Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

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The Swiss Solvency Test

The Swiss Solvency Test (SST) is designed to capture the economic risk situation of insurance companies. This supervisory instrument aims to ensure that insurance companies can permanently provide the benefits promised.

Safeguarding policyholders is one of the key responsibilities of the Swiss Financial Market Supervisory Authority FINMA. The form of protection FINMA provides is collective and not individual. It does so by ensuring that insurance companies always have sufficient financial resources available to meet their long-term payment obligations. This is the only way in which insurance companies can meet their contractual obligations concerning the benefits they have promised. Monitoring solvency levels by applying the Swiss Solvency Test (SST), an innovative calculation method, therefore serves as a form of consumer protection.

The SST defines the minimum amount of economic capital an insurance company must have available.

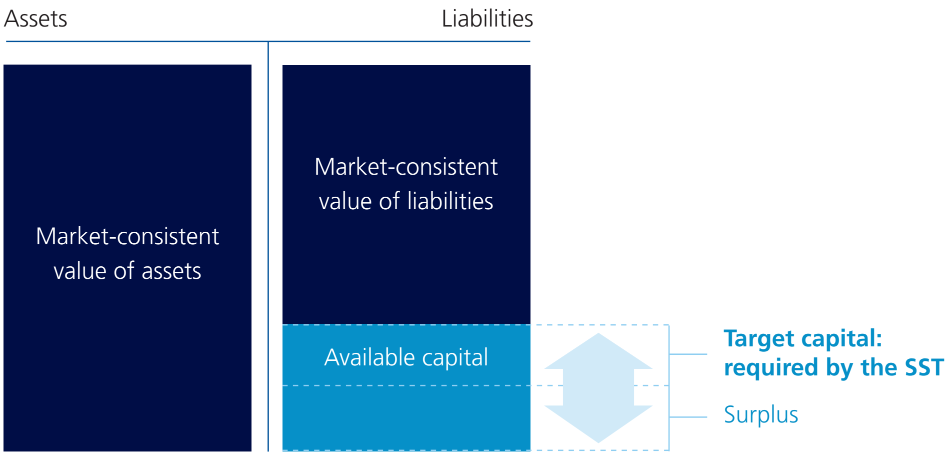
The SST measures an insurance company's risks
The SST defines the minimum amount of economic capital an insurance company must have available. This amount is determined based on the risks the company assumes. The higher the risks, the larger its capital requirements will be.

As a first step, the insurance company determines its available capital by giving a value to each position (assets and liabilities) on its balance sheet. Valuation in the SST is carried out on a market-consistent basis. It is then assessed whether the identified available capital can meet the SST requirements, i.e. whether it is sufficient to cover the company's obligations also in less favourable times. The insurance company must therefore be clear about the risks that its balance sheet is exposed to and their effect on the capital available in the event of a worst-case scenario.

FINMA determines capital requirements in such a way that an insurance company will remain financially unscathed even when faced with a once-in-a-century negative event. Capital calculated in this way is referred to as target capital. The SST considers all the relevant market, credit and insurance risks.

Insurance companies use a standard model prescribed by FINMA to assess their risks. If an insurer's specific risk situation cannot be reflected accurately in a standard model, the insurance company must develop its own internal model. Such internal models must satisfy the SST requirements and can only be used with FINMA's approval.

Balance sheet of an insurance company



The SST is based on three basic principles

- Market-consistent valuation: Financial instruments that have a market price must be recognised in the balance sheet at market price. Positions without a market price must be valued with the help of a model that is based on market prices. This ensures that the insurance company's balance sheet reflects the economic reality.
- Capital requirements are risk-based: Market, credit and insurance risks must be taken into consideration when determining the target capital.
- The balance sheet as a whole is taken into account and may not include any off-balance sheet positions. The interdependencies between the risks on the assets side and the risks on the liabilities side of the balance sheet are taken into account.

The SST allows early recognition of insurance companies experiencing financial distress.

The SST allows for early warning

The SST allows early recognition of insurance companies experiencing financial distress. Moreover, as the available capital is determined at market value, any changes in interest rates or equity prices are reflected immediately in the available capital.

Effective risk management that relies on hedging or risk transfer can protect the available capital against fluctuation in the financial markets.

However, a situation in which the available capital was less than the target capital would be a cause for alarm. FINMA would then require the insurance company to take measures to be adequately capitalised again. For example, FINMA can request the insurer to reduce its risks or transfer the portfolio to another insurance company. The SST thereby contributes towards identifying risks at an early stage and protecting policyholders' interests.

The SST heightens risk awareness

The SST enables insurance companies to manage their relevant risks. Because the SST relies on market-consistent valuation principles and risk-based capital requirements, it provides a more exact picture of the insurance companies' risk situation. On the other hand, key indicators of the SST may vary substantially and thus require permanent monitoring. The SST requires insurance companies to manage their risks in line with economic principles and has helped them to make clear improvements in how they deal with risk management.