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Part 3: The new supervision philosophy

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The insurance market has changed significantly over the last fifteen years – and accordingly also the demands on supervision. What has not changed, however, are the fundamental goals of insurance supervision, namely:

- protection of policyholders from abuse and defraudation;
- protection of policyholders from the consequences of insolvency;
- a functioning market. This last, somewhat abstract goal also serves the protection of policyholders. Only a functioning market with healthy competition makes security and freedom of choice possible.

At the same time, the legislative power has deliberately advanced liberalization of the insurance market over the last few years, which has enabled insurance companies to assert themselves in an increasingly competitive environment, also internationally. Liberalization likewise requires that insurance supervision adopt a strategic orientation allowing the many different challenges posed by an increasingly demanding and complex business environment to be taken into account.

Preconditions of the supervision philosophy

I would like to address the "how" of this strategic orientation of FOPI today by presenting to you in more detail the concept – or rather, our philosophy – of risk-based supervision associated with the new Insurance Supervision Act (ISA):

The interests of policyholders can only be protected if the market functions as optimally as possible, that is if

- a culture of responsibility prevails:
  The management of the insurance companies is responsible for complying with the laws, ordinances, and rules, as well as for appropriate conduct of business
- the insurance industry acts with integrity:
  Confidence in the insurance market can only exist if those responsible act with integrity.
- an open risk culture prevails:
  An insurance company must be able to handle its risks.
- transparency exists:
  Transparency must exist both within the insurance company and in relation to the market participants. FOPI therefore promotes an open dialogue not only in relation to supervision, but also among the individual stakeholders.
- legal certainty exists:
  Legal certainty is indispensable for economic efficiency. The supervisory authority participates in safeguarding legal certainty. This is achieved in particular by interpreting the existing scope of discretion in the interest of long-term security and by not pursuing short-term interests.

Strategic principles of supervision

Based on the preconditions outlined above, FOPI defines its supervision philosophy through the following key terms: risk-based, principle-based, and competition-oriented.

Risk-based supervision

The central orientation of supervision is based on a quantitative and qualitative analysis of the risks of insurance companies. This ensures that the claims of policyholders can be met with a high degree of probability. The main goal in this respect is not to prevent insolvencies at any cost. The responsibility of supervision is rather to protect policyholders from the consequences of insolvency.

Principle-based supervision

The goal of FOPI is to rely on principle-based supervision to the extent possible. The Swiss Solvency Test (SST) as a core element of risk-based supervision is an example of principle-based supervision. This means that the supervisory authority does not insist on compliance with rules and requirements that are generally static and associated with a lot of bureaucracy, but rather it defines overarching guidelines, compliance with which is the responsibility, but which is also in the best interest of the individual insurance companies themselves. In this way, for instance, the SST defines the character of the key economic parameters and the requisite internal models and at the same time enumerates the minimum requirements on transparency and responsibility on the part of the top management.

Because of its open approach to interpretation, principle-based supervision is significantly more complex than rule-based supervision, and it therefore places greater demands not only on the insurance companies, but also on the staff members of the supervisory authority. It is therefore essential that the supervisory authority be endowed with the necessary competences. Or in other words: Principle-based supervision can only work if the supervisory authority is able to present itself as a competent and recognized interlocutor in relation to the – generally better paid – experts and the management of the insurance company in question.

Competition-oriented supervision

At the same time, FOPI must ensure that competition in the insurance market works and that its impact is beneficial to all relevant market participants – within the guideposts established by law. From a regulatory perspective, promoting this competition means that the dynamic momentum and ability of the market to regulate itself must be used deliberately to establish supervision that is as efficient and cost-effective as possible. In addition, various transparency requirements help ensure that both supervision and the market are able to undertake an evaluation of the company that is as close to the truth as possible.

Moreover, competition also exists between the regulations of different countries and regions. From a global perspective, the nature of the regulatory conditions is therefore of decisive importance for an insurance company operating internationally. Accordingly, FOPI consciously relies on a supervision philosophy that makes competitive advantages possible for the companies under its supervision and therefore ultimately for the affected client.

Instruments of supervision

FOPI is convinced that these strategic principles provide the basis for competent supervision that supports the competitiveness of the insurance sector, and for ensuring that this supervision can also be designed in a very cost-effective and efficient manner. For this purpose, all supervisory activities – to the extent that laws and ordinances allow room for manoeuvre – are based on cost/benefit considerations. For instance, this means that requirements of a purely formal nature are avoided to the extent possible.

The Swiss Solvency Test (SST) developed by FOPI creates a considerably better understanding of the assumed risks and the necessary capital adequacy – both for the supervisory authority, but also for the companies themselves. On the basis of in-depth knowledge of their own risk structure, the SST helps the affected insurance institutions achieve a competitive advantage over companies that do not have this knowledge.

In addition to the central questions of reserves and solvency, the new law contributes an additional dimension of supervision that has already been conceptually applied in the SST: the increased attention paid by supervision to a qualitative review of the various risks. The supporting idea behind this model is self-monitoring and self-assessment, based on relevant guidelines provided by the supervisory authority. Interventions by the authority only occur if the self-assessment leads to conspicuous or strikingly divergent results compared with the general benchmark values based on experience.

At its core, insurance supervision is direct supervision, and not dualistic supervision in the sense of transferring essential supervisory activities to audit companies. Naturally, however, a moderate outsourcing of supervisory activities is sought, in which the cost/benefit ratio of all inspection activities can be optimized. In this regard, it must be taken into consideration that outsourcing to highly specialized private experts inflates costs, since the requisite expertise is a limited resource and therefore very expensive. Moreover, outsourcing in the areas of the aforementioned core competencies is not desirable for the reasons of principle explained above.

Transparency

FOPI wants to support and promote regulation by the financial market to the extent possible. In this sense, FOPI supports the voluntary transparency of insurance companies. Both for the policyholders and for the insurance market, it is desirable if the insurance companies publish relevant risk information – sensitivity, risk measures, their main exposures, their rating, or their probability of failure according to the SST – so that the market participants can get an idea of the financial situation of the company. In this respect, we do not primarily define our role as a supervisory authority by formulating detailed transparency requirements. Rather, the market and the relevant market participants should demand more relevant information themselves.

At the same time, the new ISA and the newly revised provisions of the Insurance Contract Act (ICA) address important concerns of consumer protection. In addition to improving transparency in the individual insurance lines as well as expanding the information requirements of insurers, the legislation in particular now makes insurance brokers subject to supervision.

Transparency in the sense of publicly accessible information and verification also affects the supervisory work of FOPI itself, however. Wherever possible, new supervision concepts should be developed and discussed in public and with the participation of circles that are as large as possible. This is achieved by creating special organs such as the Standard Setting Board and on the basis of our involvement in international bodies such as the IAIS, the Joint Forum, or the OECD.