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New Swiss Insurance Regulations from a EU Solvency II Perspective

Swiss Insurance Day

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New Swiss Insurance Regulations

- New Swiss insurance supervisory regulation in force since January 1, 2006
 - Insurance Supervisory Law (ISL) of December 17, 2004 (SR 961.01)
 - Insurance Supervisory Ordinance of November 9, 2005 (ISO)
 - Insurance Supervisory Ordinance of FOPI of November 9, 2005 (ISO-FOPI)
 - Various Directives and Circulars



Comparison of main elements of the new Swiss Insurance Regulation to Solvency II



Main elements: Triggering events



- Wish to modernize the 30 years old regulation that does not reflect developments
- Consolidation of various directives
- Should overcome differences in national implementation of the prior directives
- Better Regulation Approach
- Experience of the years 2001 and 2002 including the limits of Solvency I



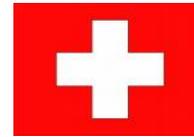
- Wish to modernize the more than 20 years old regulation that does not meet modern requirements in all respects
- Consolidation of various statutes and ordinances
- Experience of the years 2001 and 2002 including the limits of Solvency I



Main elements: Supervisory philosophy



- Principle based
- Risk oriented
- Relying on management acting responsibly
- Three pillar system
 - Solvency II
 - Governance and Risk Management
 - Reporting and disclosure
- Principle of proportionality



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Main elements: Purpose



- Financial solidity of insurance undertaking
- Protection of the stability of the financial system
- Fair and stable markets



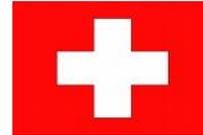
- Protection of solvency and avoidance of abuse
- Protection of system only indirectly recognised



Main elements: Objectives



- Improve consumer protection (Insurance contract law to date not harmonised)
- Modernise supervision
Improve integration
- Enhance competition of European insurance undertakings



- Consumer protection addressed in part by the Insurance Contract Law, in part by the Insurance Supervision Law
- Modernise supervision
- Focus on Switzerland and its relation to foreign countries
- Enhanced competition – as by product of regulation



Main elements: Quantitative supervision



- Solvency requirements
 - Cover the entire balance sheet
 - Protect not only against insurance risks, but also against
 - Market risks
 - Credit risks
 - Operational risks
 - Minimum Capital and Solvency Capital Requirements
- Insurance liabilities



- Swiss Solvency Test
 - Covers the entire balance sheet
 - Protects not only against insurance risks, but also against
 - Market risks
 - Credit risks
 - No inclusion of operational risks
 - Minimal and Target Capital
- Insurance liabilities/Tied assets



Main elements: Qualitative supervision



- Focus on Governance (including also Risk Management)
- Complemented by mandatory functions
 - Risk Management and Risk Modelling
 - Actuarial
 - Compliance
 - Internal controls
 - Internal Audit
- Investment principles



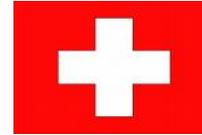
- Focus on Governance and Risk Management/Internal Controls System (includes Compliance too)
- Complemented by
 - Responsible Actuary
 - Internal and External Audit
- Investment policy



Main elements: Traditional supervision



- Elements of Traditional Supervision maintained
 - Scope of application (with exceptions)
 - Admission
 - Certain elements of ongoing supervision
 - Cessation of business
 - Etc.



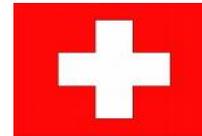
- Elements of Traditional Supervision maintained
 - Scope
 - Certain elements of ongoing supervision including Solvency I
 - Cessation of business
 - Etc.



Main elements: Supervisory processes



- Internal assessment of risks and solvency (Own Risk and Solvency Assessment, ORSA)
- Supervisory Review Process, focusing on assessment of risk profile, quality of risk management and of governance



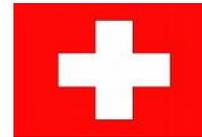
- Swiss Solvency Test
- Swiss Quality Assessments (Governance Tool, Risk Management/Internal Controls System Tool)
- Solvency I
- Insurance liabilities/Tied assets
- Reporting FIRST



Main elements: Group supervision



- Identification of Group Supervisor within the EU
- Allocation of roles between Group Supervisor and national supervisory authorities



- Determination of competence for group und conglomerate supervision
- Parallel to solo-supervision
- Group and conglomerate supervision addresses Solvency I and II, Governance and Risk Management



Main elements: Next steps



- Report on Guarantee Schemes end of 2007
- Review of IORP and Conglomerates Directive in 2008
- Decision on European Standard Formula in 2009
- Solvency II Directive to enter into force of law in 2012



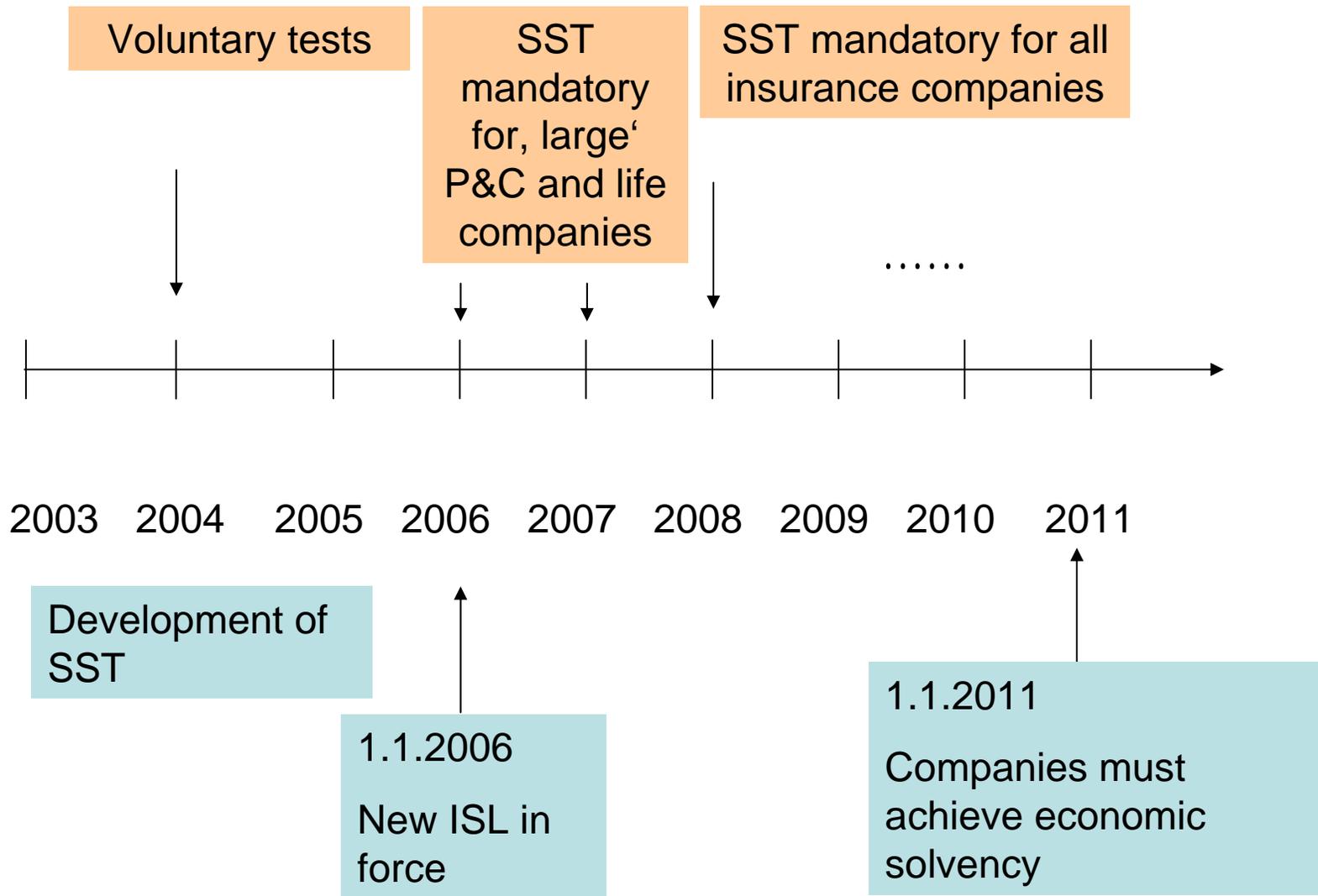
- Finalise Directives
- Adjust for integrated supervision by end of 2010



Swiss Solvency Test SST and Solvency II



SST Implementation Plan





SST and New Insurance Supervision Law (ISL)

- Both Solvency I and Solvency II requirements have to be met
- Reporting both on a statutory and an economic basis
- Rigid rules for tied assets

SST has established itself as an essential supervisory tool



SST and IAIS

- The International Association of Insurance Supervisors (IAIS) defines a three pillar approach to supervision
 - Solvency capital requirements (quantitative)
 - Supervisory review process, corporate governance and risk management requirements (qualitative)
 - Transparency and market conduct requirements

- SST is fully compliant with IAIS requirements in respect of quantitative supervision
- SST has implications for pillar II and pillar III: risk management, corporate governance and transparency requirements



SST and Solvency II

The basic principles of both frameworks are identical

- Total balance sheet approach
 - All financial instruments have to be taken into account, no off balance sheet items
 - All positions must be dealt with consistently
- Economic valuation
 - Assets and liabilities are valued market consistently
 - Positions having a market value are marked to market
 - Positions having no readily available market value are marked to model
 - Non hedgeable insurance liabilities: cost of capital approach



SST and Solvency II

The basic principles of both frameworks are identical

- Risk based capital requirements
 - Solvency capital requirements are based on the risk profile of the entity
 - The risk categories which are taken into account by the SST are insurance risk, market risk and credit risk
 - Operational risk is taken into account by Solvency II but not by SST
 - Liquidity risk largely outside the scope of both frameworks
- Both frameworks are an integral part of the risk management of the supervised entity



SST and Solvency II

Differences in implementation

- Calibration (SST v. Solvency II)
 - Risk measure: Expected Shortfall vs. VaR
 - Confidence level 99% vs. 99.5%
 - Time horizon and holding period: one year
- Standard Model
 - Stochastic model vs. formula based approach
 - Slight differences in modeling the dependencies between risk categories
 - SST uses generic and specific scenarios
 - SST emphasizes principles and encourages the use of internal models (mandatory for reinsurers and groups)



SST and Solvency II

Differences in implementation

- Group Model
 - Modeling of the group structure vs. consolidated approach
 - Transfer of assets between legal entities only on the basis of capital and risk transfer instrument (CRTI)
 - Model takes into account
 - Restricted fungibility of capital
 - Limited liability of shareholders
 - Group solvency is equivalent to solvency of each legal entity of the group taking CRTI into account
 - Realistic assessment of diversification effects and group risk



SST and Solvency II

Differences in implementation

- Eligible own funds (EOF)
 - SST recognizes only two tiers of capital
 - To some extent mandatory convertibles can be recognized as tier 1 capital
 - Guarantees, calls, etc have impact on required capital (in general no material effect on EOF)
- Solvency ratios not directly comparable:
RBC/TC vs. EOF/SCR
- Transparency requirements: definition still needs to be refined within the SST framework



SST and Solvency II

Differences in scope

- Within the framework of the new ISL, all legal entities must meet the risk based capital requirements as defined by the law
- For reinsurance captives, required solvency capital is based on formula
- Insurance groups and conglomerates under group supervision must perform a group SST

Similarities in roll out of both solvency systems

- SST: Field tests since 2004, full implementation in 2011
- Solvency II: QIS I, II, III, ...



SST and Solvency II

Summary and conclusions

- The basic principles of both frameworks are identical
- All legal entities and groups have to meet risk based capital requirements
- SST and Solvency II are equivalent
- SST is fully compliant with IAIS requirements in respect of quantitative supervision



Impact of Solvency II on third country insurance undertakings



Impact of Solvency II on third country insurance undertakings (1)

Branches

- Branches of third country insurance undertakings dealt with like branches of EU insurance undertakings
- Admission to crossborder business from third countries into the EU to be decided by national jurisdictions of the EU, provided they meet the EU and international requirements
- Requirements for testing equivalency of solvency regimes of third countries
- Agreements on mutual recognition provided for

For relationship EU-CH

- Non-Life Insurance Treaty 1989/1993



Impact of Solvency II on third country insurance undertakings (2)

Groups

- Equivalence test of supervisory regime in country where parent undertaking has its head office outside the EU
- Fall back rules in case of non-equivalence
- Agreements on cooperation, mutual recognition and information exchange provided for



Concluding remarks



Concluding remarks (1)

- Both models represent a very modern concept of insurance regulation and pursue the same purpose with similar or equivalent instruments
- Complemented in the EU by an integration focus
- Switzerland is fairly advanced with the implementation, since the ISL entered into force of law in 2006
 - New Regulation largely known in Switzerland
 - Further implementation guidance being developed
 - Transposition of the Integrated Insurance Framework will require adjustments



Concluding remarks (2)

- Legislative process and implementation guidance still ahead in the EU
 - Direction clearly visible, results not yet visible in all details
- Platform for a pro-active exchange, recognition and cooperation between the EU and Switzerland in the area of insurance supervision