. Where an insurer is licensed for more than one branch of insurance (i.e. line of business), the minimum capital is the highest of the different branches. Under current exchange rates (approximately EUR1 = CHF1.21 as of October 2014), these are higher than the Solvency II requirements in all cases. A slightly lower requirement might be possible under the Swiss regime for certain composites, however there are currently no Swiss insurers with the combination of licences that would permit this. We also note that under Article 10 ISO FINMA is empowered to deviate from these amounts if justified by particular circumstances, so long as the minimum capital remains between CHF 3 million and CHF 20 million.

#### *Enforcement measures*

204. FINMA has the supervisory powers to take necessary and appropriate actions if insurers fail to comply with the SST or if the interests of policyholders are threatened. These powers are in particular set out in Articles 31 et seq. FINMASA and Articles 51 et seq. ISA and Circular 2008/44.

205. Enforcement measures that FINMA could take include:

- block an insurer's free access to its own assets;
- order the deposit of assets or block them;
- assign powers entrusted to an executive body of an insurer to a third party in full or in part;
- transfer the insurance portfolio and the associated tied assets to another insurer subject to the latter's agreement;
- order the realisation of tied assets; and
- demand the dismissal of persons entrusted with the direction, supervision, control or management of the insurer, of the person(s) with general power of attorney or of the accountable actuary, and ban them from exercising further insurance activities for a maximum of five years.

For example,

- If there is non-compliance by the executive body of an insurer, FINMA will have the power to assign the powers entrusted to these governing bodies to a third party in full or in part.

- If the responsible governing bodies of an insurer do not carry out the actions ordered by FINMA when the insurer is in the Yellow, Amber or Red Zone such that there is a continued risk to the interests of policyholders and beneficiaries, FINMA will have the power to dismiss the respective person(s).

## **Internal models**

### *Use of internal models*

206. By default, an insurer would use the FINMA standard model except where the FINMA standard model is deemed inappropriate, in which case FINMA may require the insurer to use an internal model or the insurer may apply for approval to do so on its own initiative. Insurance groups, reinsurers (excluding reinsurance captives) and most life insurers are required to use an internal model. As at May 2011, 70 (out of 140) insurers have applied to use an internal model for SST calculations. FINMA takes the view that for many of the small and mid-sized non-life insurers the corresponding standard model is deemed appropriate.

### *Change policy*

207. In accordance with Circular 2008/44 Section VIII(H)(d), an insurer must submit to FINMA any and all material changes to its internal model for approval. The insurer must submit the associated documentation for the model changes. Where there are material changes to the internal model, the impact of these changes on the SST calculations has to be assessed and documented. The details of FINMA's model change policy are spelled out in a corresponding guideline.

208. In addition, FINMA will also verify on a regular basis whether general advances in modelling methods have been taken into account in an internal model. If necessary, FINMA may require that the internal model be adapted in line with such advances.

### *Pre-approval*

209. An internal model that is used by an insurer for SST purposes requires the prior approval of FINMA as set out in Circular 2009/44 Section VIII(H)(a). Such approval may take the form of qualified approval subject to terms and conditions.

210. Where an application for an internal model approval has been made and there is sufficient and detailed documentation of the internal model, the insurer may use the internal model on a provisional basis unless otherwise advised by FINMA, during FINMA's review period until an official approval is issued by FINMA.

211. As part of the provisional use of the officially unapproved internal model, FINMA may impose a capital add-on on the insurer where appropriate.

212. Based on our meeting with FINMA during our on-site visit, we understand that, provided a certain quality level is assured, FINMA is comfortable with an insurer using a provisional internal model for an interim period until the definitive model is approved. This requires that the insurer has been engaging with FINMA on its internal model developments, and as such, FINMA is familiar with the model even if there is no final approval yet. For each individual case, it is FINMA's midterm goal to reach a formal decision on the internal model application. Where FINMA perceives weaknesses in a provisional internal model, FINMA may require the insurer to define and undertake additional specific scenario testing and improvements in relation to model risks and/or impose a capital add-on. Where there are material weaknesses, FINMA will prohibit the use of the provisional internal model.



213. In view of the principle underlying the Solvency II Directive requirement that an internal model used for the calculation of capital requirements should be subject to prior supervisory approval, which is to ensure that the internal model provides policyholders and beneficiaries with protection at the same level of confidence as that provided under the standard formula, we are satisfied that FINMA has requirements that are equivalent to the Solvency II Directive requirements. Nevertheless, it is our view that more specific and articulated controls and governance around the use of provisional internal models would be beneficial as part of best practice.

#### *Use test*

214. An internal model used for SST purposes has to be an integral part of the risk management system and strategic decision-making process of the insurer, in view of its impact on the TC, RBC and SST ratio, and the corresponding ladder of supervisory intervention.

215. In particular, Circular 2008/44 Section X(B) requires senior management and the board of directors to have sufficient understanding of the risk internal model, its outputs and its limitations, in order to be able to gauge the implications of the internal model with regard to the insurer's risk management and capital requirements. In particular, they must know and take into account the results of the internal model in their decision-making.

#### *Statistical quality standards*

216. Circular 2008/44 Section VIII(H)(b)(aa) sets out the principal requirements for the statistical quality standards of an internal model which include:

- An insurer is required to model all its significant positions and take into account all the relevant risks pursuant to the Circular. To this end it must show the risks to which it is exposed and which relevant risks result from the individual positions and their interaction.
- Future unknown quantities such as the value of a risk factor, a position, a financial instrument or the RBC at the end of the year are to be modelled stochastically. In particular, the risk model has to establish the common distribution function of these risk factors, define the functional dependence between the risk factors, the positions and/or the financial instruments, and enable the probability distribution function of the loss of RBC during the year to be determined.
- The methods for determining the probability distribution of the RBC have to be based on sound actuarial and financial mathematical methods. The choice of the common distribution functions of the risk factors and the calibrations of this distribution function have to be based on realistic and credible assumptions. The modelling of dependencies between the risk factors also has to be taken into account.
- The change in the market-consistent valuation of assets and liabilities in relation to the underlying risk factors has to be explained (risk factor mapping).
- The risk factors and the estimation methods used for their distribution parameters must be shown.
- When modelling is done in sub-modules, the aggregation of the sub-modules or the results from the sub-modules have to be explained.
- Model parameters are to be determined applying sound statistical estimation methods.

- The data used must be complete, correct and timely. Where too little relevant data is available, expert opinions may be used. FINMA may require an insurer to apply more prudent parameters, where the parameters used previously are not deemed sufficiently suitable for modelling its risks.
- The dataset used and the parameters derived from it must be verified at least once a year prior to undertaking the SST calculations, taking into account materiality, and updated as necessary.

#### *Validation standards*

217. An insurer is required to review and validate at regular intervals the suitability and appropriateness of its internal model taking into account its risk profile, and its compliance with the SST requirements in general, as set out in Circular 2008/44 Section X(C).
218. The findings of the review are to be communicated to the board of directors or senior management.

#### *Documentation standards*

219. Circular 2008/44 Section VIII(H)(d) requires an insurer to provide FINMA with self-contained documentation of their internal model which will enable a knowledgeable third party to ascertain, in a reasonable amount of time, whether the regulatory requirements for approval of the internal model are satisfied.

220. The documentation should:

- Describe the various internal model modules and the interactions between those modules;
- Explain the methodology (theories and assumptions) on which the internal model is based, and its implementation within the insurer;
- Describe the limitations and weaknesses of the internal model;
- Indicate which positions and financial instruments or risks have not been taken into account;
- Delineate the empirical basis of the internal model. In particular, it must describe the manner in which the model parameters have been estimated, and how the datasets and other information sources have been used in the process;
- Demonstrate whether the insurer, based on its own assessment, complies with the calibration test as well as the methodology and parameter tests; and
- Demonstrate the manner in which the data quality, and in particular the quality of information pertaining to positions and exposures, is ensured.

#### *Profit and loss attribution*

221. There is no explicit SST requirement for profit and loss attribution.

222. However there is an implicit requirement for profit and loss attribution under the SST, with a profit and loss attribution being implicitly required in:

- The insurer's explanation of the change in the market-consistent valuation of assets and liabilities in relation to the risk factors (Circular 2008/44 Section VIII(H)(b)(aa)(§120));

- The analysis of the datasets and parameters used, which an insurer is required to undertake at least once a year (Circular 2008/44 Section VIII(H)(b)(aa)(§123)).

It is our view that explicit requirements for profit and loss attribution would be beneficial as part of best practice.

#### *Partial internal model*

223. In accordance with the Guidelines on SST modalities dated 1 March 2012, an internal model application has to specify and contain:

- The names of all of the legal entities for which the (partial) internal model is to be used.
- The modules and risks which are covered by the (partial) internal model.
- The reasoning explaining why and how the insurer believes that the organisational, qualitative and quantitative requirements in respect of an internal model are fulfilled.

224. In addition to requiring insurers to consider the dependencies between risks as part of their SST calculations, in the case of partial internal model applications FINMA will check as part of its internal model approval process:

- whether in the internal model part the risks are reasonably well captured; and
- whether the standard model is able to allow for the remaining risks.

225. FINMA may also require the insurer to undertake additional scenario testing specific to model risks.

226. An insurer which uses an approved internal model for its SST calculations may not replace the internal model with the FINMA standard model unless the insurer has submitted sufficient justification for this replacement to FINMA and FINMA has approved the replacement as set out in Circular 2008/44 Section VIII(H)(c).

#### **Investments**

227. Swiss-domiciled insurers must be organised in a way that ensures that all material risks are appropriately measured, identified, monitored and mitigated as well as reported upon (Article 22 ISA, Articles 96-98 ISO and Circular 2008/32). In addition, investment risks are more specifically covered in the context of the business plan to be submitted by undertakings. This encapsulates the organisation of risk management, investment strategy, investment process and management as well as maintaining the solvency position of the undertaking.

#### *Investing prudently*

228. Under the general principles regarding investments, Swiss-domiciled insurers must submit their investment guidelines for approval (Article 4 (2d) ISA). FINMA's assessment takes into account the prudent investor rule and considers common practices in modern portfolio management. Tied asset rules only apply to insurers writing direct insurance business. For reinsurers FINMA may decide, in view of the reinsurer's risk capacity and/or the aspects considered in its assessment of the insurer's investment guidelines, to impose limits on certain investments, categories or structures, possibly in combination with additional reporting requirements. In recent years there have been several cases where such measures were applied.

## *Derivatives*

229. The use of derivative instruments is restricted to a) the reduction of risks arising from investments and/or from liabilities towards policyholders, and b) the efficient management of investments (Article 100 (1) ISO).

## *Risk concentration*

230. If without a particular risk mitigation instrument or asset an insurer's SST ratio would be below 80%, that position is regarded as constituting a concentration and FINMA is likely to restrict the instrument or asset's eligibility to meet the SST. For reinsurance captives there are high capital charges for exposures to counterparties exceeding 10% of available economic capital. Exposures exceeding 30% of available capital are charged with 100% of underlying capital.

231. Direct insurers are required to secure claims arising from their insurance contracts by means of tied assets. There are no tied assets requirements for reinsurers or at group level. Under the tied assets requirements there are explicit quantitative limits on risk accumulation and risk concentration. Counterparty risk exposure and unhedged foreign currency exposure are restricted. Furthermore, asset allocation has to consider the undertaking's liquidity needs. As a basic principle, tied asset investments have to be highly liquid compared to other assets in the same asset class.

232. For each asset class a number of qualitative (economic and legal) restrictions apply. In a quantitative sense an explicit limit system applies to investments in stocks, securitised debt, real estate, mortgages, alternative investments and derivatives other than for hedging purposes. There are also limits within the asset classes for diversification purposes. Securities lending is allowed but restricted.

## **Specificities for 172**

### **(I) Reinsurance captives**

#### *Overview*

233. Reinsurers captives are not currently covered by the full SST. Once the pending ISO revision enters into force in 2015 it is anticipated that reinsurance captives will be fully subject to the same SST requirements as other insurers without any exemption.

#### *Size of reinsurance captive market*

234. The size of the reinsurance captive market is fairly small at around 2.2% to 3.1% of the overall total reinsurance market, based on the latest available data at year end 2012 and 2013<sup>13</sup>. The figure increased in 2013, since a new reinsurance captive was licensed. Given the complexity and the size of its risk profile the company is subject to the SST. Most of the reinsurance captives are relatively small in comparison to the overall reinsurance market in Switzerland, with the largest reinsurance captive only making up around 0.4% to 1.2% of the overall total reinsurance market by total assets and total gross premiums respectively. The table in §235 below sets out further details on the position of reinsurance captives in the market as at the end of 2012 and 2013.

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<sup>13</sup> 2013 figures are indicative preliminary figures still to be finalised and officially published by FINMA.

235.

**2012 market information of reinsurance captives compared to all reinsurance companies**

| No. of reinsurance captives as at Dec 2012 (to insert data date) | Total gross reinsurance premiums written – reinsurance captives (CHF) | Total gross reinsurance premiums written – reinsurance market (CHF) | Total assets – reinsurance captives (CHF) | Total assets – reinsurance market (CHF) | Total Technical Provisions – reinsurance captives (CHF) | Total Technical Provisions – reinsurance market (CHF) |
|--|---|---|---|---|---|---|
| 35 (ALL)   | CHF 753m<br>(2.2%)  | CHF 34'817m<br>(100.0%)   | CHF 2'700m<br>(2.0%)                      | CHF 135'626m<br>(100.0%)                | CHF 1'580m<br>(2.1%)                                    | CHF 74'119m<br>(100.0%)                               |
| 2 (reinsurance captives that are not exempted from SST)          | CHF 417m<br>(1.2%)  | CHF 34'817m<br>(100.0%)   | CHF 701m<br>(0.5%)                        | CHF 135'626m<br>(100.0%)                | CHF 586m<br>(0.8%)                                      | CHF 74'119m<br>(100.0%)                               |
| 1 (largest reinsurance captive)                                  | CHF 401m<br>(1.2%)  | CHF 34'817<br>(100.0%)  | CHF 665m<br>(0.5%)                        | CHF 135'626m<br>(100.0%)                | CHF 561m<br>(0.8%)                                      | CHF 74'119m<br>(100.0%)                               |

**2013 market information of reinsurance captives compared to all reinsurance companies**

| No. Of reinsurance captives as at Dec 2013 (to insert data date) | Total gross reinsurance premiums written – reinsurance captives (CHF) | Total gross reinsurance premiums written – reinsurance market (CHF) | Total assets – reinsurance captives (CHF) | Total assets – reinsurance market (CHF) | Total Technical Provisions – reinsurance captives (CHF) | Total Technical Provisions – reinsurance market (CHF) |
|--|---|---|---|---|---|---|
| 34 (ALL)   | CHF 1 149m<br>(3.1%)  | CHF 36'845m<br>(100.0%)   | CHF 3'865m<br>(2.9%)                      | CHF 134'064m<br>(100.0%)                | CHF 1'670m<br>(2.2%)                                    | CHF 75'878m<br>(100.0%)                               |
| 3 (reinsurance captives that are not exempted from SST)          | CHF 868m<br>(2.4%)  | CHF 36'845m<br>(100.0%)   | CHF 2'276m<br>(1.7%)                      | CHF 134'064m<br>(100.0%)                | CHF 1'224m<br>(1.6%)                                    | CHF 75'878m<br>(100.0%)                               |
| 1 (largest reinsurance captive)                                  | CHF 456m<br>(1.2%)  | CHF 36'845<br>(100.0%)  | CHF 845m<br>(0.6%)                        | CHF 134'064m<br>(100.0%)                | CHF 722m<br>(1.0%)                                      | CHF 75'878m<br>(100.0%)                               |

236. The number of reinsurance captives has also decreased in recent years, in part due to FINMA imposing more stringent supervisory requirements since the implementation of the ISA, which also applies to reinsurance captives. At the end of 2013, there were 34 reinsurance captives compared to 42 at the end of 2009. Over the same time period, there were 28 professional reinsurers at the end of 2013 compared to 26 at the end of 2009.

**(II) Tied assets**

237. There are no tied assets requirements for reinsurers. Tied asset rules only apply to insurers writing direct insurance business. For reinsurers, FINMA may decide, in view of the reinsurer's risk capacity and/or risk management considerations, to impose limits on certain investments, categories, or structures, possibly in combination with additional reporting requirements. In recent years there have been several cases where such measures were applied.

238. As there are no tied asset requirements under Solvency II, the absence of tied asset requirements for reinsurers is not inconsistent with the Solvency II requirements.

239. The actions that FINMA has taken in recent years are in line with prudent person requirement under Solvency II.

### **Specificities for 227**

240. Every single entity has to prepare an economic balance sheet under the SST.

241. That balance sheet lists assets and liabilities at market consistent values. The SST is considered equivalent as regards principle 6. So, if the solvency of the group in Solvency II is determined by the deduction and aggregation method, the capital requirements and own funds as laid down in the SST would be suitable for the group calculation.

### **Specificities for 260**

#### *Overview*

242. The solvency of a Swiss insurance group is currently measured by the group SST and the group Solvency I calculation. Once the revised ISO has entered into force, the solvency of an insurance undertaking will solely be assessed by means of the SST. The Solvency II directive prescribes two methods of assessing group solvency. That is, Method I: accounting consolidated-based method and Method II (Alternative method): deduction and aggregation method. Differing from both Solvency II methods the group SST represents a granular approach (Circular 2008/44), that is, one which results in a set of requirements for the group's various legal entities, rather than a single result for the group as a whole. Insurance groups under FINMA group supervision have to determine the TC and RBC in principle for each legal entity of the group i.e. to perform an SST for each member of the group, including the ultimate parent. This applies for entities in Switzerland as well as in other jurisdictions. It should also be noted that all Swiss Insurance groups are required to calculate TC and RBC using an internal model.

243. As a possible efficiency gain FINMA can grant approval to combine some legal entities into a cluster within the SST group model (Appendix 2, Circular 2008/44). Generally, such clustering occurs between entities within a single country as unlimited fungibility and transferability of funds within a cluster is assumed.

244. In the group SST the group is not considered as one single entity and as such there is no single group TC or RBC. However, FINMA can request that a group calculate an SST group capital requirement based on the consolidated accounts of the group (Appendix 2, SST Circular). The majority of the large groups in Switzerland already produce and submit the SST requirements based on the consolidated accounts in addition to the granular SST requirements.

245. One element of the granular SST is the SST result of the ultimate parent. This SST of the parent considers all the assets, liabilities and risks of all operations in the group as is done in the consolidated group solvency calculation. One of the key differences from the consolidated group solvency calculation is that the SST of the parent entity allows limited liability. In addition, unlike the consolidated calculation the SST of the parent contains the effect of all intra-group transactions (if they are relevant from a risk or capital perspective).

#### *Double-gearing*

246. In the granular SST calculations, double gearing is not eliminated but rather is represented appropriately in the capital requirements of the entities involved. This appropriate representation lies in the market consistent basis for valuation of subsidiaries and capital transfer instruments (loans and hybrid loans) and the simultaneous modelling of changes in the entities' RBC over one year. That is,

the granular approach examines the solvency of each individual entity but unlike a solo calculation it models the intra-group transactions in each participating entity within the group simultaneously. An intra-group transaction is effectively modelled in each entity as if it were a transaction with a third party. This means that once an item is “consumed” in one entity, it can’t be used anymore in the granular SST of another entity thus avoiding double gearing because it would there be the subject of a 100% capital charge.

247. In addition, unlike the group calculation under Solvency II (method II) the SST of the parent does not add the RBC of a subsidiary to the RBC of the parent company (in which case the intra-group arrangements must be eliminated). The RBC of the subsidiary is instead part of the RBC calculated for the parent as the SST of the parent contains as an asset the economic net asset value of the parent entity’s participations in other group entities. This allows the issue of internal creation of capital within the group to be addressed.

#### *Group capital fungibility and transferability*

248. In the SST granular approach two assumptions are applied:

- Upstream fungibility/transferability: a parent can sell a subsidiary at market price. That is, to get liquid assets it is not necessary for the parent to take assets or capital out of the subsidiary, something which may be restricted by laws, capital requirements, rating agencies and other factors. Thus the SST assumes full upstream fungibility/ transferability.
- Downstream fungibility/transferability: The SST assumes that in both normal and stressed situations a subsidiary does not get more capital than what has been agreed in a legally binding contract such as a guarantee or reinsurance contract.

249. It should be noted that within clusters full transferability and fungibility is assumed. Therefore, FINMA considers the appropriateness of this assumption in approving the clustering of entities for the SST calculations.

#### *Solo deficits*

250. Group solvency is assessed based on the information provided in the set of SST ratios for the group entities, therefore solo deficits will be clearly visible at group level. In addition, if a subsidiary shows a SST ratio of less than 100%, then this situation might be visible in the balance sheet of the parent (in the form of that subsidiary having a low net asset value) and in the target capital of other entities which have in place an intra-group transaction with that subsidiary.

#### *Risk mitigation techniques and diversification*

251. At present, the group SST has to be performed twice a year (Article 202 ISO). With the revised ISO, it is foreseen that insurance groups and conglomerates will have to report only once a year in future, in line with requirements for solo entities. A key characteristic of the granular group SST is that the effect of capital and risk transfer instruments (be it group internally or with external counterparties) are captured in the calculation of the individual RBC and TC. From that it follows that risk mitigation techniques such as reinsurance cover and guarantees are allowed for in the TC under certain circumstances. Reinsurance cover would typically reduce the TC of the cedent and increase the TC of the reinsurer.

252. In terms of diversification the key beneficiary in the SST granular approach is the parent company. Subsidiaries are assets of the parent which have a value and a

risk. That is, they contribute to the available capital and the target capital of the parent. Therefore, there is diversification between these assets to the extent to which the values of the subsidiaries would not move in parallel.

#### *Group risks*

253. If FINMA believes that in particular cases there is a need to assess the group solvency also with an SST on a consolidated basis it has the right to request the group to produce this. The group SST and Solvency II both aim to capture all risks in an insurance group, including the risk that only emerges because there is an insurance group. They differ in the sense that Solvency II requires a single solvency capital requirement considering the group as one economic entity, while the group SST follows the internal legal structure of group together with the internal transactions to derive a set of capital requirements for the entities of the group, with the possibility of supplementing this with an SST on consolidated accounts for specific groups where necessary.
254. In terms of contagion risk, the risk of having to support other entities in the group would be taken into account only insofar as there were legally binding agreements between entities. Reputational risk is not captured in the SST (though elements relating to compliance and other relevant aspects are covered from a qualitative perspective under the Swiss Qualitative Assessment). Concentration risk is captured in the SST and companies are required to report on it as part of the SST reporting requirements. Furthermore, supplementing this is the requirement that groups report on concentration risk to the supervisory team (separate to the SST reporting).
255. The technical result of the group SST is a collection of solvency ratios as opposed to a single ratio as is produced under the two methods prescribed under Solvency II. However, the group SST can be described as a group-wide model as it simultaneously models each entity within a group incorporating the mutual interactions between each entity including intra-group transactions and internal ownership.

#### *Group internal model*

256. As a stand-alone jurisdiction, Switzerland performs group supervision under applicable Swiss law. This also means that group internal models are approved on a unilateral basis under Swiss law, rather than through a formal college decision based on Solvency II. There is a lot of exchange and discussion with the other supervisors involved, however. In terms of such engagement the key requirements from FINMA's perspective are the rules on cooperation and information exchange, including the guarantee of professional secrecy.

#### *Joint inspections*

257. To date FINMA has not conducted joint inspections in Switzerland. FINMA representatives stated they are very open to conducting such inspections as part of international cooperation as set out under Articles 42 and 43 FINMASA.

#### *Non-compliance with minimum capital requirements by entity within group*

258. FINMA would not take direct action against a subsidiary in another jurisdiction. It would expect that this action would be taken by the local supervisor, possibly after consultation with FINMA, but most probably according to the rules of the local solvency regime. However, FINMA could take supervisory action towards the Swiss domiciled entities of the group, in particular the group's parent entity, to induce compliance by the non-Swiss entity with the SST requirements.
259. Where a supervised person or entity violates provisions of the relevant Financial



Market Acts or if there are any other irregularities, FINMA shall ensure the restoration of compliance with the law (Article 31 FINMASA). If a Swiss insurer did not respond voluntarily to supervisory concerns, FINMA would be authorised to issue binding rulings and oblige the supervised entity to take specific measures. FINMA also has the power to appoint an independent and suitably-qualified person who may act in place of the management bodies for the supervised entity (Article 36 (2) FINMASA). From an administrative point of view, FINMA can ultimately revoke the insurer's licence to do business. FINMA may also trigger criminal prosecution for various charges.

260. The granular group SST consists of the set of SST ratios for the legal entities of the group, i.e. there is no group TC. However, if a group additionally determines an SST TC on consolidated accounts, this may be smaller than the sum of all the entities' MCRs<sup>14</sup> due to diversification effects between the entities. For example this could occur with a set of monoline insurers, each with a portfolio with low diversification.

### **EIOPA advice**

#### *Articles 172/227/260*

261. The SST uses a total balance sheet approach and market consistent valuation. Its requirements in relation to technical provisions, own funds and internal models are seen as equivalent to Solvency II, although in relation to internal models we note that Solvency II envisages no use of provisional internal models and includes explicit requirements for profit and loss attribution.

262. The SST sets capital requirements at an equivalent level to Solvency II and accurate and timely intervention is taken in cases of non-compliance. Although there is no explicit requirement under the SST to quantify capital requirements for operational risks, this is addressed qualitatively, particularly through the SQA, and with additional scenario testing and/or capital add-ons where necessary. As a result we are satisfied that FINMA currently have equivalent requirements to the Solvency II Directive requirements to address operational risks, recognising the intricacies of operational risks and the limited effectiveness of capital requirements when addressing such risks.

#### *Article 172*

263. We note that Swiss regime will fully cover reinsurance captives once the pending ISO revision enters into force.

#### *Article 227*

264. Taking into account the overall picture, we conclude that the Swiss supervisory regime is equivalent to the Solvency II Directive requirements with respect to Principle 6 and 7.

#### *Article 260*

265. The Swiss Solvency Test for groups differs in approach to the consolidated and deduction and aggregation methods prescribed under Articles 230 and 233 Solvency II Directive respectively. That is, there is no one group solvency ratio but rather a set of solvency ratios for each entity within the group, including the parent. This is deemed equivalent to Solvency II because unlike a collection of solo calculations it simultaneously models all interactions between each entity

<sup>14</sup> There is nothing specifically named "MCR" in the Swiss regime, however here we refer to the 33% SST ratio, the point at which FINMA takes ultimate supervisory action.

rather than stripping out the intra-group transactions. This is a group-wide model, taking the group internal structure into account rather than ignoring it. In addition, similar to the consolidated group solvency calculations under Solvency II, the SST of the ultimate parent entity considers all the assets, liabilities and risks of all the group's operations. As a result we regard the Swiss supervisory regime as equivalent to Solvency II with respect to Principle 12.

**Principle 8 - Parent undertakings outside the Community: scope of group supervision**

**Objective** - *The supervisory authorities of the third country shall have a legal or regulatory framework for determining which undertakings fall under the scope of supervision at group level.*

*The scope of supervision at group level shall at least include all undertakings over which a participating undertaking, as defined by Article 212 of Directive 2009/138/EC, exercises dominant or significant influence. The scope may exclude undertakings where this would be inappropriate to the objectives of group supervision.*

266. The definition of an insurance group according to Article 64 (c) ISA encompasses all entities that, among other criteria, form an economic unit or are linked in some other way by influence or control. The wording of this article, complemented by the definition of 'control' provided by FINMA during our on-site visit, is equivalent to the criteria for inclusion in the scope of group supervision laid out in the Solvency II Directive and Directive 83/349/EEC (to which the Solvency II Directive refers for the definition of relationships of control and influence). At the same time, in exceptional cases FINMA has the power under Article 199 (4) ISO to exclude an entity from the scope of the group for the purpose of solvency assessment, if their inclusion would be misleading. Even though the Solvency II Directive allows an exclusion of entities from the scope of general group supervision, this is currently not foreseen in the Swiss regulation, which can from our point of view be regarded as a conservative approach. Furthermore according to Article 64 ISA group supervision includes all entities of a group irrespective of their activities, including operating and non-operating holding companies.
267. According to Article 65 ISA, FINMA may subject an insurance group to group supervision, where the group is managed from Switzerland or where it is managed from abroad but no equivalent supervision is exercised there and the touch points to Switzerland are strong enough for FINMA itself to exercise effective group supervision. In light of FINMA's proven willingness to take on the role of group supervisor, effective group supervision is provided for in the first scenario and in the second, within the boundaries of what can be reasonably expected from FINMA.. Where another authority also claims the role of group supervisor, FINMA is to come to an agreement with it on responsibilities, procedures and content of the group supervisory arrangements. To date no such arrangements have needed to be made.
268. The carrying out of cross-border inspections is detailed in Article 43 FINMASA. Although this article does not include any obligation to consult the relevant home country authority prior to carrying out an inspection, FINMA emphasises its openness to dialogue when planning a cross-border inspection and has provided examples of its communication and cooperation with foreign authorities. In order to further facilitate information exchange in this respect, FINMA has signed bilateral Memoranda of Understanding (MoUs) with all the members of the EEA and EIOPA.
269. According to FINMA, no group entities are currently excluded from group supervision, but rather they are granted different levels of supervision according to their perceived riskiness. Although there is no specific legal obligation for FINMA to inform the relevant foreign authority if an entity is excluded from the scope of group supervision, FINMA emphasises that from its viewpoint this follows from the general concept of cooperation. Against the background of the examples of supervisory cooperation presented to us as well as FINMA's MoUs

with EEA members, it can be concluded that this does not represent a matter of concern.

**EIOPA advice**

*Article 260*

270. In consideration of the observations laid out above it can be concluded that the supervisory regime of Switzerland is equivalent to Solvency II with regard to Principle 8. This conclusion takes into account the numerous practical examples of cooperation and information exchange with other supervisory authorities that FINMA provided during the on-site visit.

**Principle 9 - Parent undertakings outside the Community: cooperation and exchange of information between supervisory authorities**

**Objective** - Third country supervisory authorities shall be empowered by law or regulation to enter into coordination arrangements to ensure that the requirement in Article 261(2) of Directive 2009/138/EC can be met.

**Determination of the group supervisor**

271. In respect of the rules and guidelines regarding the determination of a group supervisor, there will inevitably be differences in wording and possible interpretation between regimes. EIOPA will therefore recognise a broadly similar approach to determining group supervision as equivalent, providing this does not prejudice the proper exercise of supervisory responsibilities under Solvency II. Therefore where a third country has been assessed as equivalent, it is essential that there be cooperation between all supervisors concerned prior to decisions on group supervision being taken and communicated to insurers.

**Rights and duties of the third country group supervisor**

272. The group supervisor's responsibility for the coordination and dissemination of information is based on Articles 67 to 70 ISA. Here, the group supervisor acts as coordinator in the assessment of the group from a quantitative and qualitative perspective, local supervisors are involved through early information sharing, including sharing of information received from local supervisors during group-wide assessments. The group supervisor's responsibility for review of the group's financial position is based on Article 25 ISA, which requires a consolidated management report for groups, including annual accounts, and a supervisory report. Currently, all group reports fall under either US GAAP, IFRS or Swiss GAAP FER reporting standards.

*The responsibility for planning and coordination*

273. FINMA makes use of supervisory colleges, and also, where appropriate, bilateral cooperation. The planning and preparation of supervisory colleges is carried out through preparatory steps (checklists to be filled out by all participants and forwarded to all) that are followed by the supervisory college meeting. This in turn may lead to action points for the group supervisor or the local supervisors. As a legal basis for this FINMA refers to Articles 6 (2), 42 and 43 FINMASA. In practice, FINMA has shown that it is in a position to fulfil its coordination tasks (for instance through means of teleconferences and similar).

*Framework for crisis management*

274. Article 67 ISA in conjunction with Article 22 ISA requires insurance groups to be organised in a manner that allows all relevant risks to be identified, limited and monitored. Circular 2008/32 specifies principles for an adequate corporate governance framework including risk management, which FINMA also applies to crisis management as well contingency and succession planning. FINMA has shown that emergency plans are set up for each college. It has also provided evidence of the effective sharing of relevant information.

*The assessment of the application for a group internal model*

275. As a stand-alone jurisdiction, Switzerland has a unilateral group supervisory approach. This also means that group internal models are approved on a unilateral basis, rather than through a formal college decision. There is a lot of exchange and discussion with the other supervisors involved, however.

### **Third country applicable regime as to the establishment and functioning of cooperation mechanisms**

276. FINMA is not subject to any specific laws or regulations in this respect. As a legal basis the very general legal provision of Article 6 (2) FINMASA and the legal provisions for information exchange under Articles 42 and 43 FINMASA are applied. Article 6 (2) FINMASA, which states that FINMA fulfils the international tasks related to its supervisory activity, is not elaborated upon in subordinated legislation or rules. The Board of Directors of FINMA decided, however, on 19 November 2009 on FINMA's cross-sectorally applicable policy on supervisory colleges. FINMA has evidenced that it does in practice fulfil its obligations to manage cooperation in this area.

#### *Willingness to submit information on intra-group transactions*

277. Here, the rules governing international cooperation and information exchange (Articles 42 and 43 FINMASA) are the basis for cooperation on intra-group transactions through bilateral mechanisms and supervisory colleges. In large groups the complexities resulting from such intra-group transactions are regularly reviewed and discussed. Particular attention has been paid to them during the financial crisis.

#### *Exchange of prior information on decisions that could affect the solvency of entities situated in an EEA Member State*

278. Based on cooperation through bilateral mechanisms and supervisory colleges, under the rules governing international cooperation and information exchange (Articles 42 and 43 FINMASA), FINMA does monitor the exchange of prior information on decisions that could affect the solvency of entities situated in an EEA Member State. The solvency situation is monitored continuously.

#### *Willingness to change the content of written coordination arrangements*

279. To date no coordination arrangements have been concluded, since there has been no need to do so. However, FINMA circulated a draft coordination agreement for their College meetings in 2013 and 2014, and started the discussion about the introduction of such agreements. Conclusion of the coordination agreements is envisaged during 2015. FINMA refers to the general provisions of Articles 6, 42 and 43 FINMASA as a legal basis, if there is a need to conclude such arrangements.

#### *EEA Member States' participation in the validation process of group internal models*

280. The validation process for internal models relating to the cross-border activities of a group involves all relevant supervisory authorities and is based on the cooperation regime embodied in Articles 42 and 43 FINMASA.

#### *Willingness to support restrictions on free assets for supervised entities*

281. Based on the general mechanisms for cooperation through bilateral mechanisms and supervisory colleges within the parameters set out in Articles 42 and 43 FINMASA, there is willingness on FINMA's part to support such restrictions on the free assets of supervised entities, provided the analysis of the solvency situation of the group as a whole and of the various legal entities or clusters of that group shows that such action is required and justified.

### **Third country requirements applicable for the setting up of cooperation arrangements**

282. A college of supervisors or similar cooperation arrangements can be established, composed at a minimum of all relevant authorities for the group's supervision,

under the following criteria:

- Relevance and/ or materiality of the entity within the group
- Significance of the entity for the local market
- Risk level in a particular entity
- Role of the supervisory college and its relevance to the particular entity.

283. Based on its general supervisory mandate and cooperation empowerment, FINMA has established global supervisory colleges for all insurance groups with international activities.

284. To address EEA specific issues (e.g. to discuss Solvency II implementation topics) of Swiss groups with EU presence, European Supervisory Specialised Teams (ESST) have been introduced as part of the FINMA supervisory colleges.

285. The supervisory colleges of Swiss-based insurance groups meet in person at least once a year in Switzerland. In preparation for these college meetings, all participating authorities are asked to summarise the financial and solvency position of the insurance group's operations in their country, report on intra-group transactions and highlight current issues. This information is then distributed to all participants. The most important issues are presented at the meeting and are discussed amongst supervisors.

286. At these college meetings the insurance groups present themselves to the supervisors. The topics are pre-agreed with the supervisors and discussed with the management of the insurance group. The annual in-person college meetings are complemented by quarterly college conference calls if deemed appropriate. In addition, all involved supervisors are provided with ad hoc information if material events or changes take place (e.g. acquisition, mergers, crisis situations, etc.) In 2013 FINMA held in-person supervisory colleges for Swiss Re, Zurich Insurance Group, Swiss Life, Bâloise, Helvetia and Nationale Suisse. Supervisors from all the countries in which the groups are active were invited to participate.

287. When a college of supervisors or similar cooperation arrangement is established, the functioning and organisation of these mechanisms may be based on written arrangements, including provisions regarding the obligation to cooperate, exchange of information and decision-making processes.

288. In order to ensure the efficiency and effectiveness of supervisory colleges, insurance group-specific MoUs and/or confidentiality agreements are in place, if no generally applicable MoU exists between the participating supervisory authorities. Standard confidentiality agreements have been set up by FINMA, and FINMA requires them to be signed prior to participation in a college. FINMA provided evidence of such agreements during the on-site visit.

### **Dispute solving mechanism**

289. FINMA stated that there have not been any disputes to date. If one were to occur, the aforementioned cooperation mechanisms would be applied.

### **Exchange of information and cooperation between third country supervisors and EEA supervisors in going concern circumstances and crisis situations**

290. Articles 6, 42 and 43 FINMASA operate as a legal basis for this information exchange and cooperation. FINMA has evidenced that it facilitates communication by sharing the contact details of all the supervisory authorities involved and the persons in charge. MoUs and/or confidentiality agreements allow FINMA - particularly with regard to crisis situations - to share relevant

information immediately by email, interim conference calls or ad hoc face-to-face meetings.

### **General supervisory powers to require insurers to submit necessary information**

291. To ensure that FINMA obtains all relevant and necessary information from a group, one Swiss-based company is designated by FINMA as point of contact for the supervisory authority. This legal entity is tasked with complying with the group's obligations to provide information (Article 191 (3) ISO). The duty to provide information to FINMA applies to all companies of the group (Article 71 ISA). FINMA has evidenced that in practice it supervises compliance with these legal duties. In cases where such information from an insurer/group is incorrect, FINMA is able to ensure correction by practical means without having to implement strict legal sanctions.

#### **EIOPA advice**

##### *Article 260*

292. Generally, FINMA is empowered by Articles 6, 42 and 43 FINMASA to enter into cooperation agreements and to maintain procedures of information exchange with other supervisory authorities on the basis of strict professional secrecy. With reference to the provisions for equivalent prudential regimes for group supervision set out under Articles 260 and 261 (2) Solvency II Directive, which in turn include the obligations spelled out in Articles 68 and 247 et seq. Solvency II Directive, Article 6 FINMASA can only operate as a very general legal basis for the tasks of group supervision. Equivalent requirements to those provided for in Solvency II are not clearly spelled out in legislation or in other subordinate legal provisions. The Board of Directors of FINMA has, however, adopted a cross-sectoral policy on supervisory colleges on 19 November 2009. This policy has been translated to insurance group supervisory colleges and is published on FINMA's website<sup>15</sup>. Together with Article 6 (2) FINMASA this provides an equivalent framework to that set out under Solvency II.

293. On the other hand, FINMA has provided broad evidence that a practical approach equivalent to Solvency II is implemented in day-to-day supervisory practice through FINMA's organising and taking part in colleges, as well as several EIOPA surveys, and through effective data exchange among college members. FINMA has also demonstrated that it does strictly adhere to the obligation for professional secrecy.

294. We find FINMA equivalent with regard to its co-operation and exchange of information with other supervisory authorities.

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<sup>15</sup> [http://www.finma.ch/e/beaufsichtigte/versicherungen/gruppen\\_konglomerate/pages/default.aspx](http://www.finma.ch/e/beaufsichtigte/versicherungen/gruppen_konglomerate/pages/default.aspx)



## ANNEX: Feedback statement on comments received

| <b>Summary of Comments on Consultation Paper<br/>CP-14-041-Draft Advice to EC Equivalence Switzerland</b>  |                                       |                  |   |            |
|--|---------------------------------------|------------------|---|------------|
| <p>EIOPA would like to thank the Association of British Insurers (ABI), Insurance Europe, RAA, Swiss Insurance Association (SIA), and Zurich Insurance Company Ltd.</p> <p>The numbering of the paragraphs refers to Consultation Paper No. EIOPA-CP-14/041.</p> |                                       |                  |   |            |
| No.  | Name                                  | Reference        | Comment   | Resolution |
| 1.   | Association of British Insurers (ABI) | General comments | <p>The ABI welcomes EIOPA’s findings that Switzerland will meet the Solvency II equivalence assessment criteria (with caveats). In the case of Switzerland, we welcome the conclusion that the caveats are expected to be mainly addressed by the forthcoming revisions to the Swiss Insurance Ordinance. This ensures the continued benefits of more competitive markets that help consumers in the EU.</p> <p>Equivalence is an important component of the EU Solvency 2 framework. A positive equivalence determination for Switzerland continues to be of significant importance for Swiss groups operating in the EU and vice versa. The impact of an equivalence finding ensures continued access to non-EU markets and thus makes EU markets competitive, which increases the choice of providers for EU commercial entities. More competitive reinsurance markets allows for distribution of risks beyond the EEA boundaries which protects the EU economy from significant catastrophe losses as large claims payments are made into the EU economy.</p> | Noted      |
| 2.   | Insurance Europe                      | General comments | <p>Insurance Europe welcomes EIOPA’s assessment regarding the equivalence of Switzerland (under Articles 172, 227 and 260), Bermuda (under Articles 172, 227 and 260) and Japan (under Article 172). These three jurisdictions are important market partners for European insurers and their insurers provide capacity and diversification, which our markets</p>   | Noted      |

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|  |  | <p>need. We believe EIOPA's work is an important signal in upcoming full equivalence determinations that need to be made by the Commissions in the coming weeks and then scrutinized by the European Parliament and Council before they take legal effect.</p> <p>As indicated in the past, the insurance industry has serious concerns regarding the timing of equivalence decisions. We welcome the Parliament' recognition of the urgency of this matter and its request to the Commission to present the draft delegated acts on equivalence in a separate manner – by third country and per area (Articles 172/227/260).</p> <p>Decisions on equivalence are in fact a precondition for a separate set of important decisions that need to be made by supervisors, in relation to the imminent implementation of Solvency II. Significant work has to be done in a very challenging timeframe, to ensure the necessary legal and planning security for European (re)insurers.</p> <p>Although not directly linked to this consultation, we would like to note that delegated acts on provisional equivalence under Article 227 are a precondition for the ability of multinational groups with EU head-office to compete on a level playing field in foreign markets. Such delegated acts are an important parameter in determining companies' internal models, as well as in their capital management and planning. Submission of internal models is due to commence on 1 April 2015, therefore provisional equivalence assessments need to be concluded months in advance.</p> <p>Similarly, European cedants have a strong interest to get assurance as to whether reinsurance contracts with third country counterparts (covered by Article 172) are treated the same way as contracts concluded with (re)insurers subject to Solvency II.</p> <p>When engaging with foreign counterparts in discussions on temporary equivalence (under Article 172 and Article 260), EIOPA and the European Commission should use the opportunity to also discuss and seek ways to address discriminatory practices which hinder the ability of European undertakings to conduct insurance business in those markets.</p> <p>In practice, it could take many months before a Commission decision to adopt a delegated act enters into legal force. Therefore, swift action and completion of work is needed as a precondition for effective preparation and implementation of Solvency II. We believe that the approval and</p> |  |
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|    |                 |                  | <p>further scrutiny of equivalence delegated acts should be prioritised by the Commission and other European institutions.</p> <p>The insurance industry looks forward to contributing to the extent possible to the EIOPA and European Commission work on ensuring that delegated acts on equivalence are adopted and come into force as soon as possible.</p>   |       |
| 3. | RAA             | General comments | <p>These comments are filed on behalf of the Reinsurance Association of America.</p> <p>The Reinsurance Association of America (RAA), headquartered in Washington, D.C., is the leading trade association of property and casualty reinsurers doing business in the United States. The RAA is committed to promoting a regulatory environment that ensures the industry remains globally competitive and financially robust. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross border basis.</p> <p>The Reinsurance Association of America strongly supports an open and competitive global reinsurance market. Mutual recognition procedures, such as the Solvency II equivalence process and the NAIC Qualified Jurisdictions review, facilitate such an unrestricted market among well-regulated jurisdictions.</p> <p>Competitive reinsurance markets allow for distribution of risk beyond the individual country and regional boundaries and increase the availability of these necessary products.</p> <p>Determining Bermuda, Switzerland and Japan to be equivalent will also lead to regulatory efficiency and enhance the operations of regulatory colleges in which those countries are involved.</p> <p>The RAA supports the finding of largely equivalent in the EIOPA report and believes these assessments provide a sound basis for a positive equivalence decision by the European Commission.</p> <p>We hope that the EU-US Dialogue will very soon result in a process which will allow similar recognition for US based companies doing business in the EU.</p> | Noted |
| 4. | Swiss Insurance | General comments | <p>The Swiss Insurance Association (SIA) welcomes the opportunity to comment on EIOPA's updated technical advice on the equivalence of the</p>  | Noted |

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|    | Association (SIA)            |                  | <p>Swiss supervisory system with Solvency II.</p> <p>We support EIOPA’s analysis and consider the Swiss Solvency Test and its application by FINMA as genuinely equivalent to Solvency II. In particular, it is pleasing to see that with the exception of Principle 4 where FINMA is found to be largely equivalent, EIOPA has found FINMA equivalent with no caveats.</p> <p>With respect to Principle 4, we note that the forthcoming revisions to the Swiss Insurance Supervision Ordinance (AVO) are expected to address EIOPA’s residual concerns after which point we would expect Switzerland to meet EIOPA’s equivalence criteria with no further caveats.</p> <p>A positive equivalence determination for Switzerland continues to be of significant importance for Swiss groups operating in the EU and vice versa. We would therefore like to encourage EIOPA to remain engaged in the equivalence assessment process as the European Commission prepares its delegated acts for the co-legislators’ non objection. It is important that those third countries who have been assessed by EIOPA as equivalent are confirmed as such in delegated acts in order for Solvency II equivalence assessments to remain credible globally and we count on EIOPA’s support to ensure that this is the case.</p> <p>The disapplication of sub-group supervision for the purposes of EIOPA’s guidelines on group solvency (guideline 5) requires a robust assessment of group wide risks, close cooperation between the worldwide group supervisor and EEA legal entity supervisors and an agreed annual work plan. Given the close cooperation and coordination between FINMA, EIOPA and EEA supervisors that currently exists, we would expect these criteria to be met in the case of Swiss groups.</p> |       |
| 5. | Zurich Insurance Company Ltd | General comments | <p>The Zurich Insurance Company welcomes the opportunity to comment on EIOPA’s updated technical advice on the equivalence of the Swiss supervisory system with Solvency II.</p> <p>We support EIOPA’s analysis and consider the Swiss Solvency Test and its application by FINMA as genuinely equivalent to Solvency II. In particular, it is pleasing to see that with the exception of Principle 4 where FINMA is found to be largely equivalent, EIOPA has found FINMA equivalent with no caveats.</p> <p>With respect to Principle 4, we note that the forthcoming revisions to the Swiss Insurance Supervision Ordinance (AVO) are expected to address</p>  | Noted |

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|  |  | <p>EIOPA's residual concerns after which point we would expect Switzerland to meet EIOPA's equivalence criteria with no further caveats.</p> <p>A positive equivalence determination for Switzerland continues to be of significant importance for Swiss Insurance Groups operating in the EU and vice versa. We would therefore like to encourage EIOPA to remain engaged in the equivalence assessment process as the European Commission prepares its delegated acts for the co-legislators' non objection. It is important that those third countries who have been assessed by EIOPA as equivalent are confirmed as such in delegated acts in order for Solvency II equivalence assessments to remain credible globally and we count on EIOPA's support to ensure that this is the case.</p> <p>The disapplication of sub-group supervision for the purposes of EIOPA's guidelines on group solvency (guideline 5) requires a robust assessment of group wide risks, close cooperation between the worldwide group supervisor and EEA legal entity supervisors and an agreed annual work plan. Given the close cooperation and coordination between FINMA, EIOPA and EEA supervisors that currently exists, we would expect these criteria to be met in the case of Swiss groups.</p> |  |
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