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Office fédéral des assurances privées OFAP
Ufficio federale delle assicurazioni private UFAP
Swiss Federal Office of Private Insurance FOPI

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Insurance supervision in Switzerland: from the old world to the new world

Herbert Lüthy, Director

Background
Two and a half years ago, in the summer and autumn of 2002, insurance supervision was a highly charged political issue. The basic question concerned whether the existing system of supervision could still meet the demands of the greatly changed economic environment. This question was largely answered in the negative, and a new orientation was called for.
Today, the definition of this new orientation is largely complete. We not only know where the journey is headed, but the essential elements have also been developed. This annual report is part of this effort and aims to increase transparency. It serves to account for our activities and the status of implementation of the new orientation. I am pleased that we may present ourselves to the public with this publication and brief you on our core activities. And not only that: For the first time, we are able to give you a current market overview. In a simple and clear manner, the overview shows how the sector performed in 2004. With this overview, we are fulfilling a need that has been communicated to us repeatedly over the last three years, but that we had until now only been able to fulfil in the second half of the year.

Why is there a need for supervision?
Insurance companies and banks, unlike most other business sectors, are supervised by the State. Why? In the case of insurance companies, the main reason is that insurance protection is often of great, even existential importance for individual insured persons. At the same time, the processes in these companies are very complex and difficult to grasp.
The economic importance for the individual in our country is also demonstrated by the fact that, for example, the Swiss are ranked number one worldwide in per capita expenditures for insurance: They spend about 7000 Swiss francs per year on insurance – not including social security contributions. In return, they are entitled to compensation for insured damage, payment of hospital bills, and actual payment of occupational pensions for which they have paid premiums over the course of their working life. In short: They are entitled to a high level of security. And of course, the appropriate premium should be paid for this security, namely exactly as much as is necessary to cover potential damage.
The central responsibility of supervision is to protect these fundamental interests of insured parties. Since the beginnings of insurance supervision, this has resulted in the definition of a dual task for the responsible authority:

- protection of the insured party from abuse
- protection of the insured party from insolvency of an insurance institution.

As facile as this task may seem at first glance, as complex and time-consuming it ultimately is in practice: Protection from insolvency in particular, which must be guaranteed over the long term, places high demands on the responsible supervisory authorities.

Supervision in the past: from the old world…
Until now, this task in Switzerland has primarily been fulfilled through prior approval of the insurance products by the supervisory authority. The focus was on approval of the premium; i.e. a premium that was neither abusive nor a threat to solvency.
But the „right" premium alone does not suffice to prevent insolvencies of insurance institutions; not, for example, if the insurer's reserves plummet below the necessary minimum due to unforeseen developments, or if its equalization fund is not adequate, i.e., its capital resources are insufficient. In addition, the functioning market has an effect. For reasons of competition, individual market participants may decide to reduce their premiums to a minimum and simultaneously distribute surpluses rather than retain them. These mechanisms led to the understanding that the central element of effective insurance supervision cannot be preventive product monitoring, but rather comprehensive solvency monitoring, in conjunction with general protection from abuse.

…to the new world

In practically all countries, these insights have led to a fundamental rethinking of the supervision philosophy and of supervision law. Also in Switzerland: with the new Insurance Supervision Law (ISL), our country is receiving modern legislation. This legislation takes into account the developments of recent years in three ways:

- Maintenance of preventive product monitoring in socially sensitive areas, namely occupational pensions („collective life") and in supplemental health insurance pursuant to the Insurance Contract Law (ICL). Product monitoring will therefore continue to be an important activity.
- Extension of protection from abuse, especially by introducing broker supervision and extending requirements with respect to corporate governance. However, expectations should not be too high in this area. The over 12'000 brokers and insurance agents who operate in Switzerland cannot be supervised „up close". Broker supervision must therefore limit itself to the monitoring of key points such as registration (as a seal of approval of relevant expertise), training, and appropriate liability insurance. In the area of corporate governance, i.e. the monitoring of good business management, the law only provides for general requirements. The focus here is currently on the step-by-step implementation of a process of newly developed quality review.
- Greater emphasis on solvency protection, especially by introducing the legislative requirement to take into account the risk profile of the insurance enterprise. This is at the heart of the new supervisory philosophy – accordingly, the following discussion will pay special attention to it.

The „new" risk-based solvency supervision

The central question for solvency supervision is how solvency can be ensured in the first place. The first step is to secure the appropriate reserves. Then, the correct equalization fund must be provided, which essentially corresponds to equity capital. The solvency margin provides information on the amount of this equalization fund. The monitoring of correctly structured reserves and the solvency margin of the insurance institutions accordingly shift into the focus of risk-based supervision activity. As part of its risk-based supervision, FOPI will therefore issue very specific guidelines for calculating reserves. Especially in the case of damage insurers, the process for calculating the correct reserves is defined as a risk process that should lead to the evaluation of the fundamental data. The plan is to implement this process through self-assessments of insurers themselves, subject to monitoring by the supervisory authority. In addition – as will be explained in more detail below – an additional solvency value will be introduced on a completely new basis.

Solvency II

The rules currently applicable to the calculation of solvency, i.e. the equity capital of the insurance institution, are based on the so-called „Solvency I" process of the EU. Switzerland implemented these rules through amendments to the old ISL. These Solvency I principles will continue to hold and have been integrated into the new ISL.

At the same time, it is undisputed both within the EU and in Switzerland that the definitions for calculating solvency in accordance with Solvency I do not suffice. They are insufficiently differentiated and, in particular, do not take into account the risk profile of the insurance portfolio. The corresponding capital deposit requirements therefore also do not reflect the risk-oriented capital need. International rating agencies have therefore long consulted risk-based measures in order to evaluate the financial strength of insurance companies. How necessary such an approach is was demonstrated to the broader public in a dramatic way when the stock markets collapsed (approximately March 2000 to March 2002): Many insurance companies worldwide ran into severe difficulties, since their equalization funds had not adequately taken the capital risk into account.

The discussions in this regard are being conducted in the EU under the name „Solvency II" – in a certain analogy to Basel II in the field of bank supervision. At the same time, important differences between insurance companies and banks must be taken into account. In the case of insurance, the dependencies between risk concentrations, risk aggregations, and risk diversifications play a significantly greater role. In addition, insurance supervision is in general also subject to the desire of politics and society that insurers take on parts of the social security net.

The questions to be dealt with are accordingly complex. The Solvency II discussion has already led to very good, generally accepted principles, but has not yet led to any concrete implementation. As always, the devil is in the details, and it should therefore be expected that much work remains to be undertaken in the EU until the Solvency II rules can be adopted as general directives and attain the force of law in the EU States. This will likely not be the case before 2008 and could even take until 2010 or 2012. Switzerland does not want to and cannot wait that long.

The situation in Switzerland: new ISL and new Supervision Ordinance

The principles of Solvency II that are already available, the pilot projects undertaken in Switzerland, and the risk-based models used in other countries (such as Australia, Canada, the United Kingdom, and the United States) show that the consideration of risk in calculating necessary capital resources not only results in many differentiated solutions, but also deepens the understanding of the risk situation of an insurance company.
This circumstance is not only of utmost importance for supervision, but also – and this is probably even more crucial – for the companies themselves. FOPI therefore took up the principles of Solvency II and staked out the goal of elaborating the corresponding application and implementation of risk-based solvency supervision even before entry into force of the new ISL. Such a large and ambitious goal was only achievable with the support of all affected actors in Switzerland (and some actors abroad) who possessed the relevant know-how. In the spring of 2003, FOPI therefore launched a project that was supported by specialists from the insurance industry, management consultant companies, and universities. The project succeeded in elaborating the appropriate applications and mathematical models by the summer of 2004 to the extent that a first field test with ten selected insurance companies could be undertaken. The Swiss variant of risk-based supervision, named Swiss Solvency Test (SST), has also attracted attention abroad.

Initially, the main result of the 2004 field test was that it could even be conducted. Although this may sound trite, it was of fundamental importance to FOPI. In addition, it was shown that SST demonstrates a favourable cost/benefit ratio for insurance institutions as well, and that it leads to very good and plausible figures. The results of the field test helped further develop SST, so that a new field test can be conducted in the early summer of 2005, this time with 45 insurance companies.
FOPI is therefore well-prepared for the scheduled entry into force of the new ISL on 1 January 2006. The relevant provisions of the Supervision Ordinance can be supported by the experiences of two field tests. At the same time, a step-by-step enactment of SST is intended, due to the extraordinary complexity of the risk categories to be calculated, but also due to the related learning process among all involved actors.
SST therefore creates a considerably better understanding of the risks entered into and the necessary capital resources, both for supervision and for the companies themselves. But why doesn’t FOPI wait for the corresponding Solvency II rules of the EU? The answer is simple: An introduction of SST as soon as possible not only will increase the effectiveness of supervision, as is demanded in any event by the legislative power with the new ISL. Due to the more in-depth knowledge of their own risk structure, it will also help affected insurance institutions achieve a competitive advantage over companies that do not have this knowledge.

Comprehensive qualitative supervision

In addition to central questions of reserves and solvency, the new law contributes an additional dimension of supervision that has already been applied conceptually in SST: the increased attention of supervision to qualitative review of the various risks. But this requires additional, qualitatively oriented models.

These models complementing SST are therefore deliberately embedded in an overall concept of comprehensive assessment of the general risk management of companies. The central question in this regard is how new actuarial, but also operational risks can be managed in advance. The goal is therefore to have a set of instruments that meet the demands of the insurance industry in the field of tension between protection of insured parties and solvency supervision. The goal is also to attain a holistic overview of the market and to identify the risks for insurers early on that are relevant to success. At the same time, FOPI wants to ensure that the very limited human resources of supervision are developed in a targeted manner and can be employed efficiently.

Against this backdrop, FOPI has developed a general model for qualitatively oriented supervision that can also be tested with the companies and then modified if necessary. 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 will only occur if the self-assessment leads to obviously or strikingly divergent results compared with general „benchmark values" based on experience. This form of qualitative supervision is particularly suited to the processes of risk management, corporate governance, the provision of reserves, and the use of information technologies, and can be expanded to other risk-relevant business processes as needed.

Foundation established for the future

The expansion of consumer protection, the implementation of risk-based solvency protection with the Swiss Solvency Test, and the complementary attention paid to qualitative supervision are the cornerstones of the new system of supervision. This new orientation in the quality aimed for meanwhile entails that the supervisory authority must have sufficient quantitative and qualitative resources.

The new system of supervision will strengthen the security of the insurance market and thereby also the interests of the insured parties. The task of FOPI over the next few years will be to implement this new supervision philosophy and the newly created supervision instruments step-by-step and to continuously adapt them to the current demands and circumstances. At the same time, the supervision activities that are no longer necessary as a consequence of the expansion of solvency monitoring will be reduced, so that supervision can increasingly focus on what is essential. During the implementation of the new supervision strategy, FOPI will therefore also ensure that innovation and competition are not thwarted by over-regulation. In this way, supervision will make an essential contribution both to the protection of insured parties and to the stability of the Swiss financial centre.

Total revision of the ISL / Partial revision of the ICL: Implementation can begin

After intensive debates in both chambers, the Swiss Parliament adopted the draft bills on 17 December 2004. The new provisions are expected to enter into force on 1 January 2006. The main goals of the revision were to secure the long-term stability of the insurance companies and to improve the protection of the insured parties.

1. Consideration by Parliament
The new supervision rules were a topic of discussion in all parliamentary sessions of the year under review: After the Council of States, which was the first chamber to consider the proposal in December 2003, the National Council considered the draft bills in the spring session; the Council of States considered the draft bills again in the summer session in June to reconcile the differences between the versions of the two chambers, the National Council again in the autumn, and both chambers one last time in the winter session. Just prior to convening a harmonisation conference, the two chambers finally agreed on the proposals, so that the draft bills could be adopted by both chambers unanimously in the final vote on 17 December 2004.

Despite the long and intensive debates, the new Insurance Supervision Law (ISL) was praised overall in Parliament as a good foundation for effective insurance supervision. The so-called „new supervision strategy" was not called into question in any way. The new system of risk-based solvency supervision, the introduction of group and conglomerate supervision, the increased observance of the principles of good corporate governance, the creation of the function of a responsible actuary, the strengthening of consumer protection through the expansion of information obligations in accordance with supervision law, the obligation incumbent upon independent insurance brokers to enter themselves in an official register, and the tightening of penalties were broadly endorsed and remained uncontroversial. Over the course of the parliamentary debates, the proposal of the Federal Council of 9 May 2003 nevertheless was subject to not insignificant changes in some other equally important points:

a) One of the goals of the revision of the supervision rules was the replacement of *preventive product control* through a tightened solvency control. Through this liberalisation, the Federal Council aims to increase competition and accordingly the diversity of insurance products at lower premiums. At the same time, this shift is intended to achieve harmonisation with the law in EU member States. Parliament endorsed this idea only in part. It decided to maintain preventive product control in the "socially sensitive" areas of occupational pensions and the supplementary insurance to mandatory health insurance.

b) The area of *occupational pensions* took up a large part of the parliamentary debates.

- The „transparency requirements" for life insurance adopted as part of the second Pension Law* revision, which entered into force on 1 April 2004, were included in the draft of the new ISL, but were viewed with great suspicion. Parliament demanded in particular an enshrinement of the „legal quote" in the Law and not only in the Ordinance, as this had been the case since 1 April 2004. „Legal quote" is understood to be the minimum share of returns on assets and any risk or cost profits, that must be credited to the insured parties in accordance with life insurance agreements. Parliament fixed the legal quote, in accordance with the existing ordinance provision, at 90%.
- The procedure for reconciling the versions of the two chambers focused almost exclusively on the business activities of life insurers with respect to occupational pensions. The National Council demanded that all occupational pension schemes entered in the register for occupational pensions be subject to supervision in accordance with the Pension Law, not insurance supervision. The Council of States ultimately agreed to this demand.
In addition, the National Council had proposed that the provisions of the Pension Law trump the provisions of the ISL if life insurers engage in business activities relating to occupational pensions by concluding collective agreements, and that Federal Office of Private Insurance (FOPI) should take into account any mandatory insurance rules when monitoring premium rates. The National Council subsequently dropped both demands due to disagreement with the Council of States.

* Federal Law on Occupational Old Age, Survivors' and Invalidity Pension Fund = Bundesgesetz über die berufliche Alters-, Hinterlassenen- und Invalidenvorsorge (BVG)

c) The partial revision of the *Insurance Contract Law* (ICL) also took up much discussion time. As an expert commission is currently undertaking a draft for a total revision of the ICL, the draft bill therefore only envisaged amendments that arose necessarily from the revision of the ISL or that had to be viewed as urgent due to repeated parliamentary initiatives. Parliament, however, also considered it necessary to regulate certain questions of consumer protection already on the basis of the partial revision and not to wait for the results of the expert commission. In particular, this affected the strengthening of information obligations for insurance companies vis-à-vis insured parties in the area of business activities relating to occupational pensions.

2. Supervision Ordinance*

The new Law requires new ordinance provisions. The efforts in this regard have been underway for quite some time. In 2003, FOPI project groups outlined the content of a new ordinance; in the first half of the year under review, it developed a concept for the legislative procedure and a specific draft ordinance on the basis of this preparatory work. The preliminary draft was circulated for consultation to interested circles in the middle of August, including in particular the Swiss Insurance Association, the consumer protection organisation, and the associations of insurance brokers. The numerous and in part very substantial comments resulted in the review of various points of the draft. The concept for a new Supervision Ordinance envisages the unification of all existing provisions, which are currently distributed among more than a dozen ordinances, in a single ordinance. The plan is to have the new Supervision Ordinance enter into force at the same time as the Law, i.e. on 1 January 2006, after the conclusion of the external and administration-internal consultation processes.

3. Money Laundering Ordinance of FOPI**

The Money Laundering Ordinance of FOPI will continue to remain outside the Supervision Ordinance. It is not based on the Insurance Supervision Law but on the Money Laundering Law***. The Money Laundering Ordinance is also in need of revision. One reason for this revision is the new ISL itself, the final clauses of which amended the Money Laundering Law for the purpose of transferring the responsibility for monitoring measures for combating money laundering by independent insurance brokers from the Money Laundering Control Authority to FOPI. A further reason is the ongoing adjustment of the Money Laundering Law to the revised recommendations of the Financial Action Task Force of the OECD. A final reason is the revision of 17 December 2003 of the insurance agreement with the Principality of Liechtenstein, which further specified the powers and the applicable law for the supervision of due diligence in concluding contracts via foreign branches and free movement of services across borders. The work on revision of the Money Laundering Ordinance is being undertaken in parallel with the revision of the Supervision Ordinance.

* Aufsichtsverordnung (AVO)
** Geldwäschereiverordnung des BPV (VGW)
*** Geldwäschereigesetz (GWG)

Swiss Solvency Test – first trial run conducted in 2004

The risks to which insurance companies are exposed are manifold: tight stock markets, terrorist attacks, natural disasters, and demographic developments, to name only a few. A new approach for ascertaining the ability of insurers to handle risks – their „security" – is the Swiss Solvency Test (SST) conducted by the Federal Office of Private Insurance (FOPI). In the year under review, a first trial run was carried out with the model developed for the SST.

1. Objectives of the SST

In short, the SST determined a target capital that is necessary for an insurer to survive the risks assumed with adequate security. The Swiss Solvency Test primarily pursues two objectives:

- One aim is to promote risk management in insurance companies. The outcome of the SST is therefore more than merely the target capital. Just as important is the path to this outcome, individual interim results, scenarios, and assessments of the responsible actuary or the offices responsible for risk management in the insurance enterprise.
- In addition, the target capital has the function of a warning signal: If the available risk-bearing capital is less than the necessary target capital, this does not entail the insolvency of the enterprise. Rather, either the necessary capital must be built up over a certain period of time, or the risks are to be reduced in such a way – e.g. through improved asset liability management (ALM) – that the resulting target capital can be covered by the available risk bearing capital. The SST is to a large extent formulated on the basis of principles. This means that, where possible, no strict formulas are given for the calculation of the target capital, but rather the supervisory authority defines guidelines that must be respected. Companies are at liberty to choose the path adapted to their circumstances for the calculation. For the supervisory authority, this requires increased insight into the company-specific models and gives the insurance enterprises the incentive to quantify and manage their risks themselves.

2. Consequences for the insurers

In developing the SST, attention was paid that the additional work required of the insurers when conducting the solvency tests will be appropriate.
A significant consequence of the SST will be that more responsibilities will be transferred to the management and to the responsible actuary. The responsible actuary or other offices in the insurance enterprise responsible for risk management must submit an SST report to the management, which may then be requested by the supervisory authority. The SST report serves to document both the risk situation and the calculation of the target capital. The SST report must be drafted in a way that the management and the supervisory authority can assess the true risk situation of the insurance company, but also that an external actuary can reproduce the calculation of the target capital.
With the help of the SST, supervision will increasingly orient itself according to the actual risk situation of the insurance enterprises and also analyse the market-consistent, i.e. economic, evaluation of the assets and obligations, in addition to the statutory figures. The verification of the internal models used will be a challenge for supervision.

3. Swiss supervisory authority engages in pioneering work

The SST gears itself to international developments, taking into account, however, the specific circumstances of the Swiss insurance market. Risk-based solvency systems have already existed for quite some time in Canada, Finland, and the United States. Australia, the Great Britain, the Netherlands, and Singapore have recently introduced systems similar to SST or are close to introducing them. For the last few years, the EU has worked on Solvency II, and an EU-wide introduction is expected in about 5 years.
The SST was conceived as compatible with the future European solvency test in accordance with Solvency II, to the extent this is already foreseeable. Since Switzerland will begin the introduction of the SST earlier than the EU, Switzerland is playing a pioneering role within Europe.

4. Status of work

The development of the SST began in the spring of 2003 and was conducted in close collaboration with representatives of the Swiss Actuary Association, the insurance industry, and the universities, as well as with auditing companies and consulting offices. By the end of 2003, the SST methodology had been fixed, and by the summer of 2004, a number of working groups were developing a model. The result was a model for the probabilities of the available economic capital within a year (stochastic model), which was combined with a series of extreme scenarios (e.g. worldwide flu epidemic).

In the second half of 2004, a number of life and non-life insurers applied this model in a trial run to their own individual situation. This trial run served to determine parameters, to estimate the time investment necessary for the individual insurer, and to recognise inconsistencies in the model. Although this was only a first trial run, the results were such that all participants rated them as plausible.

Some gaps were discovered in the model, however. Since the winter of 2004, mixed working groups have again been taking measures to improve the model. These measures include the evaluation of guarantees, the assessment of the reserve risks, and the manner in which extreme scenarios are dealt with.

5. Future developments

In the summer and autumn of 2005, a further trial run will be conducted. Participation is open to all insurance enterprises that would like to participate. This trial run will again serve to determine individual parameters and models and to test the applicability of the SST to smaller insurance enterprises. In contrast to 2004, the SST will not only refer to business activities in Switzerland, but will also encompass the foreign branches of Swiss insurers. For this purpose, the internal risk models of the insurers will be used.

The use of internal risk models is also envisaged for reinsurers. The reason is that the portfolios of the reinsurers are too disparate to be described by a standard model provided by the supervisory authority. The discussion in this sector deals first of all with the question of how the risks can be measured for legal entities in Switzerland, but also for global corporate groups, and second of all how the effect of diversification within a group (profits in country X together with losses in country Y) can be taken into account and passed on to subsidiaries. This must happen in a way that takes into consideration that capital within a corporate group cannot be moved around completely freely.

With the entry into force of the revised Insurance Supervision Law (ISL), expected on 1 January 2006, the SST will also be introduced. Transitional periods are envisaged for adapting capital reserve requirements to the results of the SST for each individual insurance enterprise as well as in particular for the calculation of the necessary values, such as the market-consistent evaluation of assets and liabilities or the amount of the necessary risk-bearing capital.

Supervision of insurance brokers

Insurance intermediaries now subject to federal supervision

On 9 December 2002, the European Parliament and the Council of the European Union decided to supervise insurance mediation in the EU (cf. Directive 2002/92/EC). With the introduction of the new Insurance Supervision Law (ISL), expected to enter into force on 1 January 2006, Switzerland will also have established an equivalent supervision mechanism. The background is the harmonisation of the regulatory environment throughout Europe: Swiss insurance intermediaries should not be comparatively disadvantaged by comparison with insurance intermediaries abroad with respect to transnational activities. At the same time, a greater control of insurance brokers is being demanded in Switzerland for the benefit of consumer protection.

The legislative basis

The Federal Office of Private Insurance (FOPI) is responsible for the supervision of insurance brokers provided for in the new ISL. Articles 40 et seq. of the new ISL inter alia require FOPI to manage a public register. The Law regulates the preconditions for inscription into the register and determines the information duties of all insurance brokers vis-à-vis insured parties. These information duties must now be fulfilled by every insurance intermediary, independently of whether the intermediary is bound to an insurance company or not. Amongst other things, the person must now be indicated who can be held liable for negligence, errors, or incorrect information. Around 3000 independent insurance intermediaries operate in Switzerland and will be subject to compulsory registration. An additional 10’000 agents of insurance companies will be subject to voluntary registration. The voluntary registration of the agents of insurance companies will be basically welcomed by the insurance industry, because a registration will be considered as necessary in order to be able to keep up with the insurance brokers.

Preparatory work in 2004

After reorganisation of the entire Office as of 1 July 2004, the Insurance Intermediaries Supervision Service was able to begin its work. Its primary responsibility is the establishment of an insurance intermediary register. First, the preconditions for registration into the register were determined: According to the legal provisions, insurance brokers can only be registered if they can demonstrate sufficient professional qualifications and adequate financial guarantees.

- In the area of professional qualifications, rules on the acquisition of the relevant new professional qualifications were established in collaboration with the insurance industry. The rules govern the organisation of examinations and dispensations in addition to training curricula. Upon successful completion of written and oral exams, the insurance intermediaries receive the title of „Insurance Broker VBV“ (Berufsbildungsverband der Versicherungswirtschaft).
- With respect to the question of financial guarantees, the focus is primarily on professional liability insurance for economic loss. At the present time, only a few insurance companies offer coverage in this regard. The Swiss Insurance Association (SIA) has begun to address this problem and will create special sample insurance contract terms and conditions for a product for insurance brokers this year.

Work beginning in 2005

In the current year, solutions must be found in the areas of register management, management of accounts receivable, and archiving. Since, according to the new ISL, the register must be open to the public, the option of querying the register will be made available via Internet. Preparations for this service are underway.
In addition preliminary work is being carried out on other points in intermediary supervision. This is mainly to do with questions on distribution, collaboration agreements, treatment of client complaints, and commission systems.
With the planned introduction of the new ISL on 1 January 2006, insurance brokers will be given six months time to submit an application for entry into the register to the supervisory authority.

Reorientation of non-life insurance supervision

Risk management is also being given a central role in the new supervision over non-life insurers (hereafter non-life supervision): Art. 22 of the revised Insurance Supervision Law (ISL) requires that companies be able to assess, limit, and monitor all risks. The Federal Office of Private Insurance (FOPI) is undertaking to realign non-life supervision according to these risk analyses of the insurance companies. First projects were initiated in the year under review.

In the area of non-life insurance supervision, the „Non-life Insurance" division was created as part of the restructuring of FOPI as of 1 July 2004. About 100 insurance companies that are supervised as non-life insurers have been newly allocated to this division.
In addition to the traditional supervision of non-life insurers, the new division also had to deal with the realignment of non-life supervision. The revised ISL shifts risk management to the centre of supervision activities. Art. 22 requires that insurance companies organise themselves in a way that they are able to assess, limit, and monitor all substantial risks. In addition to traditional insurance risk, many other risks play a role, such as operational risks, financial risk, or strategic risk. With a view toward risk-oriented supervision, FOPI has integrated this risk philosophy into the consideration of the reports submitted by the supervised institutions in the year under review.

1. Results of the SST are included
The results and conclusions from the first field test of the Swiss Solvency Test (SST) will be included in the new non-life supervision; in the year under review, 10 large non-life and life insurers took part in the SST. For the coming year, 45 additional non-life insurers have indicated their desire to participate in the second field test. The evaluations of this test series will provide important indicators for optimising the SST as well as the new non-life supervision.

2. New supervision strategy
With these changes, non-life supervision will in the future not only ensure solvency protection and compliance with the tightened legal provisions, but will also monitor the entire organisation of the insurance company, also on the basis of the existing risk landscape. For the definition and implementation of the new legal point of departure, a number of larger projects were launched in the autumn of 2004 and are being launched in the first half of 2005. It was essential for FOPI to take an inventory of the risks of the dynamic market environment, to reconcile them with already existing knowledge of risk management of the insurance companies, and to refine them. The projects also aimed at a national and international market comparison (benchmarking) of possible evaluations of insurance risks (risk assessment, risk limitation, and risk monitoring), in order to achieve a „best practice".
The new non-life supervision will deal with the analysis of core processes. As a priority, non-life supervision will focus on topics, such as with the settlement of claims and reserve processes.
The objective of the supervision is to verify the most important points of risk management and, where necessary, to define steps on the basis of deficiencies identified.

Group and conglomerate supervision

1. Background
The economic development in the direction of globalisation has also affected the insurance industry. An increasing number of Swiss insurance companies have bought or founded subsidiaries in Switzerland and abroad and have developed into international insurance groups. Although this trend has slowed somewhat in the last three to four years due to the poor stock market development and the focus has been on the core markets, the slump in globalisation should probably be regarded as a temporary development.
In addition, there has been a noticeable trend towards bankassurance in recent years. Large insurers increasingly not only want to offer a broad insurance range, but they also have become active in the banking sector through acquisitions or formations. Banks have also shown the desire to benefit from the synergies of bankassurance, by buying or founding insurance companies. These developments have led to the creation of the five finance conglomerates in Switzerland, four of which are insurance-dominated conglomerates and one of which is a bank-dominated conglomerate. About fourteen so-called insurance groups exist in Switzerland. This number also includes the conglomerates, since a sub-group can always be identified within a conglomerate that constitutes an insurance group.

2. The risks of insurance groups
Supervision of these comparatively young entities must take into account the developments on the market and the related new risks: risks that can arise with such an internationally active economic entity are, for instance, group-internal „risks of contagion", supervision arbitrage between financial activities that are regulated differently, unrecognised risk concentrations, or „falsifications" of the picture of a single company by double use of the same funds, to name only a few.
It is therefore indispensable that the supervisory authority is able to gain an overall picture of the group and that it exchanges information with regulators in other countries, in order to prevent distortions of competition and to achieve greater stability of the financial market. This is important not least in view of enhanced protection of insured parties.

3. Consolidated supervision in Switzerland
On the basis of individual decrees, the finance conglomerates have been made subject to consolidated supervision, through interpretation of the current Insurance Supervision Law (ISL). The new ISL, adopted in December 2004, provides an explicit legal basis for the supervision of groups and conglomerates, resulting also in the consolidated supervision of insurance groups in the future.
In the second half of 2003 and the first half of 2004, the ordinances on group and conglomerate supervision were drawn up, as part of the comprehensive ordinances on the new ISL. The ordinances are compatible both with regulations already issued as well as with the new EU directives (cf. regulation in the EU).

- Credit Suisse Group (bank-dominated conglomerate with Winterthur as insurance component)
- Zurich Financial Services
- Swiss Life
- Bâloise
- Swiss Re

Since conglomerates constitute an economic unit that encompasses both insurance companies and banks, supervision cannot be the sole responsibility of FOPI. With respect to consolidated supervision, FOPI therefore works together with the responsible authority for bank supervision.

4. Consolidated supervision compared with individual supervision
Consolidated supervision complements solo supervision. In contrast to individual supervision, where an insurance company of Switzerland is subject to supervision, consolidated supervision encompasses all companies of a Swiss group, worldwide.

5. Practical supervision activities
In addition to developing the regulation on consolidated supervision of Swiss Re, the practical supervision activities in 2004 included analysis of the reports received and the figures the conglomerates had to achieve; discussion of these reports with the responsible offices in the groups; and visits to the conglomerates for the purpose of deepening understanding of supervision topics.
Contacts with other regulators in Switzerland and abroad took up a further large part of the supervisory activities: In 2004, 8 meetings took place with the Swiss Federal Banking Commission and 6 meetings with foreign supervisory authorities dedicated to the supervised conglomerates. The high demand for coordination of group and conglomerate supervision also required numerous telephone conferences with foreign supervisory authorities, in addition to the personal meetings.
Moreover, FOPI was invited to two coordination meetings of foreign insurance groups that own subsidiaries in Switzerland.

Regulation in the EU and consequences for Swiss groups

Consolidated supervision: Directive adopted in 1998
The EU also recognised the need for consolidated supervision early on and adopted a directive in 1998 on the supervision of insurance companies that are part of an insurance group. The directive had to be implemented into national law by June 2000.
In accordance with these requirements and the accompanying enabling protocol, a country is determined for the coordination of the supervision of each insurance group within the EU (usually the country in which the group engages in the most extensive business activities). The responsibilities of the coordinator consist in compiling the information of the EU supervisory authorities to which the group is subject and to chair the annual coordination meeting. The coordinator does not, however, assume responsibility for the additional supervision.
Since Switzerland is not a member of the EU, it is theoretically excluded from this process, on the one hand, and on the other hand, a coordinator within the EU is also sought for the Swiss insurance groups. In practice, however, the Swiss supervisory authority can participate in these coordination meetings, but without a formal vote, and the Swiss authority is also not allowed to take on the role of coordinator.
Since this approach is not a satisfactory solution either for the supervisory authorities or for the companies, FOPI has been engaged since the middle of 2004 in reaching an agreement with the EU in order to receive equivalent rights and duties as the EU member States for this task.

Adoption of the conglomerate directive
The adoption of the directive on conglomerate supervision followed in 2002, the implementation of which had to be completed by 1 January 2005 in the member States. Also according to this directive, the supervisory authority of a country must be determined as a coordinator. Its responsibilities are more comprehensive, however. In addition to the coordination function, it also assumes general supervision of the group. It therefore is given the function of the lead supervisor („lead regulator“).
The conglomerate directive is not only defined more broadly with respect to the function of the coordinator, but it is also more open vis-à-vis non-EU countries. Accordingly, the possibility exists that the conglomerate supervisory authority of a third country can be qualified as equivalent, so that the third country can assume the function of lead regulator.

Equivalence requirements
According to a general recommendation of the finance conglomerate committee of the EU issued in July 2004, Switzerland fulfils the equivalence requirements. This statement – of great importance for the Swiss groups – can prevent that the conglomerates are subject to double supervision by Switzerland and the EU: Each member country of the EU in which a Swiss finance conglomerate undertakes activities must now review whether it can comply with this recommendation. Only upon conclusion of this process, which is undertaken individually for each conglomerate, will Swiss groups be able to assume that they will not be subject to double supervision.

Implementation of the transparency requi for the insurance of occupational pensions

In the year under review the „Life Insurance" department was primarily involved in implementing the prescriptions which came into force on 1 April 2004 on transparency and the minimum quota on profits achieved in occupational pensions in favour of the insured persons. In a first step a review was undertaken with respect to the separation of the safety fund for all life and pension insurance activities into one fund for occupational pensions and another one for the remaining business activities of each life and pension insurer. The next step following this separation consisted in initiating and accompanying the implementation of the new transparency requirements.

1. Implementation of the legislative requirements by FOPI

1.1 Separation of the safety fund

When implementing the legislative requirements the protection of all insured persons has to be respected (Art. 1 of the Insurance Supervision Law, ISL). This means that the separation of the safety fund and the allocation of investments to the new safety fund for occupational pensions must be undertaken in a way that neither the insured persons for occupational pensions nor the ones for other life insurance policies are unilaterally advantaged or disadvantaged. For this purpose FOPI compiled a detailed description of the principles and the process for separating the safety fund available to the life insurers.

In the year under review the details of the allocations of investments in the safety fund for occupational pensions as proposed by the life and pension insurers were thoroughly examined. After some considerable modifications, the proposals were all approved. Subsequent to the approval, the auditing companies of the life and pension insurers started to examine the implementation – a process that will continue into the year 2005.

1.2 Further changes in accordance with the 1st Pension Act revision*

■ The second major task concerns the introduction of a separate profit and loss account for occupational pensions. Different levels of information must be followed: The account must be structured in a way that its content serves to inform the insured persons, all institutions administering pension funds and FOPI as the supervisory authority. In particular, compliance with the legally prescribed minimum quota to the insured persons must be proven.

■ If an employer cancels its association agreement with an institution administering pension funds, the manner of pension payments must be regulated in particular. In this regard the new legal prescriptions in accordance with Art. 53e of the Pension Act are now subject to legal and technical supervision by FOPI.

2. Financial reporting within the scope of the transparency requirements

Due to the new transparency requirements, which will sustainably improve information provided by funds (foundations and institutions administering pension funds) and life and pension insurers to insured persons, FOPI must now undertake more in-depth reviews compared to reviews in the past. These reviews concern safety fund cover, the calculation of policy settlement values, the development of the surplus funds and the payment of surpluses as well as other transparency data in the occupational pension business. A revised questionnaire on pension funds (specially drawn up for the year 2004) and the newly drafted presentation of the separate profit and loss account (starting in 2005) serve as the basis for the in-depth reviews. Their completion is based on the statutory statement of account requirements in accordance with the rules of the Swiss Code of Obligations and the overlapping rules of supervision law.

* Federal Acton Occupational Old Age, Survivors' and Invalidity Pension Fund = Bundesgesetz über die berufliche Alters-, Hinterlassenen- und Invalidenvorsorge (BVG)

rements

International Financial Reporting Standards (IFRS) and statutory accounts statement
The goal of the International Financial Reporting Standards (IFRS) is to harmonise financial reporting for the purpose of better information and comparability, also among life and pension insurers. Within the insurance sector as a whole, life and pension insurers are hit most. In the statement of account according to the IFRS guidelines, assets and liabilities and the various options and guarantees, such as capital option and interest guarantee, are valuated according to fair value, i.e. according to market values or values close to the market.
In Switzerland a statutory statement of account, i.e. a statement of account according to the Code of Obligations must still be compiled. Contrary to the IFRS guidelines, this type of statement of account is based on the lower-value principle for the assets and the valuation according to the insurance tables at the time of policy conclusion for the liabilities. This type of valuation is self-consistent and is very suitable for the system of direct life and pension insurance as practised in Switzerland, but does not indicate any market values. It is, however, mandatory to provide information on market values in the appendix to the statement of account.
In particular, FOPI was able to demonstrate on the basis of enquiries concerning financial reporting that the use of the statutory statement of account cannot lead to profits for the insurer that exceed the legal threshold – the minimum quota and the related requirements concerning transparency are accordingly fulfilled extensively when applying the statutory statement of account.

3. Transitional provisions
A number of legislative amendments, such as in particular the new requirements on transparency and the minimum quota, entered into force during the fiscal year, i.e. on 1 April 2004. Equally, investments for covering the safety funds for both occupational pensions and other life and pension business activities could only be divided and reviewed by FOPI in the course of 2004. It is therefore not possible to compile precise statements of account for occupational pensions for 2004. Estimates and, accordingly, simplified statements of account shall therefore be accepted for 2004, before a precise procedure will be available as of 2005.

Compulsory transfer of portfolios / Supervision problems with bankrupt healt

The insolvency of three health insurance schemes offering supplementary health insurance policies also occupied the Federal Office of Private Insurance (FOPI) in the year under review: The responsible division was mandated to accompany the transfer of insured pools to other companies and to undertake securing measures for the protection of insured parties and other creditors. Some problems arose under supervision law in this regard.

Three health insurance schemes that offer private supplementary health insurance policies in addition to social health insurance have become insolvent in recent years: For the KBV health insurance scheme and the Accorda health insurance scheme, adjudication in bankruptcy is imminent; bankruptcy proceedings have already been initiated for the Zurzach health insurance scheme. In all three cases, the reasons for the insolvencies lie in the sector of mandatory health insurance.
These cases also affected FOPI: For health insurance schemes operating social health insurance and private supplementary health insurance within the same legal entity, shared supervision applies. Supervision of social health insurance (Health Insurance Law) and institutional supervision are the responsibility of the Swiss Federal Office of Public Health (SFOPH); supervision of supplementary health insurance activities is the responsibility of FOPI. In the event of insolvency, recognition as a health insurance scheme is withdrawn; this has a reflexive effect on the supplementary health insurance activities. Approval for the undertaking of supplementary health insurance activities is tied to the condition that approval for undertaking social health insurance has been granted. Accordingly, as soon as the Federal Department of Home Affairs withdraws a health insurance operation's recognition as a health insurance scheme and its authorisation to engage in business activities due to insolvency, FOPI must act immediately and apply for withdrawal of approval in the supplementary health insurance sector from the Federal Department of Finance and initiate the measures for the protection of persons provided for in the Non-life Insurance Law*.

1. Measures in accordance with supervision law
Insured parties have an interest in concluding their mandatory basic health insurance and their supplementary health insurance with a single insurer. In the insolvency cases mentioned above, both supervisory authorities have therefore endeavoured to find a single health insurer willing to provide organisational support to the insolvent health insurance scheme and to take over the entire pool of insured persons. The objective is for the pool of insured persons of the insolvent health insurance scheme to find a health insurer that provides the necessary financial and organisational guarantee that the claims of the insured persons can continue to be fulfilled in the future.
Among the applications received, the application receives the support of the supervisory authorities which offers the best guarantees with respect to protection of the insured persons, i.e. seamless transition of the pool of insured persons, sufficient solvency, continuation of the existing products or offering equivalent products, financial means for any price to be paid for taking over the insured pool, continuing employment of the former staff members of the insolvent health insurance scheme to the extent possible (know-how of business operations, settlement of benefits, data processing, etc.). Additional criteria may play a role in individual cases, such as the geographic area of operations.
Such a transfer of an insured pool is relatively unproblematic for the area of mandatory health insurance since acceptance is compulsory for the insurer and since standardised products exist. In the area of supplementary insurance, a diversity of products and freedom of contract exist, which does not make the transfer particularly easy.

* Schadenversicherungsgesetz (SchVG)

th insurance schemes

2. Protection of insured parties and equal treatment of creditors in bankruptcy

In the chapter entitled „Securing Measures" of the Non-life Insurance Law, a series of measures are provided that FOPI and the Federal Department of Finance may order for the protection of insured parties with supplementary health insurance in the case of insolvent health insurers. In addition to the protection of the insured parties, FOPI must also observe the principle of equal treatment of creditors in bankruptcy. This did in fact occur in the three insolvency cases:

2.1 Compulsory transfer of insured pools to supplementary health insurances
Art. 15, para. 2 of the Non-life Insurance Law stipulates that the supervisory authority take measures necessary for the protection of insured parties ex officio. The verbatim provision is: „It (The supervisory authority) may, in particular, transfer the insured pool and the corresponding tied assets to another insurance facility or order the compulsory liquidation of the values of the tied assets."

Insurance contracts expire four weeks after adjudication in bankruptcy of the insurer has been initiated (Art. 37 of the Insurance Contract Law). So that insured persons do not lose their coverage, the entire portfolio of supplementary health insurance policies of the insolvent health insurance scheme with the corresponding values of tied assets is transferred to the health insurer willing to assume the portfolio. The insured parties receive the guarantee that they may continue their insurance contracts with the new health insurer at the same or at least equivalent conditions, without review of risk or addition of new health or age conditions. This provision is doubly important in the area of supplementary health insurance policies, since persons above the age of 50 and young, sick insured persons would, as a rule, not be able to obtain a contract with a new insurer.

In the case of a compulsory portfolio transfer, insured persons are not, however, given an exceptional right to cancel the contract, as is the case for a voluntary portfolio transfer in accordance with Art. 39 of the Insurance Supervision Law. This point is the object of an appeal before the Federal Appeals Commission for Private Insurance. The case is still pending.

2.2 Blocking of tied assets
Until the time that the compulsory portfolio transfer is approved, the tied assets are blocked. This measure aims to secure the special assets that have been earmarked to cover obligations vis-à-vis insured parties with supplementary health insurance in accordance with Art. 8 of the Non-life Insurance Law, also with a view to preparing a compulsory portfolio transfer. Withdrawals may only be made with the approval of FOPI.

The tied assets are special assets that are accorded privileged use for the payment of the claims of insured persons with additional health insurance subject to the Insurance Contract Law in the case of bankruptcy. Any surplus is allocated to the bankruptcy estate.

2.3 Deferment of bankruptcy
This option is based on Art. 21 of the Non-life Insurance Law, according to which the initiation of adjudication of bankruptcy for an insurance institution requires the agreement of the Federal Department of Finance. The adjudication of bankruptcy is deferred until the transfer of the portfolio has been completed and a large share of the benefit claims has been settled successfully.

2.4 Measures to protect the interests of other creditors
FOPI is also required to ensure that it does not grant approval to any transactions that disadvantage the other creditors in the bankruptcy. In the case of compulsory transfer of portfolios, FOPI ordered that the value of the transferred portfolios be determined by means of an expert assessment. Evaluation of the portfolio is intended to ensure that FOPI does not agree to a transaction in which services rendered and consideration received are grossly disproportionate and in which funds are extracted from the bankruptcy estate through the creation of excessive profits.

Swiss private insurers – a market overview

1. Introduction
For reporting year 2004 (with previous year figures from 2003), FOPI obtained comprehensive data on the business developments of life and damage insurers during an early phase prior to compilation of the definitive report. Along with financial data and solvency figures, additional information on asset values was requested (including conversion of amounts reported according to regulations into a market-oriented presentation). This data was obtained with the goal of compiling a market overview. In individual cases, adjustments were made to enable an adequate comparison with the data from the previous year.

2. Accounting principles
The supervised insurance companies balance their books according to the principles of the Swiss Law of Obligations. An exception is made for fixed-interest securities, which may be entered on the assets side as amortized cost. The obtained provisional data of the insurance companies is therefore based on careful accounting. In addition, however, a conversion was required for asset values into a market-oriented presentation, and the resulting differential values were compared with the allowability of valuation differences for solvability.
Individual statutory account statements serve as the basis for the supervisory instruments, since the demands of insured parties primarily exist vis-à-vis the legal unit. The assessment of the surplus allocations is also based on the statutory account statement of the individual insurance company.
In addition to this detailed review of the financial and earnings situation of an individual legal unit, FOPI in particular also reviews the overall solvency of an insurance group. In this connection, statements are requested that comply with international accounting principles (IFRS, US GAAP). In individual cases, the insurance company must justify significant differences to FOPI between statutory financial statements in accordance with the Law on Obligations and statements in accordance with international accounting principles.

3. Summary of the results of the market overview
The overall picture shows that the insurance sector in Switzerland has clearly recovered from the difficult years of 2001 and 2002. An overview of the most important results:

- The equity capital basis was significantly strengthened, especially in the case of life insurers, which led to a corresponding improvement of the average solvency indicator.
- The premium volume shrank in the case of life insurers, primarily due to the decrease in single premiums.
- In the case of damage insurers, costs were reduced effectively, and in some sectors, premiums were adjusted. For these reasons, the premium volume increased by 6%, and the combined ratio is now significantly below 100% on average.
- The earnings from capital investments could not be maintained at the level of the previous year. The decrease resulted primarily from the lower direct earnings and the lower profits from realizations. The low interest-rate environment affected direct earnings, since matured or sold loans had to be reinvested at lower interest rates. Realized profits were affected by the fact that the low interest-rate environment in 2003 was in part actively utilized to realize latent reserves into bonds. In addition, restructuring of bond portfolios in 2003 and the reduction of the share quota led to high realization profits.

(figures in billion CHF)	Life insurers 2004	2003	+/-%*	Damage insurers 2004	2003	+/-%*
Earned gross premiums	**37.7**	41.2	-8.38	**45.8**	43.4	+5.83
Expenditures for insurance cases (gross)	**41.5**	41.6	-0.24	**31.0**	30.2	+2.75
„Claims Ratio"**	**N/A**	N/A	N/A	**67.73%**	69.76%	-2.03
Capital investment and interest earnings	**11.3**	14.3	-21.03	**2.1**	3.5	-40.28
Expenditures for insurance operations for own account	**3.3**	3.6	-7.68	**10.0**	10.1	-1.05
„Cost ratio"**	**10.30%**	10.19%	+0.11	**25.57%**	28.88%	-3.31
„Combined ratio"**	**N/A**	N/A	N/A	**93.30%**	98.64%	-5.34
Reported equity capital***	**6.8**	5.7	+18.02	**17.2**	16.3	+5.68
Solvency ratio**	**205%**	177%	+28.00	**312%**	328%	-16.00
Cover margin of the safety fund (life insurers) / fixed reserve (damage insurers)	**6.1**	7.0	-11.99	**7.4**	7.4	-0.43

* also in the following tables, percentage deviations are calculated using the non-rounded figures
** actual deviation, not in percent
*** before allocation of profits

4. Supervised enterprises

Type of insurance institution	No. of insurance institut. on 01.01.04	Δ	Newly authorised	Suspended 31.12.2004	No. of insurance institut. on 31.12.04
Swiss:					
Life	24				24
Non-life	79	-2		Alpina, merger with Zürich Versicherungen Genfer, merger with Zürich Versicherungen	77
Reinsurance	21	+1	Signal Iduna Glacier Re	AG Re	22
Captives of reinsurance	39	+3	Sonepar International Re Quebecor World KOT Re Asek Re Heineken Re	Re Horizon Imtech Re	42
Life branches:					
British	1				1
French	1	+1	Cardif Leben		2
Non-life branches:					
Belgian	4				4
British	10	-1		Northern	9
Danish	1				1
German	8				8
French	4		Cardif Allgemeine	Assurance Mutuelle de France	4
Irish	2				2
Luxembourgian	1				1
Dutch	1				1
Swedish	2				2
Spanish	1	+1	Houston Casualty		2
Norwegian	-	+1	Assuranceforeningen Gard		1
Guernsey	2				2
Bermuda	1				1
Insurer subtotal	202	4			206
Health Insurance Funds	57		Xundheit	Helsana KK	57
Total	**259**	**4**			**263**

5. Most important supervision instruments for monitoring business activity

The insurance companies must submit a comprehensive annual report on the year under review as of 31 December, as well as separate reports on fixed reserves, derivative financial instruments, and financial data on the group results. In addition, FOPI conducts periodic surveys of the year under review. In the event of special business incidents, the insurance company must inform FOPI immediately (e.g. if the acquisition of borrowed or equity capital is planned).
Private insurance companies domiciled in Switzerland must fulfil certain solvency criteria, so that the claims of insured parties are guaranteed at all times. FOPI currently has at its disposal two legally enshrined instruments in particular: fixed reserves and the solvency margin.

5.1 Fixed reserves
Capital investments in fixed reserves (in the case of life insurers, the safety fund) cover the necessary technical reserves (obligations vis-à-vis insured parties) and are kept in a separate deposit. In the case of bankruptcy of an insurance company, these reserves are liable for the claims of insured parties above all other demands. FOPI specifies investment and assessment requirements for the capital investments in fixed reserves. This helps achieve an appropriate diversification and prevents risks of over-concentration. The investments must fulfil the principles of appraisability and convertibility. A safety margin of 1% (2% in the case of non-life insurers) is added to the total amount of necessary technical reserves.
Deficient cover of the fixed reserves is already reached when the target amount (technical reserves + safety margin) is no longer completely covered by the fixed reserves. In this case, the insurance company is required to remedy the deficient cover immediately.

5.2 Solvency margin
Equity capital resources are a determinative value in assessing the solvency of an insurance company. In the insurance sector, equity capital plays a different role than in industrial companies, for instance. In an industrial company, equity capital can be considered operational capital in a certain sense, while in an insurance company, it is more like safety capital, which is drawn upon in exceptional damage years to support the annual result. The higher the capital resources, the more risks an insurance company can assume. In an exceptional catastrophic case, the survival of the company largely depends on its own resources. While the relation between equity and borrowed capital is of considerable interest in the industrial sector, the relation between own resources and risks on the asset and liability side of the balance sheet is of foremost importance in the insurance sector.
The solvency margin of an insurance company covers a part of the enterprise risks and is intended to secure the survival of the enterprise in an exceptional damage year. This general measure is determined by a prescribed model calculation and is based on the standards applicable in the EU. The entire amount of the solvency margin must be backed up by equity capital or borrowed capital with the character of equity capital. If this provision is no longer met, the insurance company must submit a restructuring plan to FOPI. FOPI determines what requirements the restructuring plan must fulfil and by what deadline the measures provided for therein must be undertaken. Along with fixed reserves, the solvency margin provides an additional protection of the insured parties from insolvency of the company.
All of the following statistical data and evaluations are based on the solvency definitions in accordance with Solvency I. However, this does not yet adequately take into account the risk profile of the individual insurance companies. A comprehensive evaluation will be covered by risk-based solvency supervision (in this context, see the introductory article to this Annual Report on page 4 and the article on the Swiss Solvency Test on page 10).

5.3 Early warning systems
In addition to the annual, comprehensive report, provisional account statement data are requested in advance. Along with the submission of provisional statement data, FOPI required supervised insurance companies to demonstrate the changes of certain balance sheet items for 2004 on the basis of three provided scenarios. The anticipated distribution quotas to shareholders also had to be reported. The equity capital basis of the companies was already significantly strengthened in 2003 after 2001 and 2002, years that involved heavy losses. FOPI continues to monitor the distribution practice, in order to continue to guarantee an appropriate strengthening of the equity capital quota in the future.

6. Data of the year under review*

6.1 Premiums

Development of earned gross premiums
Life and damage insurers

(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**51.5**	52.0	-1.03
Foreign business overall	**32.0**	32.5	-1.22
Total	**83.5**	84.5	-1.10

The development of the total premium receipts was characterized by a decrease of the amount in the case of life insurers and an increase in the case of damage insurers.

Development of earned gross premiums
Life insurers

(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**30.9**	32.8	-5.87
Foreign business overall	**6.8**	8.4	-18.23
Total	**37.7**	41.2	-8.23

The decrease by a total of 3.5 billion Swiss francs was heavily influenced by the weakening of the single premium business. Single premiums decreased by 3.7 billion to 15.9 billion Swiss francs.

Development of earned gross premiums
Damage insurers

(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**20.6**	19.2	+7.29
Foreign business overall	**25.2**	24.1	+4.68
Total	**45.8**	43.3	+5.83

In contrast to life insurers, damage insurers were able to increase their earned gross premiums, primarily due to raises in premiums. Only 13 of the companies surveyed recorded a decrease in premiums.

* The compiled figures are in part based on provisional account statements of the insurance companies. This should not have an effect on the expressiveness of the figures in the present market overview.

6.2 Insurance benefits

Development of the expenditures for insurance cases (gross)
Life and damage insurers

(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**51.1**	49.8	+2.75
Foreign business overall	**21.4**	22.0	-2.90
Total	**72.5**	71.8	+1.02

Life insurers recorded a slight decrease (-0.24%), damage insurers an increase (+2.75%) in expenditures for insurance cases.

Development of the expenditures for insurance cases (gross)
Life insurers

(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**37.3**	37.4	-0.36
Foreign business overall	**4.2**	4.2	+0.65
Total	**41.5**	41.6	-0.24

While the expenditures for insurance cases of life insurers were practically the same as the amount of earned gross premiums in the previous year, the expenditures in the year under review were 3.8 billion Swiss francs higher. The gross unearned premium reserve increased by 2.16% to 248.8 billion Swiss francs.

Development of the expenditures for insurance cases (gross)
Damage insurers

(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**13.8**	12.4	+12.18
Foreign business overall	**17.2**	17.8	-3.78
Total	**31.0**	30.2	+2.75

The development of expenditures for insurance cases of damage insurers is in proportion to the business expansion in the year under review.

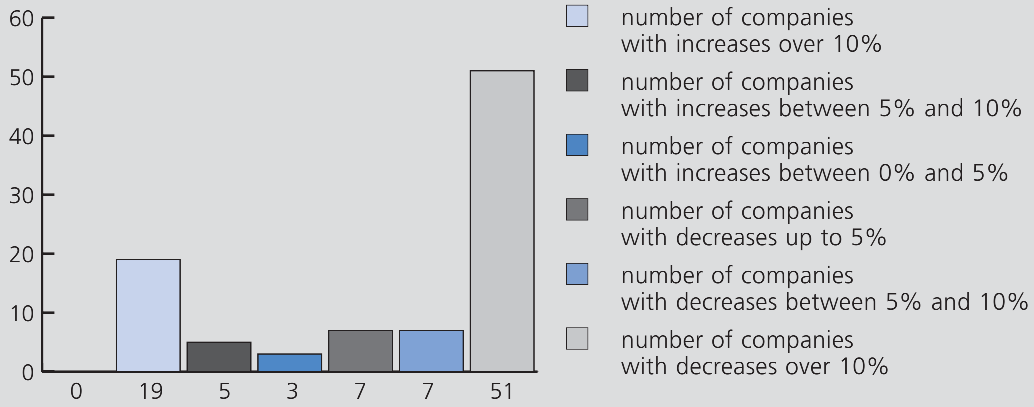
6.3 Capital investment and interest earnings

Development of capital investment and interest earnings
Life and damage insurers

(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**10.0**	12.8	-21.71
Foreign business overall	**3.4**	5.0	-32.82
Total	**13.4**	17.8	-24.84

Direct capital returns were slightly lower than the level of the previous year. The low interest-rate environment was apparent here, since matured or sold loans had to be reinvested at lower interest rates. A significant decrease in realized net profits was recorded in comparison with the previous year. In 2003, some comparatively large bond amounts were realized, which led to high capital gains due to the low interest environment. In addition to the targeted realization of such latent reserves, the shifting of short-term loans into long-term securities was also decisive for these sales transactions. In the case of some companies, the reduction of share quotas resulted in higher realization profits in 2003.

Capital investment and interest earnings: entire market



Development of capital investment and interest earnings
Life insurers

(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**8.7**	10.9	-20.15
Foreign business overall	**2.6**	3.4	-23.89
Total	**11.3**	14.3	-21.03

Of the reduced earnings of 3.0 billion Swiss francs, 1.0 billion are due to the decrease in direct capital returns and 1.9 billion are due to the decrease in realized net profit.

Development of capital investment and interest earnings Damage insurers			
(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**1.3**	1.9	-30.78
Foreign business overall	**0.8**	1.6	-51.25
Total	**2.1**	3.5	-40.28

The capital investment and interest result of the damage insurers contains net write-offs of 1.2 billion Swiss francs (0.2 billion in the previous year). The direct capital returns decreased significantly in the foreign business segment.

6.4 Administrative expenditures

Development of expenditures for insurance operations for own account Life and damage insurers			
(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**6.4**	6.5	-0.58
Foreign business overall	**6.9**	7.2	-4.72
Total	**13.3**	13.7	-2.76

Both life and damage insurers recorded a decrease in expenditures for insurance operations.

Development of expenditures for insurance operations for own account Life insurers			
(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**2.4**	2.5	-3.28
Foreign business overall	**0.9**	1.1	-18.28
Total	**3.3**	3.6	-7.78

The efforts to improve the „Cost Ratio“ manifested themselves in a reduction of the expenditures for insurance operations.

„Cost Ratio“ Life insurers			
	2004	2003	+/-%
„Cost Ratio“	**10.30%**	10.19%	+0.11

Despite a clear reduction in the expenditures for insurance operations, the „Cost Ratio“ could not be improved due to the lower business volume.

Development of expenditures for insurance operations for own account Damage insurers			
(figures in billion CHF)	**2004**	2003	+/-%
Swiss business overall	**4.0**	4.0	+1.15
Foreign business overall	**6.0**	6.1	-2.43
Total	**10.0**	10.1	-1.03

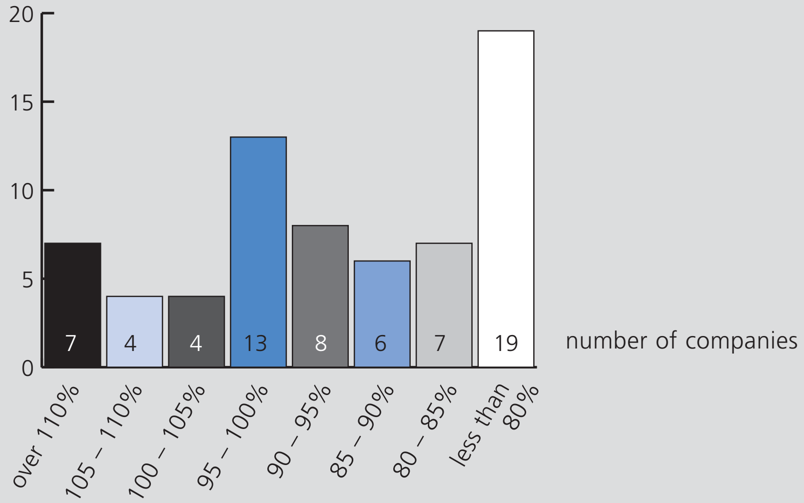
Despite increased business volume, the expenditures for insurance operations could be decreased, which manifested itself in a clear reduction of the „Cost Ratio".

Ratios for damage and cost development Damage insurers			
	2004	2003	+/-%
„Claims Ratio"	**67.73%**	69.76%	-2.03
„Cost Ratio"	**25.57%**	28.88%	-3.31
„Combined Ratio"	**93.30%**	98.64%	-5.34

The „Combined Ratio", as the most important indicator in damage insurance, is clearly lower than 100% in the year under review.

6.5 „Combined Ratio"
The following figure shows the breakdown of the effective „Combined Ratio" by number of damage insurers:

„Combined Ratio"
Damage insurers



6.6 Capital investments

The „Asset Allocation“ (on the basis of the market-oriented values) presents itself as follows as of 31 December 2004:

Capital investments

Share in %	**Life insurers**	**Damage insurers**	**Total**
Real property and buildings (incl. real estate used by the company itself)	11.18%	6.71%	9.93%
Shares in real estate companies	0.39%	0.05%	0.30%
Shares in affiliated enterprises and permanent holdings	2.78%	34.23%*	11.59%
Loans to affiliated enterprises, permanent holdings, and shareholders	1.66%	0.32%	1.28%
Shares and stakes in investment funds, other variable interest securities, and own shares	9.03%	6.47%	8.31%
Fixed-interest securities	50.84%	34.05%	46.14%
Promissory note bonds and debt register claims	6.68%	2.29%	5.45%
Mortgage claims	8.12%	2.81%	6.63%
Fixed deposits and similar capital investments	3.82%	3.29%	3.67%
Hedge funds	1.53%	0.32%	1.19%
Private equity	0.11%	0.11%	0.11%
Liquid resources	1.24%	3.85%	1.97%
Other capital investments	2.62%	5.50%	3.43%
Total	**100.00%**	**100.00%**	**100.00%**

* About 90% of the reported amount fell to two companies without a holding structure which maintain their permanent holdings through the parent company.

The table demonstrates significant differences between the strategies of life and damage insurers that are mainly due to different liquidity planning.

6.7 Equity capital and solvency

Development of the reported equity capital

(figures in millions of Swiss francs)	**2004**	2003	+/-%
Life insurers			
- Equity capital before earnings	**5'768**	4'518	+27.76
- Earnings	**1'064**	1'271	-16.24
Damage insurers			
- Equity capital before earnings	**15'924**	14'247	+11.77
- Earnings	**1'299**	2'050	-36.61
Total of equity capital for life and damage insurers	**24'055**	**22'086**	**+8.93**

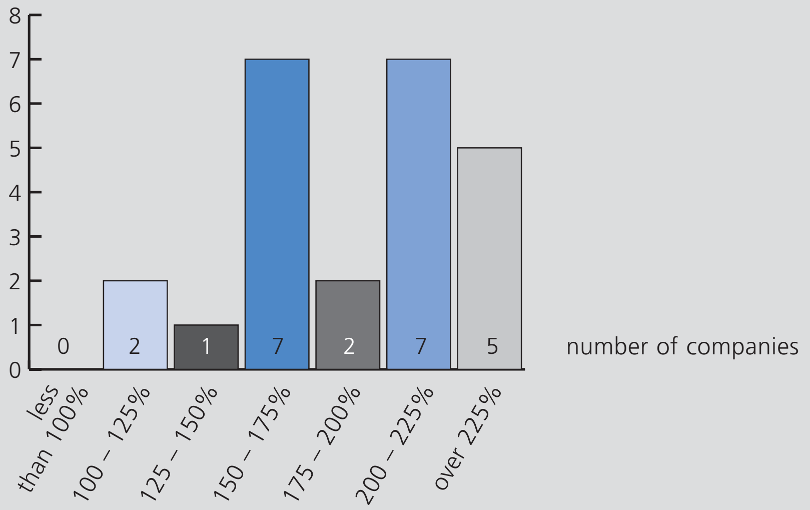
The equity capital base of the entire insurance sector was again significantly strengthened.
The anticipated distribution quota (dividend) is 18.10% for life insurers (effective distribution in the previous year: 9.80%) and 38.99% for damage insurers (effective distribution in the previous year: 58.59%).

Available solvency margin
Life and damage insurers

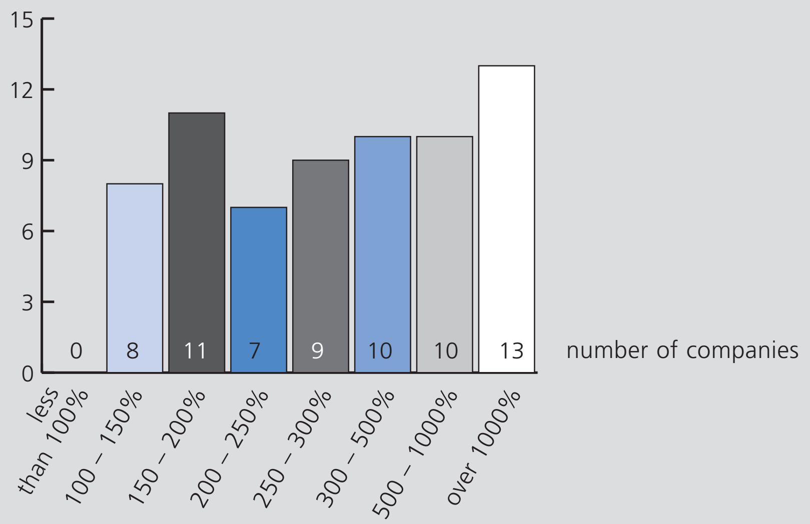
(figures in billion CHF)	**Life insurers**	**Damage insurers**
Reported equity capital	6.8	17.2
Valuation differences on assets	10.6	1.8
Other allowable values	5.5	2.2
Available solvency margin	**22.9**	**21.2**
Required solvency margin	**11.2**	**6.8**
Solvency ratio in the year under review	**205%**	**312%**
Solvency ratio in the previous year	**177%**	**328%**

The reported solvency ratios also include additional safety margins, since not all companies include all valuation reserves (differences between the market-oriented values and the accounting values on the assets side) in the available solvency margin. Amounts of about 3.2 billions Swiss francs were not included in the case of life insurers; in the case of damage insurers, the difference even amounts to about 4.3 billion Swiss francs.

Solvency ratios
Life insurers



Solvency ratios
Damage insurers



The category of damage insurers with a solvency ratio cover of over 1000% primarily includes small companies that are in the start-up phase or whose minimum capital requirements are higher than the solvency requirements. A few companies are part of a group and retain the profits for tax reasons.

6.8 Safety fund and fixed reserves

Safety fund and fixed reserves		
(figures in billion CHF)	**Life insurers**	**Damage insurers**
Cover values of the safety fund / cover values of the fixed reserves on 31 Dec 2004	218.2	36.1
Target amount of the safety fund / of the fixed reserves on 31 Dec 2004	212.1	28.7
Cover margin in the year under review	**6.1**	**7.4**
Cover margin in the previous year	**7.0**	**7.4**

6.9 Stress test

The figures presented in this market overview are a snapshot and therefore static. FOPI wanted to ascertain how the stability of the insurance sector responds when certain negative events occur. For this purpose, FOPI defined three negative scenarios and had their effects on the insurance companies calculated.
The following three scenarios were provided to the insurance companies:

a) Reduction of the market value of the share and private equity portfolio by 20%; interest rate level unchanged.

b) Increase of the interest rate level by 1%; no change of the market value of the share and private equity portfolio.

c) Reduction of the market value of the share and private equity portfolio by 20% and simultaneous increase of the interest rate level by 1%.

The effects on the solvency ratio were to be shown for all three scenarios, and the calculation was to be adjusted for any hedge transactions.

Stress test	**Life insurers**	**Damage insurers**
Reported solvency ratio	205%	312%
Solvency ratio for scenario a)	169%	303%
Solvency ratio for scenario b)	111%	304%
Solvency ratio for scenario c)	70%	294%

The valuation reserves that are not included in the available solvency margin for damage insurers entailed that the effects on the solvency margin were only marginal in the three provided scenarios. Life insurers had higher amounts of assets affected by the scenarios, and the amount of non-included valuation reserves is significantly lower. Scenarios b) and c) must therefore be put into perspective, since they only represent the situation on the reporting date, and the matching maturities on the liabilities side of the balance sheet (ALM) were not taken into account.
The new Swiss Solvency Test (SST, see also article on page 10) will considerably expand these scenarios, thanks to its risk-based approach.

The worldwide business of the five largest insurance-based groups – an overview

1. Introduction
In contrast to individual supervision, in which Swiss companies and their branches are considered, group supervision encompasses all companies of an enterprise worldwide. This supervision not only takes into account insurance companies, but rather all business units, such as banks, securities traders, and also non-regulated components. Pursuant to a number of individual decrees concerning consolidated supervision, five groups are currently required to provide data to the supervisory authority concerning their course of business and capital resources. The point of departure for worldwide consideration of the group is the extent of consolidation according to recognized accounting standards. The following institutions are among the conglomerates and groups subject to our supervision:

- Bâloise Holding (Bâloise)
- Swiss Life
- Swiss Re
- Winterthur Group (WGR)
- Zurich Financial Services Group (ZFSG)

The figures and statistical data below are based on the information that the enterprises publish in their consolidated annual reports. A direct comparison of the data between the various groups is, however, very difficult, given the different accounting standards, core activities, and regional focuses.
Bâloise, Swiss Life, and ZFSG compile their consolidated annual accounts in accordance with the International Financial Reporting Standards (IFRS). Since IFRS currently does not encompass any insurance-specific guidelines, the insurance business is evaluated according to the Generally Accepted Accounting Principles in the United States (US GAAP).
In contrast, WGR compiles its consolidated annual report as a subgroup of the Credit Suisse Group in the framework of the CSG requirements, entirely according to the US GAAP accounting rules.
Swiss Re, in turn, drafts its financial statement in accordance with Swiss GAAP FER and Swiss stock corporation law.

2. Overview
An essential element of consolidated supervision is the review of sufficient equity capital resources and the solvency at the level of the group. The calculation of the solvency requirements in the insurance sector is closely based on the requirements of Swiss individual supervision and the related EU directives. In the banking sector, the rules of bank supervision law apply. The sum of the requirements in the insurance and banking sector are juxtaposed with the allowable equity capital of the entire enterprise. The allowable parts are specified in the individual decrees, and the group must always demonstrate its equity capital strength. All enterprises mentioned fulfil the specified minimal requirements for solvency. The solvency ratio in percent (quotient of the solvency requirements to the allowable equity capital) was between 160% and 230% for the five groups at the end of 2004. This represents an improvement for all groups in comparison with the previous year. Here it should be pointed out that this is the figure in accordance with Solvency I and not that of the future rate in accordance with Solvency II.

Statistical data
The most important statistical data of the groups subject to supervision:

Statistical data

(in millions of Swiss francs)	Bâloise 2004	Bâloise 2003	Swiss Life 2004	Swiss Life 2003	Swiss Re 2004	Swiss Re 2003	Winterthur 2004	Winterthur 2003	ZFSG 2004	ZFSG 2003
Gross premiums *										
• Non Life insurance	**3'081**	3'089	**1'049**	1'072	**20'011**	21'669	**11'094**	10'858	**46'682**	48'686
• Life insurance	**3'956**	4'301	**19'259**	17'688	**11'721**	11'669	**10'298**	11'486	**13'617**	15'613
Balance sheet total	**59'621**	64'301	**165'613**	162'478	**184'492**	169'698	**165'275**	163'028	**394'656**	393'511
Equity capital	**3'483**	3'320	**6'697**	4'964	**19'177**	18'511	**8'243**	7'766	**25'294**	23'456
Return on equity capital	**6.5%**	2.9%	**10.7%**	5.3%	**13.6%**	10.2%	**8.8%**	-26.9%	**13.3%**	12.1%
Profit **after** tax	**222**	91	**624**	233	**2'475**	1'702	**699**	-2'433	**2'950**	2'489

* incl. reinsurance

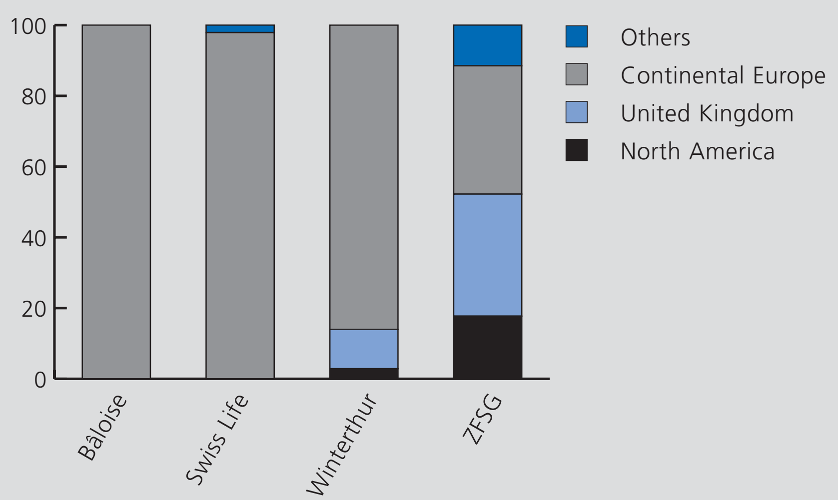
3. Balance sheet total by region
The balance sheet total by region provides an overview of the regional focuses:

Balance sheet total by region

	Bâloise 2004	Bâloise 2003	Swiss Life 2004	Swiss Life 2003	Swiss Re* 2004	Swiss Re* 2003	Winterthur** 2004	Winterthur** 2003	ZFSG 2004	ZFSG 2003
North America					**N/A**	N/A	**4'734**	5'044	**69'960**	65'972
United Kingdom				3'955	**N/A**	N/A	**18'395**	16'985	**136'137**	126'909
Continental Europe	**59'621**	64'301	**162'155**	154'836	**N/A**	N/A	**148'691**	146'572	**143'139**	145'403
Others			**3'458**	3'687	**N/A**	N/A	**-6'545**	-5'573	**45'419**	55'227
Total	**59'621**	64'301	**165'613**	162'478	**184'492**	169'698	**165'275**	163'028	**394'655**	393'511

* distribution of balance sheet total by region not provided
** negative figures for Others due to consolidation effects

Graphical presentation for 2004



4. Capital investment items

The following table shows the distribution of overall capital investments among the most important investment categories. Across the entirety of the groups, no trends can be deduced for 2004 so far in comparison with the previous year.

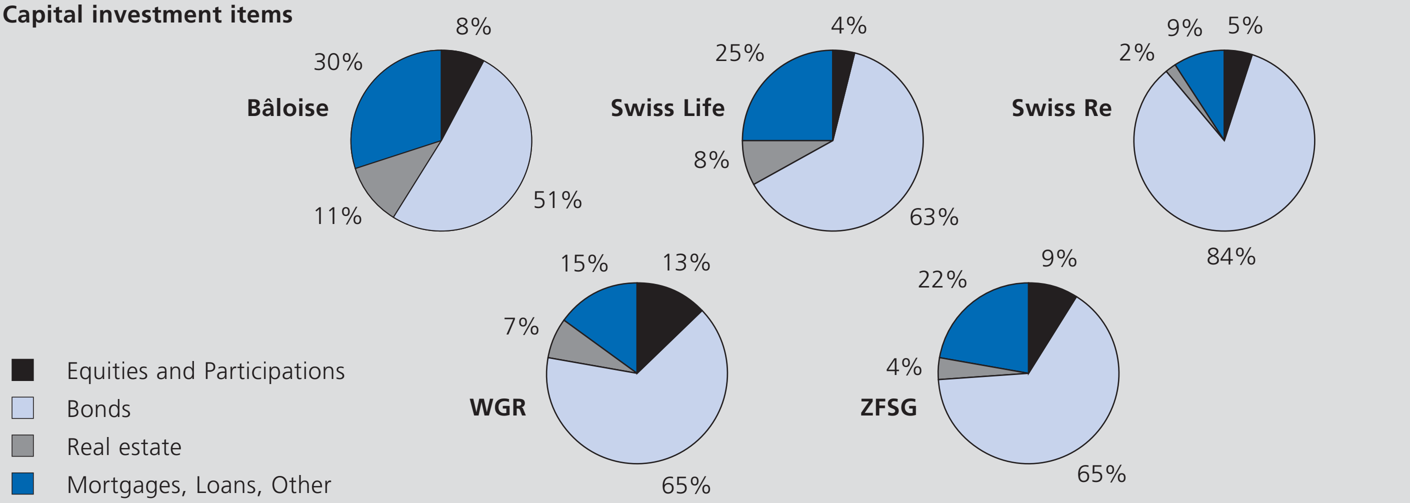
Capital investment items

	Bâloise		Swiss Life		Swiss Re*		Winterthur		ZFSG	
(in millions of Swiss francs)	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
Equities	**4'067**	3'476	**5'106**	5'883	**5'261**	6'751	**16'433**	13'713	**19'316**	24'701
Participations	**148**	224	**58**	64	**N/A**	N/A	**398**	610	**736**	799
Bonds	**27'170**	29'525	**86'732**	79'337	**82'978**	71'601	**82'763**	82'581	**141'743**	139'993
Real estate	**5'619**	5'653	**11'514**	11'082	**1'699**	1'646	**8'658**	8'613	**8'203**	9'244
Mortgages	**9'798**	11'002	**8'645**	12'038	**6'361**	6'133	**10'028**	11'054	**11'690**	13'978
Loans	**1'400**	1'457	**12'126**	13'562	**N/A**	N/A	**5'063**	4'523	**16'993**	9'265
Other	**4'597**	4'971	**13'087**	12'027	**2'207**	2'074	**4'618**	3'791	**19'240**	20'142
Total	**52'799**	56'308	**137'268**	133'993	**98'506**	88'205	**127'961**	124'885	**217'921**	218'122

* Participations are included under Other and Loans under Mortgages

The following figures show the distribution of capital investment items by percentage as of 31 December 2004

Capital investment items



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