Country: Switzerland

1. Background Description

The supervisory authority FINMA has been in operation since January 1, 2009, and it exercises prudential and market conduct supervision in accordance with Switzerland’s financial market acts. It supervises financial markets, including banks and insurers. Its purpose is “the protection of creditors, investors, and insured persons as well as ensuring the proper functioning of the financial market.”

2. Solvency Regulation Description

The hallmarks of Swiss solvency regulation are the Swiss Solvency Test (SST) and Swiss Quality Assurance (SQA). The Swiss Solvency Test is a principles based system using a total balance sheet approach and market consistent valuation. For purposes of determining capital requirements, a standard model or an insurer full or partial internal model (that has received approval) may be used. Approved internal models are expected to be used by reinsurers and for other complex insurance business. The SQA consists of two questionnaires relating to corporate governance and risk management/internal control that insurers are required to fill out and file with the regulator annually.

3. Minimum Capital Standards

The minimum capital standard is like a safety net and is based on statutory accounting. It is the same capital requirement as under Solvency I.

4. Target Capital Requirement

Solvency standards are set so that with a 99% probability, the assets of the insurer could be turned over to a third party and be run-off. To meet this solvency standard, insurers’ actual capital must exceed their target capital. Target capital consists of two components: the risk margin and the 1-year expected shortfall. The expected shortfall is the most significant component of target capital, and it is the same thing as the policyholder deficit or Tail Value-at-Risk (or TVaR). The risk margin represents the cost to the runoff insurer from holding capital while runoff of reserves is taking place. The cost of capital used to calculate the risk margin is 6%, and this value is provided by the regulator.

The standard model distinguishes between financial risks, insurance risks, and credit risks. The financial and insurance risks are handled stochastically, while a risk factor-
based approach is used to deal with credit risk. The financial, insurance, and credit risks are combined probabilistically with various company-defined and regulator-prescribed scenarios. A diversification discount is taken in arriving at target capital.

With approval, insurers can use a stochastic full or partial internal model instead to arrive at target capital. The internal model must incorporate all relevant risks and correlations among these risks. The data and parameters used in the internal model must be up-to-date and relevant. The insurer must show that it uses the internal model in its own operations, that it is integrated into the insurer’s daily risk management processes, and that it is regularly updated and tested. Internal models are the responsibility of senior management.

5. Peer Review

Each insurer within a group is expected to set up an effective and independent internal audit function that covers all of its commercial activities.

6. Reporting

Reporting is conducted on a statutory and on an economic (or market-consistent) basis.

Companies must report their target capital and their risk bearing capital to the regulator. (Risk bearing capital is the difference between the market consistent estimate of assets and the best estimate of liabilities.)

Insurers must submit the SST report to regulators. The SST report is an annual report that summarizes the risk position of the company. This report must contain all of the information needed to explain how the insurer came up with its target capital estimate. Finally the report must be signed off on by the CEO.

A template is provided in association with the SST Report. Included in the SST report are items such as

1. Reconciliation of statutory assets and market consistent valuation of assets.
2. Reconciliation of target capital with standard model results. Deviations from the standard model must be explained.
3. A description of any concentrations in risk for the insurer.
4. Assessment of any other relevant risks such as strategic and political risk.
5. Assessment of future anticipated risks the insurer might be exposed to.

Although not originally developed as part of SST, new reporting requirements exist for Swiss insurers that are related to the type of information required in the SST report. These new reports are part of the Swiss Quality Assessment (SQA).

The Swiss Quality Assessment consists of two annual questionnaires – the Swiss Quality Assessment Corporate Governance Tool and the Swiss Quality Assessment Risk
Management/Internal Control System Tool. The corporate governance questionnaire must be completed by the parent company of an insurance group AND by each insurance company in the group under Swiss regulatory supervision. The risk management and internal controls system questionnaire must be completed only at the group level in the usual case.

8. **On-Site Examinations**

9. **Off-site Analysis**

Supervisors at FINMA must review internal models for their appropriateness.