FOPI press conference **Zurich, 17 April 2008**

Part 3: Regulatory challenges ahead

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Unofficial translation

Supervision as a framework: implementation hurdles

If we take a closer look at the presented developments relating to traditional, quantitative and qualitative supervision, it becomes clear that, while these three approaches already intermesh quite well, they still need to be brought even closer together. Traditional fixed rules need to be tied to qualitative assessments. Qualitative criteria need to be used to assess quantitative data. Interweaving these various methods will provide us with a more complete picture of an insurance company and its specific facets. The current circumstances have made the need for an ***integrated overview*** quite obvious. Switzerland's concept of integrated supervision of the insurance market will enable us to gain such an overview.

What objectives does FOPI seek to achieve with its integrated supervision concept? Of course, such guidelines enable us to monitor the solvency of insurance companies not in a "zero failure regime", but specifically to protect insurance takers. However, monitoring of the solvency of insurance companies does not just depend on fulfilment of quantitative guidelines but also on the responsible design checks and balances in corporate decision-making processes. With the turbulence that swept through financial markets, the importance of this factor hit home.

A responsible design of checks and balances therefore means not just protecting solvency for the long term. It also means shielding solvency from the risk of careless decisions based on a desire for short-term gain.

Regulation therefore equates to creating a multifunctional framework that acts to protect solvency. Within this framework, the company is free to act while nevertheless fulfilling its obligations. The core purpose of supervision – i.e. to ensure that the capital used to cover policyholder entitlements is not compromised by reckless capital market transactions – must not be hindered. At the same time, companies need to be left free to be innovative and develop their activities. And it is here where we find the boundaries of the supervisory mandate: supervision does not mean scrutinising each individual strategy and transaction; instead, companies are encouraged to be both creative and responsible at the same time.

But how effective is regulatory action in the face of dynamics which, in an increasingly interdependent world, can very quickly hammer down individual companies, even those that would normally have nothing to do with the turbulence?

Let’s be realistic. There is no way to prevent excesses and bubbles in a global market economy, nor is it possible for governments to intervene for risk of stunting the growth of individual branches or economies.

Nevertheless, the image of a supervisory authority as a framework amounts to drawing a demarcation line between what supervision entails and does not entail. On the one hand, the supervisory authority needs to pursue the broad objectives established by lawmakers to protect solvency. At the same time, the supervisory authority needs to give insurance company adequate leeway based on a set of traditional, quantitative and qualitative supervision guidelines. Specifically, strictly non-insurance related activities must not be allowed to endanger the core insurance business and corresponding policyholder entitlements.

In its "Article IV Consultation” released in mid-March, the International Monetary Fund recently confirmed that Switzerland’s concept is heading in the right direction.

Implementation of supervision the greatest challenge

It has also become clear that the greatest challenge facing efforts to oversee the Swiss insurance market is not further development of the concept but rather ***implementation of supervisory activities***. Once everyone agrees on the concept, the next step is to set aside adequate resources enabling the concept to be properly applied using an iterative process with the supervised insurance companies.

At present, there are already numerous motivated and experienced employees in the insurance and financial industry willing to implement the concept. However, more resources are needed, particularly to handle this year's planned revision of the SST reports and internal models of over 150 insurance companies. In addition to more resources, continuous efforts should also be made to improve the efficiency of the supervisory process. In recent months, we have already had very positive experiences with processes where special groups had prepared specific dossiers for supervisory divisions. In short, there is still room for further improvement.

The revision of SST reports and the Swiss Quality Assessments will provide us with information that can be used for the further development of regulatory activities. Finally, we should continue to work closely with international partners and further develop these ties.

International embedding of supervisory activities

A positive development has been the gradual convergence of supervisory systems worldwide. This should curtail regulatory arbitrage and foster further international development of regulatory and supervisory activities. Measures have been taken in several countries to modernise regulatory activities on the insurance market. In 2007, FOPI once again focused its attention on expanding its network. This enabled FOPI to establish dialogue with both the EU and an umbrella organisation of insurance regulators in the US. International discussions have focused on the differences between the EU guidelines published in July 2007 and Solvency II. For the most part, Solvency II is based on the same principles such as Switzerland’s supervisory concept involving the Swiss Solvency Test (SST). Many countries around the world are now considering whether to implement similar concepts.

Generally speaking, a large number of countries are moving in the direction of greater emphasis on protecting solvency, which gives SST and Solvency II all of their relevance. The current crisis has demonstrated, however, that maintaining a certain number of different models can also bring advantages. While these models may be, in part, redundant, they also bring greater security to the entire system. Once the solvency of insurance companies is verified through the use of various systems, the risks will be come even clearer.

Efforts were also made to make further progress was also towards future European group supervision. These supervisory activities cover risk-based testing of group solvency, risk concentration, internal group transactions, risk management and the internal control systems. On 11 April 2008, the Commission of European Insurance and Pension Supervisors (CEIOPS) recommended that its member states consider Switzerland's approach to conglomerate supervision as being equivalent to group supervision. Switzerland is determined to further develop its supervisory activities of insurance companies that are managed from outside of Switzerland. This will be achieved through the creation of supervisory colleges, composed of the main supervisory authorities. Such cooperation already exists and will make it easier to overcome difficult situations and crises in the future.

Overview of FINMA

And now, a few words about FINMA. Starting from 1 January 2009, the Swiss Federal Banking Commission (SFBC), Anti-Money Laundering Control Authority and Federal Office of Private Insurance (FOPI) will merge to form a new integrated entity: the Swiss Financial Market Supervisory Authority (FINMA)

- The various degrees of exposure to financial market turbulence and the various mechanisms set in place show that the FINMA will need to apply rules of thumb and case-per-case analysis to determine when situations are the same and when they are different. Upcoming challenges will need to be analysed and interpreted by qualified asset management teams and well-positioned employees on the insurance company side in order to establish supervisory objectives, and take the necessary measures.

- At the same time, the regulator will need to optimise its working processes. This will make it more efficient, enabling existing resources to be used only where needed.

- The integrated supervisory concept will **need to be developed further and properly implemented** in order to ensure the successful supervision and regulation of the insurance market. The SST has now reached the decisive phase with implementation of its financial portion. By focusing on objectives in the area of corporate governance and risk management, the foundation for solid future development is laid.