

Partial revision of the Insurance Supervision Act (ISA)

**What the partial revision of the ISA
means for insurance companies and
insurance intermediaries**

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List of abbreviations

KID	Key information document
DFD	Swiss Federal Department of Finance
FinSA	Swiss Federal Act on Financial Services, Swiss Financial Services Act
FINMA	Swiss Financial Market Supervisory Authority
FSAP	Financial Sector Assessment Program
IMF	International Monetary Fund
SchKG	Swiss Federal Act on Debt Enforcement and Bankruptcy
SST	Swiss Solvency Test
ISA	Swiss Federal Act on the Supervision of Insurance Companies, Insurance Supervision Act
ISA consultation draft	Consultation draft on amendments to the Insurance Supervision Act (ISA)
ICA	Swiss Federal Act on Insurance Contracts, Insurance Contracts Act





1. Introduction

The Swiss Federal Act on the Supervision of Insurance Companies (Insurance Supervision Act, ISA) came into force on 1 January 2006 and governs the Swiss federal government's supervision of insurance companies and insurance intermediaries. Developments over the last few years - such as the legislative work on the Financial Services Act (FinSA) - as well as the absence of an independent restructuring law for insurance companies resulted in the need for adaption of the law. Against this background, the Federal Council tasked the Federal Department of Finance (FDF) with drawing up a consultation draft for the partial revision of the ISA in 2016. The consultation opened on 14 November 2018 and closed on 28 February 2019. The changes contained in the ISA consultation draft predominantly relate to provisions on restructuring insurance companies, a regulatory and supervisory approach based on consumer protection, rules of conduct for insurance intermediaries and the requirement to register with an ombudsman's office.

This brochure gives you an overview of the planned changes to the ISA and highlights possible consequences for individual players.

2. Executive summary

The ISA shall contain a **restructuring law** according to which insurance companies can be restructured rather than have to be directly liquidated. This change takes into account the interests of the policyholders in the event of insolvency.

Insurance companies that have professional clients only can be granted **regulatory alleviations** according to the principle of proportionality. In addition, companies with particularly innovative and sustainable business models can be completely exempt from supervision if policyholders' protection is ensured.

The ISA consultation draft, analogously to the FinSA, contains **rules of conduct for insurance intermediaries** when selling insurance products with investment characteristics. These specify that appropriateness tests must be carried out as a requirement for mediating life insurance where the customer bears an investment risk (qualified life insurance).

These tests must also be documented. In addition, non-tied insurance intermediaries must inform policyholders about the compensation received in connection with the services provided. Insurance intermediaries are no longer allowed to act simultaneously as tied and non-tied intermediaries. Just like insurance companies, they must be affiliated to an independent **ombudsman's office**.

The **transitional period** by the end of which the new requirements must be met is, in all cases, six months from the date on which the changes come into force.

Following the consultation, the Federal Council is drawing up its dispatch, which is likely to be discussed in Parliament in 2020. The revised ISA can therefore be expected to **come into force at the beginning of 2021 at the earliest**.

3. Main topics of the partial revision

3.1. Restructuring of insurance companies

Currently, there is no legal basis for restructuring proceedings for insurance companies. The ISA simply mentions restructuring as a possibility. It states that an insurance company can only go bankrupt if there is no prospect of restructuring or if restructuring has failed.¹ Paragraph 2 of the same article explicitly rules out general debt-restructuring proceedings under the Debt Enforcement and Bankruptcy Act (SchKG).² So if an insurance company gets into financial difficulties to the extent that the interests of policyholders are endangered, the Swiss Financial Market Supervisory Authority (FINMA) is only able to take safeguarding measures. One such measure mentioned in the ISA is the transfer of the insurance portfolio to another insurance company.³ There is no provision for capital measures or intervening in the rights of third parties. Under current law, this means FINMA is **de facto forced to initiate bankruptcy proceedings**.

The ISA consultation draft now provides for FINMA to initiate **restructuring proceedings** if there are reasonable

prospects of restructuring or continuing individual insurance services.⁴ It is also authorised to issue the necessary implementation provisions.⁵ The goal of restructuring is to avert the risk of insolvency and to continue to operate the business.

Possible **restructuring measures** are:⁶

- transfer of the insurance portfolio to another insurance company or to a rescue company, or continuation of the portfolio in the existing insurance company,
- reduction of existing equity capital and creation of new equity capital, conversion of debt into equity ("bail-in") and reduction of claims,
- material adjustment of insurance contracts.

As part of these restructuring measures, the rights of creditors may be infringed. However, no creditor should be in a worse position than if the insurance company had been

¹ Art. 53 para. 1 ISA

² Art. 53 para. 2 ISA

³ Art. 51 para. 2(d) ISA

⁴ Art. 52a para. 1 ISA consultation draft

⁵ Art. 52a para. 4 ISA consultation draft

⁶ Art. 52b para. 1 ISA consultation draft

declared bankrupt.⁷

In the event of the conversion of debt into equity, a reduction of claims or an adjustment of insurance contracts, the policyholder has the right to terminate the contract within three months of receiving the information and with immediate effect.⁸ If the policyholder retains the insurance contract, he/she should expect an additional premium payment or reduced cover for the rest of the term of the policy. In addition, benefits relating to existing claims may be reduced.

The ISA consultation draft also provides for **policyholders' claims** (including professional policyholders) **arising from insurance contracts** being **privileged** in the event of bankruptcy. These claims are assigned to the second class⁹, but are only settled once all other second class claims have been paid from the bankruptcy estate.¹⁰

3.2. Regulatory and supervisory approach based on consumer protection

3.2.1 Customer classification and regulatory alleviations

The current ISA does not provide for any systematic assessment or differentiation in supervisory terms between the

level of protection needed by different policyholders, and therefore does not provide for any categorisation of supervisory requirements either. It differentiates only between primary insurers and reinsurers, whereby reinsurers are subject to less intense regulation and supervision.

To take into account the principle of proportionality, under the revised ISA the regulatory and supervisory intensity will be determined by the level of protection the policyholders need. For this, different segments of policyholders have been defined. Primary insurers that have insurance contracts only with professional clients should newly also benefit from regulatory alleviations.¹¹ For this, however, they must clarify and document the status of their clients prior to concluding a contract.¹² They must also inform their clients that they are considered professional policyholders and inform them of the legal consequences of that.¹³ A non-financial company may also be classified as a professional client if it conducts professional risk management. Insurance companies that have both professional and non-professional clients can also benefit from alleviations. However, they must keep the two customer segments permanently separate.

Regulatory alleviations are also available for group-internal direct insurance and reinsurance and for reinsurers.

The table below provides a general overview:

Regulatory alleviations, i.e. the following articles do not apply	Primary insurers that have insurance contracts only with professional clients	Group-internal direct insurance and reinsurance	Reinsurance
Organisational fund ¹⁴	×	×	×
Tied assets ¹⁵	×	×	×
Special rules on legal expenses insurance, natural hazard insurance, motor third-party liability insurance, life insurance, occupational pensions ¹⁶			×
In case of restructuring: varying adjustments to insurance contracts of different categories, use of tied assets ¹⁷	×	×	×
Additional safeguarding measures for foreign insurance companies ¹⁸			×
Transfer of insurance portfolio ¹⁹			×
Ombudsman's office ²⁰	×	×	×

¹⁴ Art. 10 ISA consultation draft, and for reinsurance also Art. 15 para. 1(d) ISA consultation draft

¹⁵ Art. 17-20 ISA consultation draft

¹⁶ Art. 32-34, 36, 37 ISA

¹⁷ Art. 52e para. 2, 54abis ISA consultation draft

¹⁸ Art. 57-59 ISA

¹⁹ Art. 62 ISA

²⁰ Art. 82 and 83 ISA consultation draft

3.2.2 Exemption from supervision

Under the ISA consultation draft, FINMA can exempt an insurance company with an innovative business model from supervision, provided its policyholders are protected and it contributes to safeguarding the future of the Swiss financial centre.²¹ An insurance company that has been exempted from supervision must make its policyholders aware of this before entering into an insurance contract with them.²²

3.3. Rules of conduct for insurance intermediaries

During the legislative work on FinSA, the Parliament decided that rules of conduct in the field of insurance should be included in the ISA. The ISA consultation draft now contains rules of conduct for the insurance industry and the sale of investment products. These rules are analogously to those in FinSA. That way the same conditions apply to all actors in the financial market selling investment products.

Before recommending **qualified life insurance**, insurance intermediaries should check that the corresponding product is **appropriate** for the policyholder and what level of **knowledge and experience** he/she has.²³ In addition, the insurance intermediary must document the following information:²⁴

- which qualified life insurance was taken out
- what level of relevant knowledge and experience the policyholder has
- that the policyholder was advised against taking out qualified life insurance
- that no appropriateness checks were carried out

In the future, insurance intermediaries will no longer be able to act simultaneously as tied and non-tied intermediaries because a non-tied intermediary has a relationship of trust with its policyholders.²⁵

Non-tied insurance intermediaries	Tied insurance intermediaries
Are in a relationship of trust with their policyholders and act in their interests	All other insurance intermediaries

The ISA consultation draft increases consumer protection for private clients of **non-tied insurance intermediaries**. Non-tied intermediaries must inform their policyholders about the amount of compensation they receive from third parties in connection with the services they provide.²⁶ So far they only had to prove sufficient financial security (professional liability insurance with an annual insured sum of at least CHF 2 million or equivalent security) and fulfil professional qualification requirements for registration. Newly they also need to prove they can ensure proper business conduct and are affiliated with an ombudsman's office.²⁷ If they can no longer ensure proper business conduct, FINMA can remove them from the register of intermediaries and thus de facto ban them from conducting business.

Those who offer qualified life insurance must in future provide a **key information document (KID)**.²⁸ This should be as similar as possible to the one for financial service providers in accordance with FinSA so as to reduce complexity for customers and increase comparability between different financial products.²⁹

Tied insurance intermediaries can no longer voluntarily be registered in FINMA's register of intermediaries, but rather in the registers kept by the industry.



²¹ Art. 2 para. 3(b) ISA consultation draft

²² Art. 2b para. 1 ISA consultation draft

²³ Art. 39g para. 1 ISA consultation draft

²⁴ Art. 39h ISA consultation draft

²⁵ Art. 40 para. 2 ISA consultation draft

²⁶ Art. 45a ISA consultation draft

²⁷ Art. 42 para. 2 ISA consultation draft

²⁸ Art. 39b para. 1 ISA consultation draft

²⁹ Art. 39c ISA consultation draft

3.4. Ombudsman systems

The ISA consultation draft requires that disputes between policyholders and insurance intermediaries or insurance companies regarding legal rights be, where possible, settled through mediation proceedings with an ombudsman.³⁰ Both parties must be able to call on an independent, impartial, state-recognised ombudsman with specific expertise. This shall complement and strengthen legal enforcement by means of an appropriate and proven instrument of alternative dispute resolution.

The Swiss Ombudsman of Insurance already exists for private insurance. In addition, the Health Insurance Ombudsman is responsible for supplementary insurance under the Swiss Federal Act on Insurance Contracts (ICA). Newly all insurance companies and insurance intermediaries will be obliged to register with an ombudsman's office. The latter newly require recognition from the FDF, which is subject to certain basic conditions. The ISA consultation draft leaves it to the insurance industry, through self-regulation, to organise its ombudsman system so that it meets the legal minimum requirements. The rules on ombudsmen systems laid down in FinSA apply analogously.³¹

3.5. Other topics

3.5.1 Authorisation requirement for branches of foreign reinsurers

Previously, insurance companies domiciled abroad that only conduct reinsurance in Switzerland were exempt from prudential supervision. The International Monetary Fund (IMF) criticised this in the last Financial Sector Assessment Program (FSAP). The ISA consultation draft now changes this in order to better protect the Swiss financial centre from being misused and to create fair competition between domestic reinsurers already subject to supervision and Swiss branches of foreign reinsurers.

The ISA consultation draft therefore no longer provides for an exemption from supervision for branches of foreign reinsurers in Switzerland. It explicitly states that insurance companies domiciled abroad that have a branch in Switzerland and provide reinsurance in Switzerland or from Switzerland via this branch are subject to supervision under the ISA.³² Foreign insurance companies that intend to, or already, conduct insurance activities must also register their branch in the Commercial Register.³³

3.5.2 Group supervision

With the partial revision of the ISA, the legislator also intends to strengthen group supervision. Therefore, for example, appointments and changes to top management at the group level also need to be approved by FINMA.³⁴ This ensures a uniform regulation for individual and group supervision.

3.5.3 Abolition of the exemption from the internal audit obligation

According to the current ISA, in justified individual cases FINMA may exempt an insurance company from the obligation to appoint an internal audit.³⁵ The ISA consultation draft removes this competence in order to achieve equivalence between the Swiss insurance regulation and supervision and the EU regulation, to allow market assess for Swiss reinsurers in the EU. Insurance companies that up to now did not have to appoint an internal audit but which will be obliged to do so in future can either set up their own internal audit function or purchase the service.

3.5.4 Sanctions

The sanctions of the ISA have been reviewed when drawing up the ISA consultation draft. The FDF has only kept those that protect important supervisory interests. In doing so, it intends to strengthen supervision and relieve the prosecuting authorities of proceedings that have little use.

3.5.5 Swiss Solvency Test (SST) and tied assets

The proposed changes to the Swiss Solvency Test (SST) only relate to the formal basis. In essence, the SST is already implicitly established in the current ISA and the ISA consultation draft does not change the way it is calibrated.

Lastly, insurance companies domiciled in Switzerland are no longer allowed to accumulate tied assets for insurance portfolios of foreign branches.³⁶

³⁰ Art. 82 ISA consultation draft

³¹ Art. 83 para. 2 ISA consultation draft

³² Art. 2 para. 1(b) no. 2 ISA consultation draft

³³ Art. 15 para. 1(b) ISA consultation draft

³⁴ Art. 71bis and 79bis ISA consultation draft

³⁵ Art. 27 para. 2 ISA

³⁶ Art. 17 para. 2 ISA consultation draft



4. Impact of the changes on individual parties

4.1 Restructuring

With the envisaged restructuring law, the legislator intends to mitigate the negative financial consequences of a bankruptcy for policyholders. In addition, for certain insurance lines - such as supplementary health or life insurance - continuing the insurance contracts may also be in the interests of the policyholders as they might in some circumstances only be able to obtain another insurance policy at worse conditions (e.g. higher premiums, health check with exclusions).

Moreover, privileging policyholders' claims from insurance contracts increases the competitiveness of Swiss reinsurers vis-a-vis European competitors because their primary insurance customers can thus demonstrate improved solvency and receive a better rating.

4.2 Regulatory and supervisory approach based on consumer protection

After the revised ISA comes into force, licensed insurance companies must declare to FINMA which lines of business they intend to conduct.³⁷ For each insurance line, they must state whether they will conduct business with professional clients, as part of group-internal direct insurance or reinsurance, or with non-professional clients. This will lead to an increased administrative burden in the short term.

On the other hand, the workload of insurance companies that will newly benefit from regulatory alleviations due to the consumer protection-based regulatory and supervisory approach will reduce over the longer term.

Insurance companies that have both professional and non-professional clients should, however, expect additional costs if they intend to benefit from regulatory alleviations. These include one-off conversion costs as well as recurring costs related to determining the level of protection needed by all new customers and allocating them to one of the two customer segments. In addition, in the case of corporate customers, the insurance company will have to assess the level of professionalism of their risk management. Finally, the compliance burden will also increase as FINMA will carry out random checks of customer categorisation as part of their supervisory review.

If professional clients take out insurance with insurance companies that receive regulatory alleviations and are therefore not obliged to hold tied assets, the level of protection they have in the case of bankruptcy is lower because they will no longer have priority for receiving funds from tied assets. On the other hand, if the insurance company continues to operate, they could benefit from lower premiums.

4.3 Rules of conduct for insurance intermediaries

The planned customer protection measures will result in an increased administrative burden and additional costs for:

- non-tied insurance intermediaries, particularly due to ensuring proper business conduct and disclosing compensation received,
- insurance intermediaries selling qualified life insurance due to appropriateness tests and documentation,
- providers of qualified life insurance due to drawing up KIDs.

As insurance intermediaries will no longer be able to act simultaneously as tied and non-tied intermediaries, a non-tied intermediary must cover practically the entire product range for a given customer segment. This requires possessing the appropriate knowledge as well as having a certain size. Otherwise, the intermediary will not be able to sell certain insurance products. This could increase the pressure to consolidate.

4.4 Ombudsman systems

Additional costs may result from the obligation to register with an ombudsman's office as financial service providers must contribute to building up and running the ombudsman's office.

³⁷ Art. 4 para. 2(k) ISA consultation draft



4.5 Authorisation requirement for branches of foreign reinsurers

Branches of foreign reinsurers must either receive authorisation from FINMA and thus become subject to supervision by FINMA or cease the business conducted via the Swiss branch. During the authorisation process one-off authorisation fees and costs arising from drawing up and submitting the business plan incur. Moreover, additional annual costs incur for FINMA reporting and fulfilling the various compliance, governance and actuarial requirements.

4.6 Group supervision

The proposed adaptations to group supervision will lead to small additional expenses only. This is because it is very common for individuals to take on multiple roles within an insurance group or conglomerate and, therefore, nearly all potential group-level managers have already been tested on fitness and properness for the main insurance company.

4.7 Abolition of the exemption from the internal audit obligation

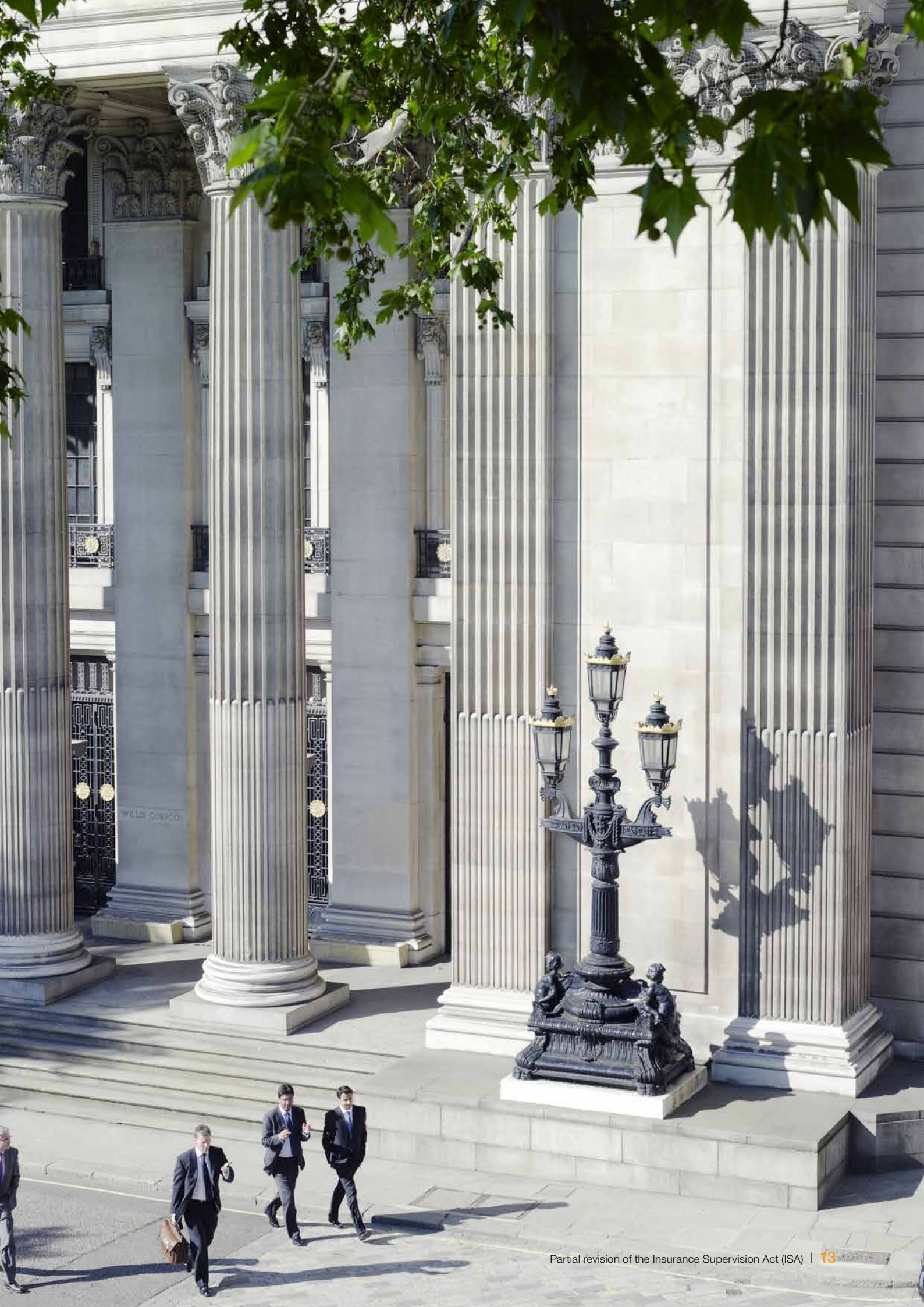
The removal of FINMA's competence to grant insurance companies, in justified cases, exemption from the obligation to appoint an internal audit affects 30 predominantly small insurance companies. They will incur additional costs. The amount of these costs depends on whether the company will establish its own internal audit function or outsource it.

5. Transitional provisions

The transition period, by the end of which the new regulatory requirements must be met, is, in all cases, six months from the date on which the changes come into force.³⁸ The following table summarises the action required for companies and individuals.

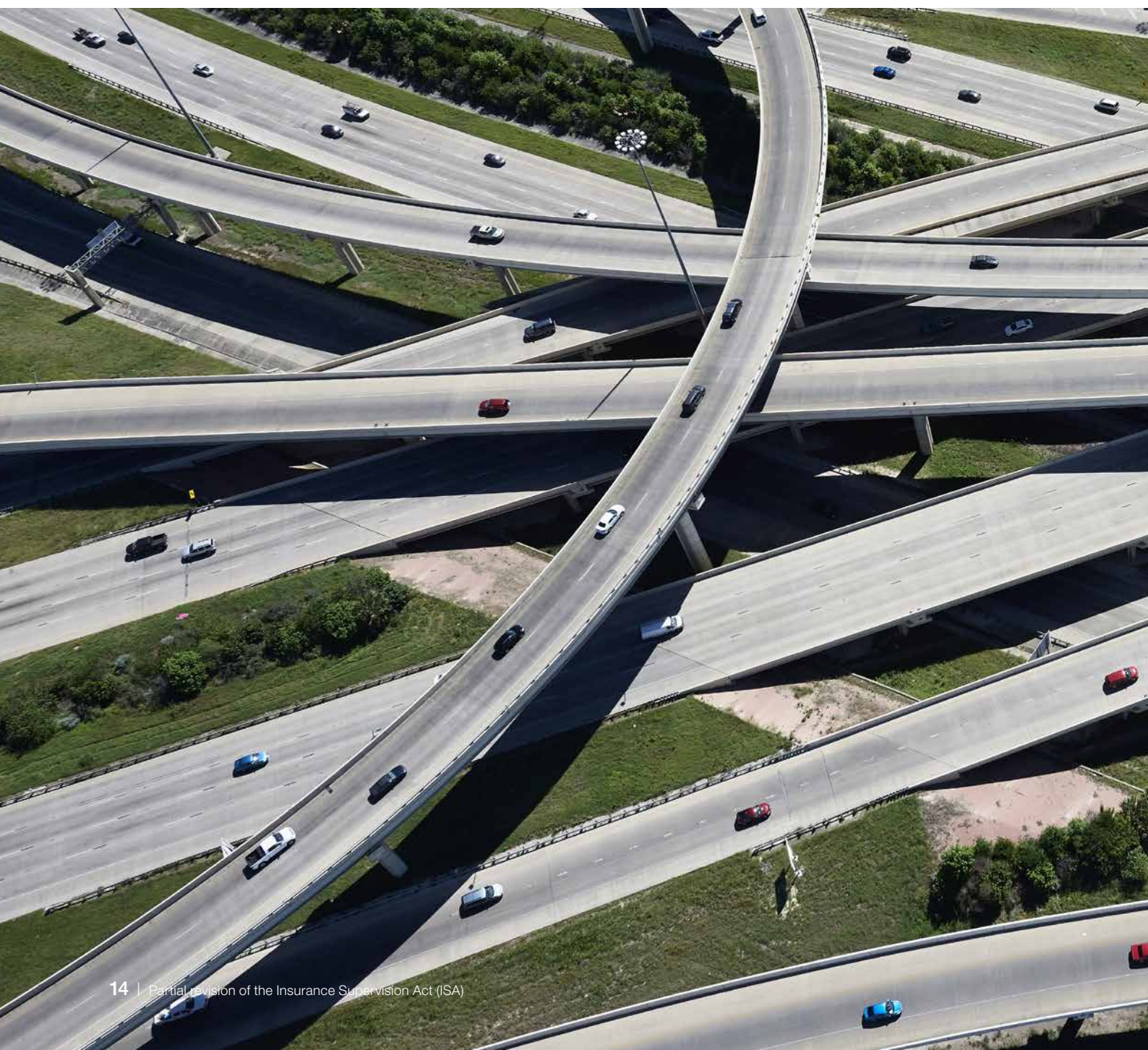
Transition period	Affected companies or individuals	Actions required
6 months	Branches of foreign reinsurers	Become subject to supervision by FINMA or cease the branch's business operations
6 months	Licensed insurance companies	Declare to FINMA, pursuant to Art. 4 para. 2(k) of the ISA consultation draft, which lines of business they intend to conduct, i.e. specifying for each insurance line whether that business will be conducted <ul style="list-style-type: none">with professional clientsas part of group-internal direct insurance or reinsurance, orwith non-professional clients
6 months	Foreign insurance companies that intend to, or already, conduct insurance activities in Switzerland	Register the branch in the Commercial Register
6 months	Insurance companies domiciled in Switzerland with insurance portfolios of foreign branches	Dissolve tied assets for insurance portfolios of foreign branches and inform the affected policyholders
6 months	Insurance companies and non-tied insurance intermediaries	Register with an ombudsman's office

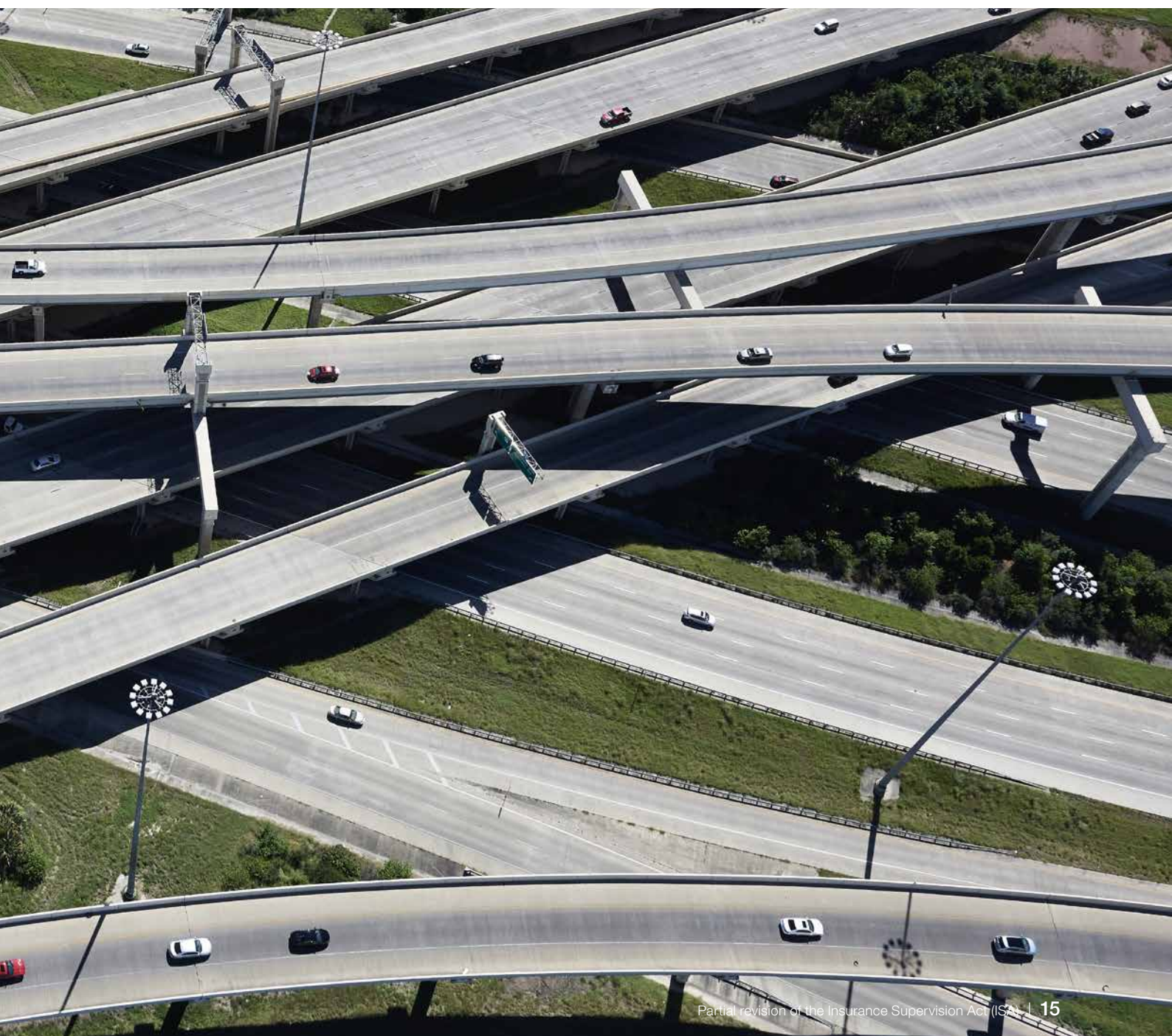
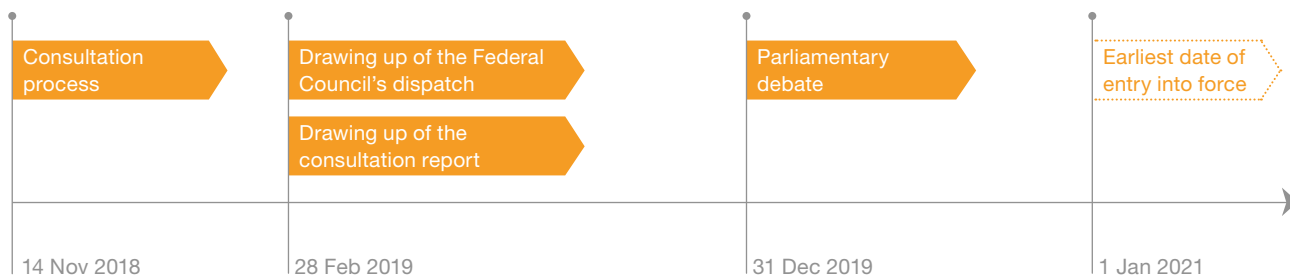
³⁸ Art. 90a ISA consultation draft



6. Roadmap until entry into force

Following the consultation process, the Federal Council is drawing up its dispatch on the revision of the ISA. This is expected at the end of 2019 at the earliest. The parliamentary debate will likely take place in the course of 2020. The revised ISA can therefore be expected to enter into force on 1 January 2021 at the earliest.





Contacts

If you have any further questions about the partial revision of the ISA, feel free to contact the PwC experts.



Dr. Günther Dobrauz

Partner,
Leader PwC Legal Switzerland

Office: +41 58 792 14 97
Mobile: +41 79 894 58 73
guenther.dobrauz@ch.pwc.com



Michael Taschner

Director,
PwC Legal Switzerland

Office: +41 58 792 10 87
Mobile: +41 79 775 95 53
michael.taschner@ch.pwc.com



Dr. Martin Liebi

Director,
PwC Legal Switzerland

Office: +41 58 792 28 86
Mobile: +41 76 341 65 43
martin.liebi@ch.pwc.com



Dr. Mirjam Meyer

Manager,
PwC Legal Switzerland

Office: +41 58 792 12 19
Mobile: +41 79 267 76 60
mirjam.meyer@ch.pwc.com

Services

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www.pwc.ch/insurancelegalservices

PwC, Birchstrasse 160, 8050 Zurich, +41 58 792 44 00