New orientation of FOPI

Speech by Herbert Lüthy
Director of the Federal Office of Private Insurance

Ladies and Gentlemen

First, a look back: Just a few years ago, the Swiss insurance industry was shaken by a crisis that not only plunged it into the red, but also triggered a profound crisis of confidence, especially among consumers and investors. In this context, it is only natural that the role of supervision was also fundamentally and critically scrutinized. Individual cases have proven that lacking or underdeveloped reputation cannot be compensated simply by showing that perhaps certain arguments voiced by insurance circles turned out to be correct after all. Instead, lost confidence can only be regained and secured in the long term if the expectations of the various parties actually correspond to the realities and possibilities. This is just as true for individual insurance companies as it is for the supervisory authority.

Creating transparency is therefore the key. This is the main reason why FOPI is conducting a press conference like this for the first time. We plan to do this every spring in the future as well, to brief the public on the supervisory activities in the preceding year and to provide a short summary of the situation in the insurance industry.

Allow me first to begin my talk with relevant statistical data:

- With an annual premium volume of about 7000 Swiss francs per capita (direct insurances without social contributions), Switzerland has the highest insurance density in the world.
- The premium volume of Swiss private insurance amounts to approximately 200 billion (thousand million) Swiss francs worldwide, about 70% of which originates abroad.
- The insurance sector employed about 135,000 people in 2004, about 44,000 of whom worked in Switzerland.

In brief: Swiss private insurance is a highly competitive and strongly international sector, the national economic importance of which to Switzerland is tremendous. And perhaps even more importantly: The Swiss insurance industry has essentially weathered the storms of the last two to three years and – as the annual results of the individual insurers demonstrate – it has asserted itself successfully in the market.

Let me continue this list of data with facts and figures by the supervisory authority for private insurance, the Federal Office of Private Insurance (FOPI):

- As of 31 December 2004, 206 private insurance and reinsurance institutions were subject to the supervision of FOPI, namely 101 Swiss and 41 foreign direct insurers and 64 Swiss reinsurers. Of the direct insurance institutions, 27 were life insurers (3 of which were foreign) and 115 were indemnity insurers (39 of which were foreign).
- In addition, FOPI supervised the supplementary health insurance operations of a total of 57 health insurance schemes as of 31 December 2004.

- FOPI currently employs about 70 persons. The supervised insurance institutions cover the costs of the Office in their entirety. In view of the precarious situation of public finances, I would like to emphasize in particular that FOPI activities do not burden taxpayers in any way.

I do not want to discuss any more statistical data in detail. But I do believe it is key to keep these facts in mind with respect to the significance and size of the Swiss insurance industry and the related regulatory duties, especially on the eve of important changes such as

- the implementation of a completely revised Insurance Supervision Law (ISL),
- the related paradigm shift toward a risk-based supervision philosophy, and
- the now definitely emerging creation of an integrated Swiss financial market supervisory authority.

Ensuring solvency and combating abuse

The lack of specificity is always astonishing with which the insurance industry is perceived in Switzerland – especially in contrast with the profile of banks. Even more so, given that hardly any inhabitant of this country does not regularly and in complex ways have to deal with insurance services. Clearly, insurances are such an obvious part of our lives that we only become aware of them when an emergency arises, i.e., a specific event, especially in the areas of health, disability, or retirement.

In itself, it is a good sign that insured parties are able to take the credit standing of insurance companies for granted. This very much has to do with the fact that insurers have always been required to maintain sufficient reserves to cover *all* claims of their clients *at any time*. These claims fundamentally even continue to be guaranteed if the insurance company closes down or files for bankruptcy.

First and foremost, FOPI is therefore a **solvency supervision authority**. Ensuring the solvency of insurance companies is in the interest of multiple goals:

- protection of the interests of insured parties (consumer protection)
- contribution to a functioning and healthy insurance industry
- contribution to the stability of the Swiss financial centre

The second pillar of supervision is **combating abuse**. Insurance companies are strictly prohibited from engaging in illegal or abusive practices that could have a negative impact on the interests of insured parties. In this connection, I would like to remind you that FOPI has intervened directly in various cases – sometimes in the context of great public interest, but usually rather unnoticed.

New supervision philosophy

The focus continues to be on the protection of insured parties, and therefore on the protection of the interests of client and consumer. At the same time, the legislative power has deliberately pushed for a liberalisation of the insurance market in recent years, which allows insurance companies to stand their own ground also in an increasingly competitive international environment and to prove their attractiveness in global markets. In particular, the ongoing convergence of insurance and capital markets creates new challenges for direct insurers and reinsurers, but also for the development of international supervision.

The new ISL has paid particular attention to these challenges, especially to the supervision of the risks arising from these developments. Since I assumed office in the autumn of 2002, FOPI has therefore targeted the question of how to tackle new actuarial and financial risks *in advance*. The goal is to have a set of tools at our disposal to pinpoint the risks relevant to the success of insurers early on (early warning system).

In the third part of this media conference, I will come back to this topic and address it in more depth. I will not only present the first insights gained from the Swiss Solvency Test (SST), a leading tool in Europe, but I will also provide fundamental information on the planned prudential supervisory regime of FOPI.

Consequences of the new legal foundations

Allow me to briefly illustrate the most important changes and consequences of the new legal foundations in a few keywords. As you know, the new Insurance Supervision Law (ISL) is scheduled to enter into force on 1 January 2006. The Federal Council is expected to decide on the date over the course of the autumn, on the basis of the recommendation of FOPI.

The main goals of the revision were to secure the long-term stability of the insurance companies and to improve the protection of insured parties:

- With the entry into force of the revised ISL and the new Supervision Ordinance, the Swiss Solvency Test (SST) will be introduced as the fundamental model for assessing the ability of insurers to handle risks. *Transition periods* are provided for the adjustment of the insurance-specific requirements to the results of the SST.
- The new ISL replaces preventive product monitoring with stricter solvency monitoring. In the socially sensitive areas of occupational pensions and supplemental health insurance, the preventive approval of products will, however, continue unchanged.
- The requirements concerning transparency and the legal quote in the Life Insurance Act, which were adopted in the context of the second ISL revision and entered into force on 1 April 2004, are also part of the new ISL.
- The new ISL now makes insurance agents subject to supervision. The priority goal is to establish a public register. Inclusion in this register is mandatory for all agents who are not bound to an insurer (brokers) and imposes various requirements concerning expertise and personal qualifications. The main motive for this change is the protection of consumers. Hans-Peter Gschwind will return to this in more detail.
- The new ISL creates the explicit legal foundation for specific supervision of conglomerates. The "Group and Conglomerate Supervision" division already implemented within FOPI is currently

developing the necessary ordinances. On the basis of the provisions in the new ISL, further legislation as part of the planned Financial Market Supervision Act is basically no longer needed. Supervision of insurance groups and financial conglomerates is therefore guaranteed, independently of the future organisation of the supervisory authorities.

- The revision expands the supervisory responsibilities in the areas of corporate governance, transparency, and consumer protection. In particular, the information obligations of insurers are increased considerably.
- All insurance companies will now be required to designate a responsible actuary. The core responsibility of the actuary is to assess risks of the enterprise, especially with respect to the determination of rates and capital investments.
- Reinsurers will now be subject to the same solvency supervision as direct insurers.
- The new Act requires new ordinance provisions. All existing provisions, scattered across more than a dozen ordinances, will now be consolidated in a single enactment. Entry into force of the new Supervision Ordinance is scheduled at the same time as entry into force of the Act, after adjustments are made pursuant to external and internal consultations.

Status quo of FOPI

I would like to make clear: In the coming months and years, FOPI is facing nothing less than the implementation of a completely revised Insurance Supervision Law (ISL) and the implementation of a fundamental paradigm shift in supervision philosophy, culminating in the phased introduction of the SST and other risk-based supervision models. At the same time, the old system will be used until the definite introduction of these models; and even after introduction of the new ISL, numerous time-consuming activities will be maintained unchanged in the areas of occupational pensions and supplemental health insurance (preventive product monitoring).

You probably are already anticipating my next remark: This is a huge task for a national regulatory authority with a staff of only 70. How do we ensure that the responsibilities mentioned can be managed and implemented on time and with the necessary care and professionalism?

In order to answer this question, let me flash back briefly to 2002. The starting point of the fundamental new orientation of FOPI at that time was provided by the evaluations by the Janssen and Schmid commissions, which identified considerable deficiencies in supervision, both qualitatively and quantitatively. While the qualitative deficiencies complained of have been remedied to a large extent in the meantime, there continues to be a substantial need for additional staff resources.

This need has, in principle, never been disputed by the responsible department, by the preparatory Committee for Economic Affairs and Taxation (CEAT), or by the National Council or the Council of States as a whole. Even more so, given that the necessary costs would not be borne by the Federal Government, but entirely by the supervised enterprise – as is the case for the Swiss Federal Banking Commission. The insurance industry would incidentally also welcome an expansion of FOPI.

However, because of the ongoing relief measures for the Federal budget, the expansion of FOPI is now only being implemented step-by-step and with considerable delay. In view of the precarious situation of the Federal budget, we understand the need for these measures of solidarity. All the same, this lack of staff confronts us with great challenges: It is still my firm intention that the new

ISL be able to enter into force on time on 1 January 2006 – the planning of FOPI continues to be completely focused on attaining this goal. However, this requires a rigorous definition of priorities, which may lead to a staggered introduction of the ISL. For this purpose, FOPI has an emergency planning system at its disposal, which entails the at least temporary suspension of non-priority tasks.

Financial Market Supervision

Moving on to a different topic: Based on the first partial report of the Zimmerli commission, the Federal Council mandated the Federal Department of Finance on 24 November 2004 to draft a report to Parliament on a new Federal law on financial market supervision (Financial Market Supervision Act) by the end of 2005.

FOPI views the creation of an integrated financial market supervisory authority as a positive development, especially since it is in harmony with the requirements of the new Insurance Supervision Act. With the Swiss Solvency Test (SST), which constitutes a significant component of the new, risk-based supervision concept, FOPI has also created a modern supervision instrument for the insurance market that is a leader within Europe. Practice has shown that financial questions have significantly gained importance among insurance companies in recent years and, as such, have in part followed the same mechanisms as banks. It therefore makes sense to deal with these mechanisms together at the level of supervision as well.

At the same time, the business models of banks and insurance companies are also very different. For instance, insurance supervision is confronted with a much more complex risk profile on the liabilities side of the balance sheet than banking supervision, due to the obligations of the market participants. It is therefore pivotal that these fundamental differences also be adequately taken into account by an integrated financial market supervisory authority. In concrete terms, this means that tailored instruments and supervision laws are absolutely essential that adequately take into account the specific insurance risks (such as the SST). It is therefore of decisive important for FOPI that the organisation and structure of the new authority do not interfere with the development and implementation of a modern and risk-based insurance supervision system.

The compromise proposal of the Zimmerli commission envisions that the financial market supervisory authority will be governed by a board of directors that is responsible for strategy. The general management will be responsible for operational implementation and will issue general directives. FOPI has always considered indispensable that the interests and powers of insurance supervision, with respect to both staffing and content, are safeguarded accordingly in both bodies. This structure guarantees unified leadership, while maintaining autonomy in specialized questions.

It is undisputed that the new authority will be subject to overall supervision by Parliament, as is the case for the existing, separate supervisory organs. At the same time, it must be ensured that the new authority will, in addition to autonomy with respect to content, have the administrative and financial autonomy necessary to keep up quickly and in harmony with the requirements of a market environment that is highly competitive internationally and liberalised nationally.

The objective is therefore not primarily that the creation of the new Financial Market Supervisory Authority use the existing synergies in the supervisory activities of banks and insurance companies – since the normalization of the comprehensive financial services strategies, this has no longer been the focus, and rightly so. Rather, the objective is to ensure that the Financial Market Supervisory Authority provide Switzerland and the Swiss financial centre with a modern, competent, and innovative supervision system that can face the challenges of the 21st century. In my view, it is therefore in the vital interest of all involved actors that the new Financial Market Supervisory Authority be able to undertake its activities as independently and autonomously as possible: independence vis-à-vis banks and insurance companies as well as independence vis-à-vis political and technical administrative influences. Let us not forget: The legislative mandate does not call for the protection of the insurance company or the bank, but rather of the interests of their clients and consumers and the reputation of the entire Swiss financial centre.