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New Insurance Law Reforms the Supervision of Insurers in Switzerland

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A new insurance supervision law, the Federal Law Concerning the Supervision of Insurance Businesses of 17 December 2004 *(Bundesgesetz betreffend der Aufsicht der Verischerungsunternehmen vom 17. Dezember 2004)* (the "Insurance Supervision Law" or "ISL") came in force in Switzerland on 1 January 2006. This NewsLetter highlights the most significant aspects of this complete revision of Swiss law governing the supervision of insurers.

Introduction

The ISL repealed the system of insurance supervision previously provided by five different statutes, foremost among them: (1) The Federal Law Concerning the Supervision of Insurance Businesses of 23 June 1978, (2) The Federal Law Concerning Non-Life Insurance of 20 March 1992 and the Federal Law Concerning Life Insurance of 18 June 1993. The primary goals of the ISL are to provide a single insurance supervision law and to adapt the Swiss insurance supervision law to current market conditions and the insurance supervision standards now prevailing in the European Union. Among other things, the ISL:

- authorises solvency regulations which supplement the previous solvency standards based on premium volumes and loss experience with the so-called "Swiss solvency test";
- requires the appointment of a responsible actuary;
- subjects insurance intermediaries (such as brokers) for the first time to licensing requirements; and
- provides for group supervision of insurance companies and insurance conglomerates.

Scope of Supervision

As before, the ISL subjects primary insurance companies, reinsurance companies and foreign insurance companies which either transact business in or from Switzerland to supervision. For the first time, the law extends supervision to insurance brokers and specifically addresses the supervision of insurance groups and conglomerates.

The ISL continues to exclude foreign insurers which engage only in reinsurance in Switzerland from supervision and specifically excludes from supervision insurance businesses that are subject to a separate federal supervision regime, such as pension, disability and survivors' benefits providers *(berufliche Vorsorgeeinrichtungen)* and insurance brokers who are dependent agents of an insured and who transact business only in respect of that insured (for example, corporate risk managers). The Swiss Federal Council, through the Regulation Concerning the Supervision of Private Insurance Businesses of 9 November 2005 *(Verordnung über die Beaufsichtigung von privaten Versicherungsunternehmen vom 9. November 2005)* (the "Insurance Supervision Regulation" or "ISR"), has further exempted from supervision foreign insurers which exclusively offer coverage in Switzerland for insurance risks arising in connection with air transport, ocean marine and cross-border transportation.

It should be noted that under prior law, foreign insurers whose insurance activities had limited economic significance or affected only a small number of insureds were exempt from supervision in Switzerland. Now, such insurers must apply for and obtain this exemption.

Licensing

The requirements for insurers intending to transact insurance business in Switzerland have, to a large extent, been retained. Insurers must apply for a license and the application must include a copy of the insurer's business plan. The review and approval of the business plan remains the focal point of the application process. As before, a license to transact business in respect of a specific line of insurance business includes the authorisation to provide reinsurance in respect of the same line of business. The ISL authorises the Swiss Federal Council to adopt specific requirements for individual lines of business. The ISL also provides, for the first time, detailed provisions relating to an insurer's withdrawal from one or more lines of business.

Solvency Measurements and the Swiss Solvency Test

ISL Article 9, paragraph 1 requires supervised insurers to have an adequate solvency ratio, this is: "sufficient free and unencumbered equity capital in relation to all of its activities". This is not new, but Article 9, paragraph 2 specifies for the first time that in determining whether an adequate solvency ratio exists, the risks that the insurer is exposed to, the lines of business that it writes, the geographic scope of its activities and "fundamental international standards" must be taken into account. Article 9, paragraph 2 of the ISL authorises the Swiss Federal Council to specify how free and unencumbered equity capital will be determined and authorises the Federal Office for Private Insurance *(Bundesamt für Privatversicherung)* ("FOPI") to set the standards for an adequate solvency ratio.

The Swiss Federal Council, through the ISR, specifies two methods for evaluating the solvency of insurers: (1) the "Solvency 1" method, which relies on a determination the required free and unencumbered equity capital based on the volume of the insurer's business (a required solvency ratio) and the free and unencumbered equity capital of the insurer (an available solvency ratio) and (2) the "Swiss Solvency Test" or ("SST"), which relies on a determination of required free and unencumbered equity capital based on the insurer's risks (target capital) and the free and unencumbered equity capital of the insurer (risk-bearing capital). The ISR requires both methods to be used, independently of each other, and to be applied each year.

It is not possible to provide a summary of the Solvency 1 method and the SST within the space limitations of a NewsLetter. In general, the Solvency 1 method is similar to the solvency calculations required under the prior insurance supervision laws and is based on indexes of premium volumes and insurance losses; the SST breaks new ground in Switzerland and requires the insurer to take into account all of its risks, not only actuarially determined insurance risks as reflected in reserves for reported claims and incurred-but-not yet-reported claims, but also market risks with respect to investments (interest rate and investment portfolio price changes), etc. Each insurer must develop its own comprehensive risk-quantification model for use in applying the SST.

Title 4 of the ISR specifies, for the first time, the components of required technical reserves. The ISR also specifies the types of investments that can be made with the insurer's restricted capital.

Responsible Actuary

The ISL requires insurance businesses to appoint a so-called "responsible actuary", who, in addition to appropriate professional qualifications, must be able to correctly assess the financial consequences of the business activities of the insurer. The insurer must ensure that the responsible actuary has access to all business records of the insurer. The responsible actuary is responsible for the correct calculation of the solvency ratios, the use of a factually correct basis for calculations and the establishment of sufficient technical reserves.

Insurance Intermediaries

The ISL defines insurance intermediaries as persons who offer or conclude insurance policies on behalf of insurance companies or other persons. Intermediaries may not transact business for the benefit of unlicensed insurers. The ISL prescribes the creation of a registration system for insurance intermediaries and requires intermediaries that are not legally or otherwise tied to a specified insurer to be registered (other intermediaries may register voluntarily) Only intermediaries who can demonstrate sufficient professional qualifications and who have professional liability insurance (or have met security deposit requirements) are eligible for registration. The ISL also prescribes minimum procedures to be observed when the intermediary contacts an insured.

Insurance Groups and Conglomerates

The ISL brings two new concepts into the language of Swiss insurance regulation: "Insurance Groups" and "Insurance Conglomerates". An Insurance Group exists when two or more businesses constitute an economic unit or are linked through influence or control or otherwise, at least one is an insurance company and collectively they engage primarily in the business of insurance. Similarly, an Insurance Conglomerate exists when two or more businesses constitute an economic unit or are linked through influence or control or otherwise, at least one is an insurance company and the other is a bank or a securities dealer of "economic significance".

Insurance groups may request insurance group supervision and insurance conglomerates may request insurance conglomerate supervision, in each case, if they are functionally managed from Switzerland or are functionally managed outside of Switzerland but not subject to an equivalent supervision as an insurance group or insurance conglomerate in that country. Supervision as an insurance group or insurance conglomerate is supplementary to the supervision exercised over the individual regulated companies. The ISL authorises the Swiss Federal Council to establish group-wide standards for free and unencumbered equity capital. Insurance groups and insurance conglomerates are required to have external auditors at the group level.

Conclusion
ISL Article 1, paragraph two states that a principal aim of the ISL is "the protection of insured against the insolvency risks of the insurers". Clearly the ISL is based on the assumption that requiring the appointment of a responsible actuary and more detailed financial reporting and the modelling will provide better protection for policyholders. It is worth remembering, however, that the road to insolvency for an insurer begins when the premiums it has charged for the risks it has insured, together with the income earned on the investment of reserves, are insufficient to pay claims to insureds and meet its obligations to other creditors. An insurer can cover a shortage of premium and investment income temporarily by drawing on its equity capital, but this does not correct the fundamental problem: the insurer has accepted inadequate prices for the risks it takes.

(A translation of the ISL in English is available at http://www.wwp.ch/publications/362.pdf).

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