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New orientation of indemnity insurance supervision

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Ladies and Gentlemen

To a very significant extent, the survival of an enterprise depends on the risks it enters into and how well it knows and controls these risks. Although this finding is very straightforward and uncontroversial, it is of utmost importance for an insurance company, since its entire business is based on successfully managing all imaginable risks of its clients. Risk management – i.e., the monitoring and control of the relevant risks – plays a central role for every insurance company by definition, so to speak.

What is true for the management of traditional insurance risks cannot be false for superordinate strategic and operational risks of a company. The new ISL therefore requires that insurers not only know and assess their risks, but also that they limit and monitor them – and ultimately master them.

It goes without saying that correctly understood risk management must have a counterpart in supervision activities. As already explained, risk-based supervision is therefore of special importance to the new orientation of insurance supervision. In the area of indemnity insurance supervision, we will therefore focus our attention in the future on comprehensive risk analyses of the affected companies, i.e., about 100 indemnity insurers subject to supervision. Relevant projects have been initiated in the year under review. In this regard, I would like to refer to Director Lüthy's remarks on prudential supervision.

The new indemnity insurance supervision approach will also take into account the results and conclusions from the first field test of the Swiss Solvency Test (SST), in which three of the larger indemnity insurers participated last year.

The goal of supervision is to review the most important points of the risk management processes and, if deficiencies arise, to define appropriate measures. In the future, indemnity supervision will therefore not only ensure solvency protection and compliance with the tightened legislative provisions, but will also review the organisation of the insurance institution on the basis of the existing risk landscape.

Agent supervision

On 9 December 2002, the European Parliament and the Council of the European Union decided to supervise insurance mediation in the EU (see Directive 2002/92/EC). With the introduction of the new Insurance Supervision Law (ISL), scheduled for 1 January 2006, Switzerland will establish similar supervision. The background is the harmonisation of the regulatory environment in the European region: In the course of cross-border activities of the insurance industry, Swiss insurance agents should not suffer comparative disadvantages vis-à-vis insurance agents abroad. At the same time, stricter monitoring of insurance mediation is being demanded in the context of consumer protection in Switzerland.

Supervision of agents is therefore being undertaken in the spirit of the new orientation of insurance supervision, which aims to strengthen consumer protection and create more transparency.

In the future, the insurance client will be able to obtain a targeted picture of the vested interests, the expertise and qualifications, and the financial security of an agent. For this purpose, an agent register will be created, in which all independent agents – about 3000 – *must* be entered. An additional 10,000 field representatives of the insurance companies will have to right to be registered *voluntarily*.

This register can definitely be interpreted as a seal of quality, since entry into this register is dependent on:

- Professional qualifications. Especially for this register, regulations have been developed with the insurance industry and various educational institutions on the attainment of the appropriate new professional qualifications.
- Financial security. The focus is primarily on professional liability insurance for financial loss. Currently, only a few insurance companies offer such coverage. The Swiss Insurance Association (SIA) has addressed this problem and will develop special model terms and conditions this year for a product for insurance agents.

Whoever sells only the products of a *single* insurer – for instance, if this insurer offers the agent the highest commissions – is by definition no longer considered independent and therefore forfeits mandatory entry into the publicly accessible register. The primary task is currently to compile this agent register. Work is underway. Upon the scheduled introduction of the new ISL on 1 January 2006, insurance agents will be given six months to submit an application to the supervisory authority for entry into the register.

Because of the large number of independent agents and field representatives, the establishment of the register is very demanding. At the same time, the task must be accomplished with very tight human and financial resources. The planned Internet application will therefore possibly be introduced with delay.

Foreigner rates for automobile liability

"Underwriting policies and risk-appropriate premiums": Under this heading, media and politics last year repeatedly dealt with the decision of the Mobiliar insurance company – a decision that has meanwhile been revised – not to conclude contracts with applicants of certain nationalities.

Let me flash back briefly to explain the position of FOPI in this regard: In the middle of the 1990's, the state requirements concerning automobile liability were reduced, with the goal of allowing greater competition in this area. In the course of this deregulation and liberalisation, the flat rate was relinquished and the preventive and systematic review of insurance terms and conditions was abolished. The introduction of mandatory contracting was explicitly rejected.

Liberalisation leads to a differentiation of the market and – to the extent legally permissible – to increased product variety. In the context of greater competition, it is natural that insurers are interested in having good risks in their pool and will tend to avoid concluding contracts with bad risks. This leads to new rate structures, especially also the creation of rates with different risk classes, which are compiled according to different objective criteria. For instance, the premiums for male and female drivers are different with some companies, young and new drivers are required to pay more, and drivers of particularly high horsepower vehicles risk being treated specially. Further differentiations are possible in principle, such as differentiation according to region or nationality.

Since the principle of freedom of contract applies in the private sector, every company is free to choose whether or with whom and with what content it wants to conclude insurance contracts. As a rule, two consequences can be derived from the principle of freedom of contract: The insurer imposes high premiums on certain categories of insurance clients (freedom of *content* of contract), or the insurer does not conclude any contracts with these categories of insurance clients (freedom of *conclusion* of contract). This contract autonomy is, however, limited: For instance, differentiation according to nationality is only permissible if it does not violate constitutional rights.

FOPI therefore asked the Federal Department of Justice to clarify whether the use of nationality in setting rates for automobile liability is permissible. In its opinion of 13 September 2004, the Department of Justice reached the conclusion that a differentiation of rates according to nationality can in principle be reconciled with article 8, paragraphs 1 and 2 of the Federal Constitution, to the extent that it is factually justifiable under the specific circumstances. If the consideration of the criterion of nationality in setting rates is primarily based on differing, statistically and objectively determined damage histories, and if this criterion is applied to all assessed, statistically relevant nationalities in the insured pool of an insurance, then the corresponding rates appear to be permissible in view of article 8, paragraphs 1 and 2 of the Constitution.

Furthermore, FOPI asked the Department of Justice to clarify whether the decision of Mobiliar not to conclude any contracts with applicants of certain nationalities is legally permissible. According to this opinion, differentiations according to nationality could in principle be reconcilable with the requirement of equal treatment under law and the prohibition of discrimination if they were to be based on factual grounds. However, it must be taken into account in this regard that the differing risks should in principle be absorbed through differentiation of rates. The exclusion of certain nationalities could therefore only be justified if automobile liability contracts with the affected nationals would entail an actuarial risk that is incalculable and that could not be absorbed through appropriate rate differences. FOPI operates under the assumption that these circumstances would only apply very rarely, if at all.

Meanwhile, Mobiliar has again started taking this principle into account. The company has already rescinded the decision to exclude certain nationalities, upon intervention of FOPI. In July, Mobiliar will introduce a new premium model in which the country of origin of the insured drivers will continue to play a role – in addition to about 15 other factors such as age, experience, damage history, and the performance of the vehicle – but no longer an exclusive role.

Earthquake insurance

In its meeting of 12 January 2005, the Federal Council decided not to change existing competences with respect to earthquake provisions. The Federal Government will continue to only be responsible for its own installations or for special structures such as dams and nuclear power plants. In the case of all other structures, the cantons are responsible for the implementation of the existing norms and directives.

At the same time, the Swiss Insurance Association (SIA) last year presented an application to FOPI for earthquake insurance only for private insurers. However, this application could not be approved for the time being due to technical gaps, and a revised application was requested. Due to the demonstrated high risk of earthquakes for certain regions in Switzerland, it would nevertheless be worth considering whether it is possible to create a uniform earthquake insurance throughout Switzerland, with the participation of cantonal building insurers and private property insurers.

Although FOPI has no authority to issue directives to cantonal building insurers, it therefore has decided, for reasons of the general interest, to assume a moderating function in this process. In a

first step, FOPI has compiled a common catalogue containing all legal questions. This is intended to clarify whether a joint insurance solution is even possible. Together with the cantonal building insurers and the private property insurers, FOPI is also reviewing the options, the feasibility, and the prerequisites for a nationwide, uniform insurance for earthquake risks. Due to the very time-consuming and technically complex subject matter, first results can only be expected by 2007 or 2008, however.