



# Clarity on Non-Life Insurance

**Evolution or revolution  
for Swiss insurers?**

**September 2016**

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## **CEO insights**

Senior insurance executives share their views on the future of the industry

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## **Industry transformation**

Digitalization, regulation and customer needs cause transformation to gather pace

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## **Drivers of change**

What impacts will Swiss tax reform, ORSA and international oversight have?



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# The evolution of non-life insurance Adapting to a changing landscape



**Hieronymus T. Dormann**  
Partner, Sector Head Insurance  
Audit Insurance

**Thomas Schneider**  
Partner, Head of Actuarial  
and Insurance Risk

Few industries can afford to stand still for long. Non-life insurance is no exception. Impacted by a range of new and upcoming regulatory initiatives and by deep-rooted changes in technology and customer behavior, the need for continual re-invention and innovation is pressing.

In this publication we address some of the latest regulatory developments that are creating significant shifts in Switzerland's non-life insurance industry. From domestic changes such as the new ORSA framework to international developments such as the Insurance Core Principles... the implications for risk management and capital requirements are extensive.

At the same time, ongoing digitalization presents fresh challenges and opportunities, with customers wanting faster, more efficient ways of concluding insurance agreements, yet also demanding greater real-time interaction and a more personal touch. The rewards are there for insurers who get it right, but successfully adapting business and operating models requires significant investments in IT, distribution and analytics.

It is clear that change is not slowing down; quite the contrary. With so many possibilities ahead, we would be pleased to discuss with you these insights into the future of your industry.

**Hieronymus T. Dormann**

**Thomas Schneider**





**Markus Hongler**  
CEO Mobiliar

**Patric Deflorin**  
Head of Insurance  
Mobiliar

# A successful combination of tradition and innovation

**Interviewer** Hieronymus T. Dormann  
Partner, Sector Head Insurance  
Audit Insurance

**Oliver Windhör**  
Director  
Audit Insurance

**KPMG:** Mr Hongler, how is Mobiliar doing?

**Markus Hongler:** In spite of a challenging market environment and low interest rates, Mobiliar is doing exceptionally well. Our solvency ratios are excellent. Consequently, our clients can rely on our strong financial stability and we have the freedom to pursue the right investments.

**KPMG:** Mr Deflorin, what are the challenges facing Mobiliar in the non-life segment?

**Patric Deflorin:** The segment is in very good shape. We are, however, aware that traditional products provide us with little opportunity to stand out. We need to differentiate ourselves from the competition in our value proposition. We face the challenge of enhancing our products with additional services tailored to clients' needs. We regularly ask ourselves: What will life be like tomorrow? And how will that impact our mobility and the way we live together?

**KPMG:** Mobiliar plans to expand. What are your main objectives in the current market environment?

**Markus Hongler:** We have been very successful with our existing business. We want to develop it and digitize and simplify our processes.

Our goal is to do the things we already do well even better and thus acquire new clients and portfolios. On top of that, we are looking for additional expertise. For example, we have acquired an interest in Scout24 and purchased SwissCaution. Both of these companies have revolutionized their respective markets and are fully digital. They already operate profitably on their own and will supplement our insurance business.

**Patric Deflorin:** We are, for the benefit of our clients, embracing the opportunities that digitalization and other businesses provide. We are ready to make the investments needed to expand our business areas. We are a Swiss company and have no ambitions to move outside the Swiss market. This has many advantages, but also means that we have to position ourselves broadly in order to grow.





Left picture above from left to right: **Hieronymus T. Dormann** | Partner, Sector Head Insurance (Audit Insurance), **Markus Hongler** | CEO Mobiliar, **Patric Deflorin** | Head of Insurance Mobiliar, **Oliver Windhör** | Director (Audit Insurance)

## "Mobiliar has succeeded in anchoring curiosity in its business."

**Markus Hongler**  
CEO of Mobiliar

**KPMG:** Do your employees support the company's growth path?

**Markus Hongler:** That is an essential prerequisite. I spend a lot of time fostering our company's close to 5,000 employees' enthusiasm for their work and empowering them to create unique client experiences.

I want them to be curious and to join me in the joy of shaping new developments.

**Patric Deflorin:** We encourage entrepreneurial thinking. Our 79 general agencies are independent contractors and share responsibility for our joint success. This spirit is influencing Mobiliar as a whole.

**KPMG:** How important do you think personal relationships are in the digital world?

**Markus Hongler:** Personal and digital interactions are not mutually exclusive. Even in the digital world, we want to remain Switzerland's most personal insurance company. In the case of a claim, our experts are on hand to provide personal assistance. Digitalization helps us to react quickly and efficiently.

**KPMG:** For years, Mobiliar has been showing stronger growth than the market. How do you explain this success?

**Markus Hongler:** We operate exclusively in Switzerland and, after some 190 years, have strong roots here. We know the market and the Swiss clients like no other company in the business. We take full advantage of this competitive edge. This is supplemented by a clear strategy that is based on stability, transparency, reliability and highly motivated employees. Our decentralized organizational structure also gives us a competitive edge since it allows us to be close to the market and act quickly. We like to feel the pulse of the market directly and handle in line with the clients' expectations.

**KPMG:** Are there any new market segments that you would like to expand into?

**Patric Deflorin:** One strategically important topic is cybercrime. It is not just a matter of tangible loss, which can be remedied through a sum of money, but also intangible consequential loss. Such crimes may impact the personal integrity of individuals. In the case of companies, interruptions to operations can jeopardize their survival or tarnish their image. At the current time, we are working hard on developing appropriate indemnification models.

**KPMG:** How is Mobiliar itself combating the risks of cybercrime?

**Markus Hongler:** We use state-of-the-art technology. We maintain a separate IT security department and have a clearly defined strategy in place for dealing with such threats. Access to sensitive information and files is restricted to those employees who require such access for their work. So far, we have not been hit by a cyberattack. However, there is no such thing as absolute security.



**KPMG:** New technologies have changed the selection of services you offer. What has this meant for your clients?

**Patric Deflorin:** For example, thanks to our new app, we have been able to make the processing of claims much simpler and faster. Our clients can now notify their claims in less than 90 seconds – that is a record! And thanks to the streamlined processes taking place behind the scenes, we provide an immediate response. Depending on the case, the final settlement of a claim may take some time. Clients expect to know the current stage of the adjustment process that their claim has reached. We believe that interaction with clients in real time is essential.

**KPMG:** Personal injuries is a problematic area. What is Mobiliar's approach to it?

**Patric Deflorin:** Accidents and health constitute about 15 percent of Mobiliar's portfolio.

## "Transparency for our clients needs to be adjusted to their expectations."

**Patric Deflorin**  
Head of Insurance at Mobiliar

We service our clients with a specially trained case management team, which handles personal injuries. The aim is to support individuals affected and to help them return to work.

**Markus Hongler:** Moreover, we also process recourse actions centrally, i.e. recovery claims against the persons responsible for the accident. Our subsidiary XpertCenter Ltd. is in charge of this service. It has a team of 13 professionals who are familiar with this particular subject matter. We also offer recourse management as a service to other companies.

**KPMG:** Is regulation making life difficult for you? As we all know, the regulations are becoming more stringent. The keywords here are ORSA and public disclosure ...

**Markus Hongler:** We can deal with regulations and lose no sleep over them. However, it is important to clearly distinguish between the regulatory authorities and politics. What is still missing in Switzerland is a consensus on how we should model our financial center for the future. For example, how are we going to create a competitive advantage that benefits all market players or at least does not penalize Swiss market players in the international contest?





*It is also up to the regulatory authorities to outline potential options and to play an active part in shaping them in a dialogue with all market players. Then it is up to the politicians to arrange for the necessary democratic legitimization.*

**KPMG:** What do you expect from FINMA?

**Markus Hongler:** FINMA shouldn't make economic policy. I'm sure that we can continue our dialogue on the basis of mutual respect and as a partnership of equals.

**KPMG:** You are committed to employee satisfaction. A new working environment, covering an area of roughly 2,000 square meters, has been established at your headquarters in Bern. What was the reason for creating it?

**Patric Deflorin:** The new working environment is designed to be open. There are no more separate offices. Different departments work alongside and with one another. This promotes communication and interdisciplinary collaboration. We also support working from home. Thanks to digitalization, everyone can work from where they happen to be: at home, in the train or at the office.

**Markus Hongler:** As a traditional company, it does require a little courage on our part to be the initiators of this new working environment. But why should we let the start-ups steal the show in this respect? Our open-plan offices create new freedoms and a new working culture, which strengthens our productivity and innovative power. I think it is important that we do our work with joy and enthusiasm.

**KPMG:** How do you find the talented individuals to achieve your ambitious goals?

**Patric Deflorin:** We also apply an organic approach to human resources. On the one hand, we employ more trainees than many other companies. On the other hand, we reach out to and develop career changers. When we require specialist knowledge, we approach the appropriate professionals directly. With Bern as our hub and branches in Nyon and Zurich, we can also offer certain locational advantages. However, what really matters is that we work day in, day out to be an inspiring and attractive employer. Talented people should come to us on their own initiative because we are an exciting and innovative company.



"Personal and digital interactions are not mutually exclusive. Even in the digital world, we want to remain Switzerland's most personal insurance company. In the case of a claim, our experts are on hand to provide personal assistance. Digitalization helps us to react quickly and efficiently."

**Core statement by Markus Hongler**  
CEO of Mobiliar

"Early-warning and recognition systems are critical for corporate development. These instruments enable us to identify key areas for targeted investment. The success of our core business allows us to make the necessary investments for the future."

**Core statement by Patric Deflorin**  
Head of Insurance at Mobiliar





**Dr. Joy Müller**  
CEO smile.direct

# Performance and growth in the digital age

**Interviewer** **Bill Schiller**  
Partner  
Audit Insurance

**Nicole Gasper**  
Assistant Manager  
Audit Insurance

**KPMG:** Where do you see the challenges for Swiss insurers in keeping pace with the latest digital developments?

**Dr. Joy Müller:** Some insurers are struggling because they are still employing old host systems that no longer meet current technological requirements. These systems fail to address the changing needs and habits of today's consumer.

That's why we at smile.direct are in the process of implementing a new IT infrastructure, because outdated systems act as a brake on interactions with clients. As people today are active while on the move, the new digital era has opened up countless opportunities. We as a company therefore need to adapt accordingly, adjust our processes and closely monitor these to ensure we remain relevant.

**KPMG:** What is smile.direct's main target group and how do you best seek to meet their requirements?

**Dr. Joy Müller:** The age group we predominantly target is between 30 and 45 years of age because we can offer them attractive products with favorable prices. Due to risk and margin considerations, we cannot offer the same favorable conditions to those outside this age range. Taking this into account, we analyze very carefully the characteristics of customers (age group, behavior, etc.) who visit our site so that we can offer them tailor-made initiatives that satisfy their individual needs.

Of course within the limits of our data protection law.

In terms of geography, smile's current focus is on German-speaking Switzerland. However, our latest analyses show that customers in the French-speaking part of Switzerland are very active online, which is why we are planning on intensifying our marketing activities there.

Compared to classic distribution networks, our organization is very lean. It has minimal overhead costs such as HR and logistics. As more than 90% of our customers conclude contracts online, all they have to do afterwards is pay the bill. A well-informed customer can conclude a normal contract within 5 minutes. This is extremely time-efficient for our customers. Our analysis shows that for other customers, the process can take a little longer. But by using state of the art web design and usability patterns, we guide customers as much as possible within the online funnel to present them with a satisfying insurance solution. In addition, our service center is available to customers who need help to conclude or change a contract.





Dr. Joy Müller | CEO smile.direct



Bill Schiller | Partner Audit Insurance

**KPMG:** How do you handle claims at smile.direct?

**Dr. Joy Müller:** We make use of Helvetia's claims department. A smile customer with a claim will be redirected to Helvetia, who sends a claims inspector onsite to appraise the damage, if necessary.

Ideally, smile would handle everything digitally. The customer would only have to send in a few photographs which would be the basis of our decision for further action. Because photos can never be more accurate than an onsite inspection, this could theoretically lead to our accepting more claims than necessary. As this way of handling claims would reduce our overheads, however, the savings could compensate for any claims leakage.

**KPMG:** To date, the Swiss market does not have as many internet insurers as for instance Germany or the UK. What are your plans for expanding your position in the Swiss market?

**Dr. Joy Müller:** The digital market is growing, so there is huge potential for us. What's more, we are in the perfect position to exploit changing customer behaviors, because we are able to meet the customers where they already are: the internet. The up-and-coming generation will make this change happen. This 'new customer' will increasingly search for offers online. They will no longer require interaction with a sales agent. Our business model currently focuses on the closing phase – that's smile's strength. There, fewer and fewer personal interactions are needed.

I am convinced that the larger insurance companies will eventually face increasing competition in the household and car insurance markets. In my opinion, they should go into niche and more complex markets and offer excellent service. The overall market share of direct insurers is still relatively small, which I think is due to the fact that many consumers in Switzerland are doing well.

The result is that they stay with one insurer for generations. Customers generally do not seem to feel any pressure to change insurers.

**KPMG:** Given the enormous consequences of such a change, do you think sales agents will become a thing of the past?

**Dr. Joy Müller:** As everything has become much more transparent, customers are no longer willing to pay more than absolutely necessary. Possibly, Switzerland's economic outlook will not remain as rosy as it looks now, which will force customers to become more price sensitive. For this reason, we believe that it is not enough to sell an insurance product – we need to focus on the customer experience. This means that the traditional sales agent will have to focus on where they can add value, such as in more complex life products or special risks or, generally speaking, wherever the client is seeking personal advice and ready to pay for it.

**KPMG:** Our society is becoming ever faster paced, more digital and increasingly interlinked. Is this a blessing or a curse? How is smile.direct adapting and anticipating future behavioral change?

**Dr. Joy Müller:** For us, this development is clearly a blessing, as it ties in neatly with our business model. The question is how to tell (and sell) the security story. After all, feeling secure has always been a fundamental need; indeed, in the Maslow pyramid it is a close second. To use a metaphor, selling light is very different from selling light bulbs. We need to anticipate what people's needs will be in the future and what might become obsolete. This is how you can move with the times. Smile makes money with new and radical perspectives. Innovation is at the core of this.

**KPMG:** In terms of your strategy regarding your customer base, you currently offer products solely aimed at individuals. Do you have any plans involving products for companies?

**Dr. Joy Müller:** I think we should stay in the retail business for the time being. We do have SMEs as clients where the owner as an individual has insured his two company cars, for instance. But in general, we remain focused on our business with private individuals. Of course, you should never say never. I still see a variety of interesting challenges in the retail insurance market. At the moment, smile does not offer life insurance, but we have been thinking about it – after all, the German market proves that selling online life insurance can be a profitable business. I would love to collaborate on this with Helvetia's other departments.

It is difficult to say what will be in 5 years, so it is all the more important to stay agile.



Nicole Gasper | Assistant Manager Audit Insurance

Together with our customers, we need to test what works and what doesn't. We can almost instantaneously measure a product's potential. We are really close to the market's pulse and are able to intensively analyze customers. Observing how people today evolve, especially how young people interact socially, is fascinating – there seem to be virtually no inhibitions on what is shared on social networks such as Facebook.

**KPMG:** What kinds of marketing and advertising channels do you use to reach your clients?

**Dr. Joy Müller:** Of course any online channels conceivable, from social media networks to chats and online banners that follow customers on their journey through the web. We are very active in search engine optimization and are heavy users of Google AdWords. We use all online channels and accompany our customers at every step. This can even mean that we place a digital

poster at a railway station. One channel we do not use for advertising, however, is television.

**KPMG:** smile is part of a larger insurance group, Helvetia. What are the strengths and weaknesses of this setup? What does smile's operational integration look like?

**Dr. Joy Müller:** Except for the claims process smile.direct is operationally completely independent and operates as a separate brand within the group. However, we benefit from our big 'mother's' supporting functions, as this constellation allows us to stay small and agile. Helvetia is a completely different kind of brand, with different values and different customer target segments. Its positioning is very separate from ours so we complement each other well. smile.direct has retained its startup flair and culture. We are teeming with radical and innovative ideas that will serve us very well as we enter into future markets.





**Patrick Ducret**  
CEO bonus.ch

**Arnaud Welti**  
Sales and Marketing  
Manager, bonus.ch

# Achieving sustainable success through transparency and independence

**Interviewer** **Thomas Schneider**  
Partner, Head of  
Actuarial and Insurance Risk

**Marc Gössi**  
Partner  
Advisory Insurance

our size, which allows us to be more agile and flexible in the market.

**KPMG:** What is the strategy of bonus.ch and how do you plan to expand your services? Will you offer your own insurance solutions?

**bonus.ch:** bonus.ch is pursuing a clear strategy in the form of transparency and independence in order to provide our clients with the best possible offers by comparing premiums and services. We are also planning to expand our line of services to life insurance and insurance for corporates.

**KPMG:** How does your company differ from comparis.ch or a similar aggregator?

**bonus.ch:** Since we started our platform in 2004, it has been our aim to create a special added value for our customers, for instance in the form of information such as insurance tips and tricks, news and press releases. The difference to comparis.ch is really

in his/her decision and to provide an offer that fits their needs.

We are active all over Switzerland (this is clearly the advantage of an internet-based comparison platform) and offer our services in the three official languages.

At this point, we are focusing on 'simple' insurance products such as health insurance, car insurance, household insurance and personal liability insurance. The main reason for this focus is that these products require very little or no personal advice.

**KPMG:** Which marketing and advertising channels are you using in order to reach your clients?

**bonus.ch:** In part we have our own TV advertising campaign but on many levels we prefer the internet. For instance, we favor search engine optimization, banner ads on partner pages, cost-per-click advertisements, newsletters and personalized e-marketing.

**KPMG:** What kind of business model does bonus.ch have and which regions do you cover with your services? Are you focusing on specific insurance services? Why?

**bonus.ch:** Our business model consists of being part of a network of potential clients and insurance partners. The platform's aim is to support the client





**Arnaud Welti** | Sales and Marketing Manager, bonus.ch

**Patrick Ducret** | CEO bonus.ch

**KPMG:** Our society is becoming ever faster paced, more digital and increasingly interlinked. Where do you see the challenges for Swiss insurers – can they keep pace with the latest digital developments?

**bonus.ch:** Unfortunately, insurers are not quite where we would like them to be. We perceive insurers to still be sitting on the fence – mere observers of what is happening out there. In Switzerland, only about 10% of all car insurance is concluded online whilst in the UK this figure is about 50%. Most likely it will take another 2–4 years until we can offer our customers effective solutions. This is an area where we are clearly

dependent on our insurance partners' willingness and ability to be innovative.

**KPMG:** How do you think driverless cars will impact the insurance sector? And does the industry have an answer to the sharing economy (e.g. Uber, Airbnb, etc.)

**bonus.ch:** One of the main questions that remains unclear is: who will be responsible in the event of damages? Who will provide services or pay for the damages caused? Is it the insurer or the constructor of the driverless car? An answer to this important question also depends on the developments in the automotive industry and remains open at this time.

As regards the sharing economy, we still see room for growth as far as insurance products are concerned. A traditional insurance policy does not yet truly reflect this new user behavior. However, the industry is already discussing this and it could also be a talking point in a political debate.

**KPMG:** According to a study conducted by the University of St. Gallen, about 50% of all Swiss customers still require a lot of relationship management and advice, which is probably not something they will receive from your portal. Do you expect client behavior to change in the near future?

**bonus.ch:** The need for advice remains especially present for complex products such as life insurance. However, we believe that there are concepts where even this advice will be provided through digital channels, such as a chat function with a CRM, video chats or a simplified exchange of documents. Certain insurance products have already been upgraded and/or prepped for digital distribution. We already expect there to be a bigger shift around 2020, as a whole new generation of digital natives enters the market.

**KPMG:** Being client-oriented is an important facet of the insurance business. How will you implement client focus on your platform?

**bonus.ch:** Here we would like to once more stress our philosophy, which we live on a daily basis: independence and transparency. We would like to offer our users the best possible price/performance ratio. In the end, of course, the customer chooses what he/she wants. However, contrary to insurance brokers, we are not beholden to different commission models. We look at the products offered as standardized products and do not favor one over another.

**KPMG:** Regulations and provisions will certainly remain a huge topic for Switzerland. Where do you see developments heading? How is bonus.ch in particular affected?

**bonus.ch:** bonus.ch's activities are mostly restricted to the internet. This is why we are very interested in the financial industry continuing its quest to become more digital. This will allow us to expand our range of products with new innovations. Just recently, new regulations on online identification were issued that will greatly simplify the process of opening a bank account.

However, it would be a shame if such developments were to be slowed down by long political debates.

**KPMG:** Where do you see the insurance market in 5 years' time and which topics do you think will be paramount at that time?

**bonus.ch:** In our opinion, the share in products focusing on the sharing economy will expand greatly in the coming years. We also expect that the number of online contracts concluded will increase dramatically. As far as the insurance sector is

concerned, insurers will have to speed up the go-to-market of products and invest in innovation and digital marketing.

Looking back, you can see that e-commerce was also regarded with a lot of skepticism at the time it was introduced. But after a while, it became an accepted form of doing business and its usefulness became clear. I imagine a similar scenario will also be true for the insurance sector. Some statistics forecast e-commerce to grow fivefold by 2020. Of course, we would clearly benefit from such developments.



**Thomas Schneider** | Partner,  
Head of Actuarial and Insurance Risk

**Marc Gössi** | Partner  
Advisory Insurance



# Tax reform: New landscape, new opportunities

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Substituting Switzerland's tax privilege regime for internationally accepted measures may seem like a threat. But by bringing its rules in line with the international community, Switzerland can enhance its appeal to insurers from around the world.



# Needed: New business models for the digitalized age

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Sufficient investment and a senior sponsor are prerequisites for achieving a digital transformation. With them, insurers will be able to leverage operational differentiation and smart analytics. And to deliver greater benefits to the customer through a genuinely omni-channel approach.





# Online and on point: Meeting customers' evolving needs

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smile.direct's CEO discusses the importance of an up-to-date IT infrastructure and lean distribution to fulfill customers' needs. The CEO of bonus.ch meanwhile emphasizes innovation, transparency and independence as the core of a convincing value proposition.



# The ORSA revolution

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The new Swiss ORSA framework will have implications far beyond risk management, impacting the organization's strategy and business-related decision processes. Implementation will require careful consideration to fulfill both internal and external reporting duties.





# Focusing on tomorrow: Mobiliar and the keys to growth

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Real-time interaction with clients is essential to success. From a new app to process claims to streamlined back-office processes to ensure efficiency, Mobiliar shares its insights into combining personal and digital interfaces to provide an efficient, individualized service.





# The pursuit of regulatory convergence

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Amid a seemingly never-ending flow of new regulations, international oversight institutions are making their own bid to enhance regulators' powers. But will these efforts to enhance solvency and capital regimes create harmony or discord in the Swiss insurance market?





Author | **Bill Schiller**  
Partner  
Audit Insurance

# International developments in regulation

As an important international jurisdiction for insurance and reinsurance companies, Switzerland will be affected by moves promulgated by international oversight institutions to enhance and harmonize regulators' powers and solvency and capital regimes. This may affect only the larger Swiss companies to begin with, but change will come to even the smaller entities as demands for a 'level playing field' will be difficult to ignore. Coming on top of ongoing challenges with the implementation of Solvency II, changes in the Swiss Solvency Test rules and the finalization of the IFRS Phase 2 project, a busy few years for risk and finance departments can be foreseen.

While many Swiss and European insurers continue to deal with the challenge of implementing and embedding the new Solvency 2 regulations and face significant changes in the Swiss solvency framework, the shape of new international rules is emerging. What are the most important features?

The International Association of Insurance Supervisors (IAIS) has continued to work towards insurance industry regulatory reform relating to Internationally Active Insurance Groups (IAIGs) and Global Systemically Important Insurers (G-SIIs). Significant themes of the IAIS Framework include group-wide insurance supervision and consistency of regulatory frameworks across geographical jurisdictions.

With the Financial Stability Board (FSB) continuing to influence the IAIS work program and two important consultations released in November 2015, it is clear that 2016 will be another pivotal year.

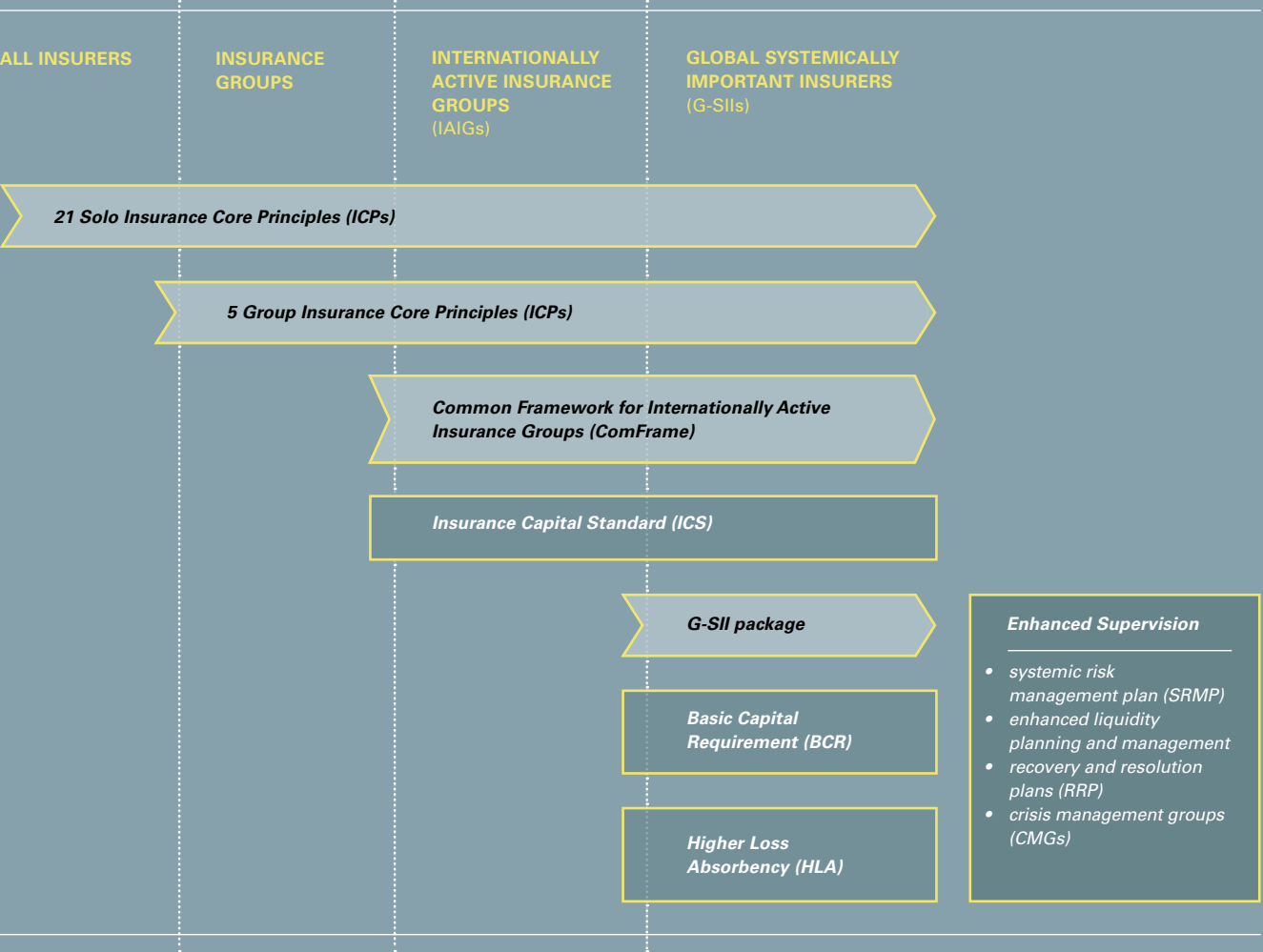
- These initiatives may have an impact on insurers, especially in relation to:**
- Insurance Core Principles (ICPs)
  - the Global Insurance Capital Standard (ICS)
  - G-SII developments
  - the International Monetary Fund’s (IMF) Financial Sector Assessment Program (FSAP) reviews.

IAIS FRAMEWORK HIGHLIGHTS

The IAIS Framework is a globally accepted framework for supervision of the insurance sector.

- It is structured in a series of increasing requirements depending on the nature of the entity being supervised:**
- The Insurance Core Principles (ICPs) are high-level principles-based standards to be followed in the supervision of insurers in all jurisdictions. These mainly apply to regulated insurance entities, but are supplemented by five group ICPs that apply to insurance groups.
  - The Common Framework for IAIGs (‘ComFrame’) applies further requirements against the approximately 50 insurance groups that meet the IAIG definition. This population of firms will need to comply with the insurance capital standard that the IAIS is developing.
  - The G-SII population (nine groups currently) must comply with all the above and are subject to enhanced supervision due to their perceived systemic risk, including both additional capital requirements and recovery and resolution measures.

The hierarchy of application of the previous requirements for insurers and insurance groups is shown in the following chart:



INSURANCE CORE PRINCIPLES (ICPS)

IAIS members – including Switzerland – are expected to implement the ICPs into their national supervisory frameworks. Compliance is assessed by the IMF and World Bank who conduct annual Financial Sector Assessment Program reviews on both a mandatory and voluntary basis. Mandatory assessments are required every five years for countries whose financial systems have been deemed by the IMF to be systemically important and this group includes Switzerland whose last assessment was in 2014.

“IAIS members - including Switzerland - are expected to implement the ICPs into their national supervisory frameworks.”



DEFINING IAIGS AND COMFRAME POWERS

- An IAIG must meet the following criteria:**
- at least one large insurance entity in the group
  - premiums written in at least three jurisdictions with at least 10 percent of the group’s gross written premium (GWP) being from outside the home jurisdiction, and
  - premiums of not less than US\$ 10 billion or total assets not less than US\$ 50 billion, based on a rolling three-year average.

ComFrame will enable supervisory cooperation and coordination and effective information sharing between supervisors, with the group-wide supervisor responsible for the supervision of the IAIG on a group-wide basis.

“The group-wide supervisor will be able to exercise some ‘direct’ powers at the level of the head of the insurance group.”

- The group-wide supervisor will be able to exercise some ‘direct’ powers at the level of the head of the insurance group, including:**
- information requests, including related to subsidiaries relevant to the overall risk of the IAIG
  - on-site inspections
  - formal discussions with members of the governing body, senior management and key persons in control functions of the head of the insurance group and
  - fit and proper assessments of these individuals.

SCOPE OF COMFRAME FOR IAIGS

- The revised 2014 draft of the framework for large groups contains the following elements.
- Module 1: Scope of ComFrame**
- Elements 1 and 2** – IAIG definition and identification process
- Element 3** – Scope of ComFrame supervision and process to determine entities to be covered

- Module 2: Elements of IAIG Compliance**
- Element 1** – Legal and management structures, cross-border issues and complexities
- Element 2** – Group-wide governance framework, including roles of the governing body and senior management of the head of the IAIG, senior management and key control functions
- Element 3** – Enterprise risk management (ERM) requirements
- Element 4** – Group-wide ERM policies required, including investment, underwriting, claims management, reinsurance strategy, insurance liability valuation and actuarial
- Element 5** – Insurance capital standard (ICS)

- Module 3: Supervisory Requirements**
- Element 1** – Group-wide supervisory process
- Element 2** – Supervisory cooperation and interaction, including requirement for supervisory colleges
- Element 3** – Crisis management and resolution

THE GLOBAL INSURANCE CAPITAL STANDARD

The IAIS released a set of high-level principles in September 2014 to guide the development of the global Insurance Capital Standard (ICS). It is evident that further refinement will take place, dependent on the results of current and future field testing.

**Timeline and process**

The IAIS has reconfirmed its aim of convergence in global regulatory capital frameworks over time. An ICS Version 1.0 will be released in time for private reporting to supervisors from 2017. However, the version that will be used for public reporting (ICS Version 2.0) will not be adopted until the 2019 IAIS Annual General Meeting.

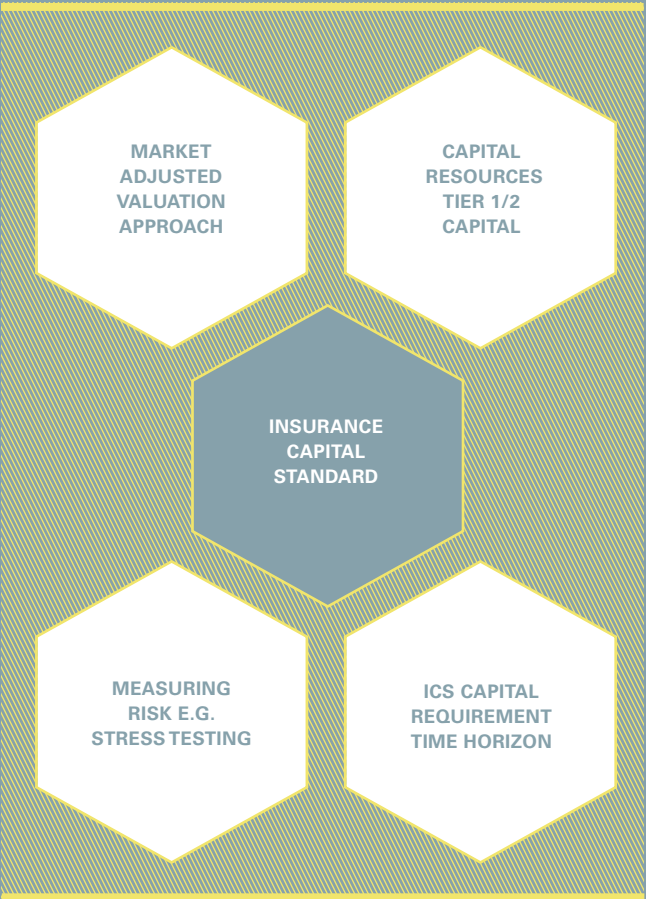
The IAIS also recognizes the need for an implementation period after adoption, to enable jurisdictions to embed the ICS into local requirements. Further, the IAIS recognizes that some form of transitional measures and phasing-in for certain elements of the ICS may be necessary in some jurisdictions.

**Interaction between ICS and existing frameworks**

The IAIS has said little to date regarding any form of jurisdiction recognition process to help supervisory authorities and insurance groups manage potential conflicts between the ICS and any local group solvency calculation requirements, for instance Solvency II in the EU. This will be important for groups, as the challenges of managing different group metrics could be significant, especially if they react differently to proposed mitigating actions. Recognizing that comparability of outcomes will only be achieved over time, the current focus will remain on developing the standard method approach.

KEY COMPONENTS OF THE GLOBAL INTERNATIONAL CAPITAL

*The key components of the ICS remain valuation methodology, qualifying capital resources, risk measurement and capital requirements, as illustrated in the following:*



**Market-adjusted valuation approach**

A key issue in the development of a global liability valuation approach for the ICS has been the lack of a global insurance accounting standard for insurance contracts. Work on the insurance contract accounting standard (IFRS 4) has continued in parallel; however the final standard is not expected to be issued until around the end of 2016 with an effective date unlikely to be before 1 January 2020. This has therefore necessitated the development of a stand-alone ICS valuation methodology, designed to broadly reflect the insurance liability valuation requirements of IFRS 4. This basis is known as the market-adjusted valuation basis, however the IAIS has indicated that further refinement to this basis is likely to be needed for the 2016 field testing exercise.

An alternative approach based on Generally Accepted Accounting Principles with adjustments (known as GAAP+) is being assessed. This has mainly been driven by the US, with the intention of allowing IAIGs to achieve a quasi-market adjusted valuation by applying adjustments to their local jurisdictional GAAP figures.

One of the other key areas for discussion in relation to the valuation of insurance liabilities relates to whether a margin over current estimate (MOCE) should be required.

The inclusion of a MOCE within the valuation of insurance contract liabilities would effectively result in the deferral of profit emergence.

Another unresolved issue relates to the definition of insurance contract boundaries. The 2015 field testing exercise included a number of questions that explored issues with the current definition.

**ICS capital requirement**

Despite opposition from stakeholders, the IAIS has confirmed that the ICS capital requirement will be a regulatory Prescribed Capital Requirement (PCR), meaning that the supervisor will only intervene on capital adequacy grounds if the group’s capital resources fall below the group’s capital requirement. No decision has yet been taken regarding the inclusion of a backstop capital measure, however, and the IAIS has indicated that this will not be revisited until ICS Version 1.0 is complete.

Importantly, the IAIS has resolved the question of the forward-looking timeframe for capital purposes, proceeding with the one year time horizon, assuming that the IAIG will carry on existing business as a going concern.

**POTENTIAL EXTENSION OF G-SII REQUIREMENTS TO DOMESTIC SYSTEMICALLY IMPORTANT INSURERS (D-SIIS)**

D-SIIs are insurers which are important to the functioning of a domestic financial system. As such, failure of any of these institutions is expected to have a negative impact on the overall stability of the domestic financial system.

Similar to the global framework being considered by the IAIS for identifying and regulating G-SIIs (the global equivalent), the US has in place a system for identifying Systemically Important Financial Institutions (SIFIs) which are the subject of enhanced regulation by the Federal Reserve. It is expected that some other local supervisory authorities may also implement some form of the framework being proposed by the IAIS for the regulation of D-SIIs within their own jurisdictions.

In this way, various components of the regulatory package applying to G-SIIs at a global level may also extend to D-SIIs. Among others, this includes a requirement to have in place a Recovery and Resolution Plan (RRP).

*In terms of a recovery plan, insurers would need to describe their recovery options and governance framework including:*

- *available options for dealing with financial stress as well as how and when these options would be triggered and what steps can be taken in practice and*
- *how the recovery monitoring and decision process is integrated within the risk management function.*

Insurers, in concert with resolution authorities, will need to establish a resolution plan.

The message from these myriad developments is clear. Change is on the cards as convergence of global standards and stricter requirements for insurance groups are pursued.

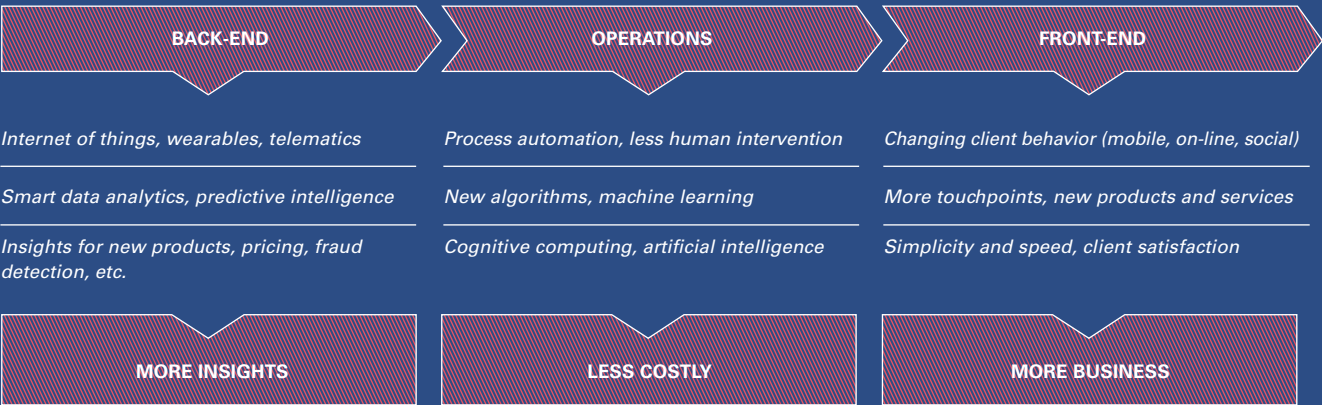
Coming on top of the challenges posed by the implementation of Solvency 2 and changes to the Swiss Solvency Test framework, it is clear that management will need to retain their focus on how the new rules affect their people, business model and external communications.



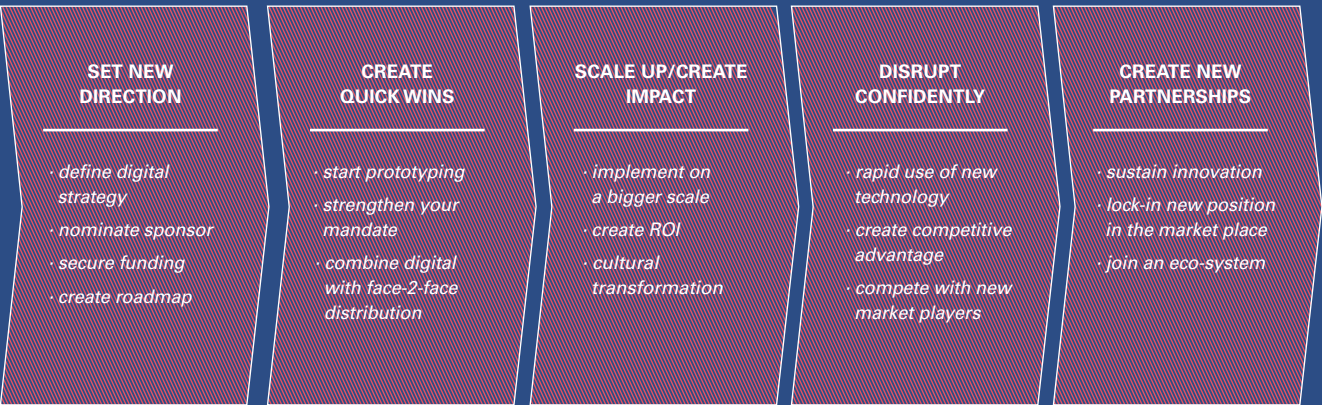
# Digitalization in insurance: From strategy to solutions

Much has already been said about the need for a digitalization strategy and key success factors. For example, experts agree that no insurance company can afford to take a 'wait and see' position. You can't even look to see what your insurance peers are doing because it's other industries that are in fact shaping customer expectations and setting the benchmark for insurance companies. The consensus is that digital transformation needs adequate investment and a senior sponsor to succeed. But where should insurance companies begin? What areas should they focus on and what steps do they need to take?

De-composing the insurance value chain helps to detect the true benefits of digital initiatives



A proposal for a digital transformation journey for KPMG insurance clients – “Start small, think big and move fast”



“The consensus is that digital transformation needs adequate investment and a senior sponsor to succeed.”

OPTION 1: DEVELOP THE FRONT-END

Digitalization will deliver big benefits at each stage of the value chain: on the front-end, insurers can gain market share, drive growth and enhance customer retention with the right digital tools. For example, Swiss Life's ‘My World’ portal gives customers a transparent view of the products they own and ways to assess what additional cover they need. The trend is shifting from multi-channel, in which customers use various sales channels successively, to omni-channel, in which customers use multiple options simultaneously.

OPTION 2: IMPROVE YOUR OPERATIONS

Operations is becoming the major source of differentiation and will be integral to the overall value proposition. It's good to have the best products or the most accurate risk assessments, but if you don't have the right processes, you won't be able to scale – which is of course the key to benefit from cost differentials.

Evidence for the rising role of operations can be seen at Zurich Insurance, where the newly appointed COO is in charge of the group-wide digitalization program, alongside a substantial investment budget. Operations is where you turn a strategy into cost-efficient solutions.

OPTION 3: DEVELOPING INSIGHTS

Analytics will also deliver deeper insights that allow insurers to optimize prices or develop entirely new customer-specific products. Swiss Re, for example, is developing smart analytics capabilities to expedite the processing of submissions and claims. It is also exploring ways to create entirely new types of services through digitally-supported underwriting.

As more and more real-time data becomes available, digital analytics will change the game in underwriting because it will allow a shift from historic risk modelling to real-time risk assessments. For example, telematics plus analytics will allow new types of pay-as-you-go motor insurance.

MAPPING THE JOURNEY

We encourage insurers to “start small, think big and move fast”. Begin by understanding your digital readiness and then define the digital strategy. You need to nominate a C-level sponsor and secure the funding. To do that, it is good to identify a number of impactful use cases and outline the roadmap. Remember to carefully manage stakeholders as you build internal awareness.

As you move into the second phase, you are looking for quick wins, so improving client touch-points by improving web, mobile and social offerings are good starting points. Start prototyping and begin to combine digital and face-to-face distribution. It is also advisable to explore access to external big data sources at this stage.

In the third phase, it is time to scale up and generate return on investment (ROI) as you hire data scientists or establish an innovation lab. As you optimize underwriting, claims, operations and service processes, we can begin to talk of cultural transformation. Digital analytics can be used to improve insights in areas like pricing or fraud detection.

In phase four, you can begin to disrupt confidently as you rapidly apply new technology to create competitive advantage and compete with new market players. At this stage you can expect to generate substantial cost savings through process automation and the replacement of legacy systems. As you add non-core value-adding services, expect customers to become fans who promote you wholeheartedly.

“We encourage insurers to start small, think big and move fast.”

The ultimate goal is to establish new partnerships and join a new ecosystem based on broader and deeper client relationships that extend beyond the insurance industry and which are characterized by a more collaborative use of technology and the ability to avoid adverse risks while increasing market share.

Digitalization is calling for entirely new business models and putting insurance companies under pressure to innovate. In a digitally interconnected world, products and services have to be comprehensive, ubiquitous, individual and, above all, authentic.



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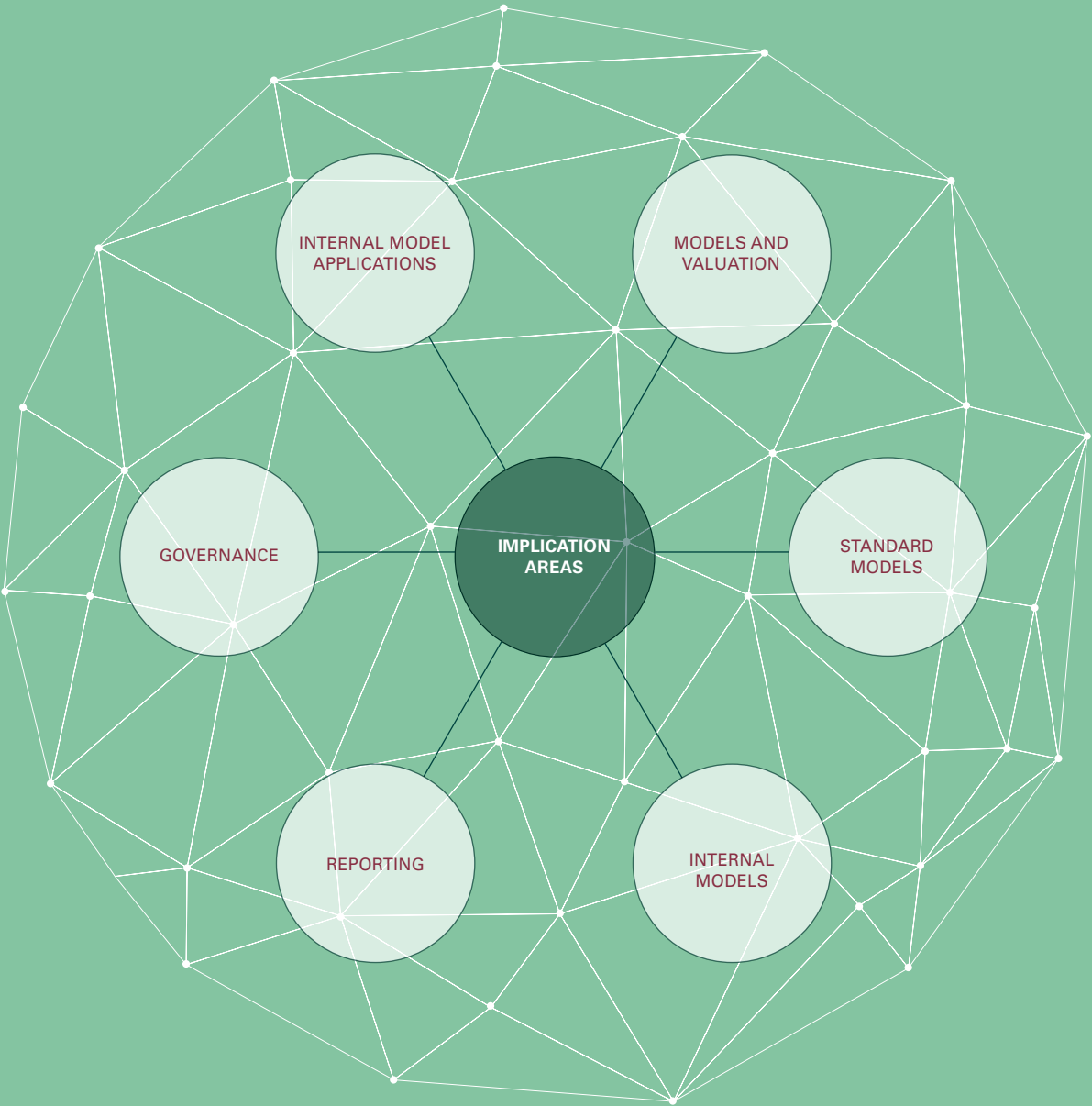
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# Imminent impact: FINMA's revised Swiss Solvency Test circular

The new SST circular was released for consultation from 31 May to 12 July 2016 with the final publication expected in the second half of 2016. From 1 January 2017 it will replace the current SST circular 2008/44. The revised circular represents the most significant change to the SST since it was first introduced in 2006. Among the many changes, there are some which will have a significant impact on the solvency ratio of (re)insurance companies. In this article we highlight the key changes.



SIGNIFICANT CHANGES

The most important change is a clarification of the assumptions to be applied to the valuation of the balance sheet at the end of the one-year SST period. This may have material impacts in terms of solvency and implementation efforts, in particular for group life business.

The second area where we expect significant effort to be required is in the revised internal model application process and internal model maintenance. The new circular lists additional requirements in order to obtain unconditional approval for the internal model. With the focus now on standard models, obtaining an internal model approval will be increasingly difficult.

The third area of material change has already been included in the new Insurance Supervision Ordinance ('ISO') Art 53a in force since 1 July 2015 and which is detailed in the new circular. It states that FINMA can demand additional SST calculations and stress tests. It's not yet clear to what extent this rule will be applied.

MODELS AND VALUATION

Valuation at the end of the one-year SST period

FINMA now rigidly specifies the balance sheet valuation methodology at the end of the one-year SST period whereas previously this was not clearly defined. It is now evident that the valuation must be based on the principle that the company is in run-off at the end of the one-year SST period.

The main assumptions under the new approach are as follows:

- No new business is written after the one-year SST period;
- Legally enforceable measures are taken to reduce insurance obligations;
- The company follows a concrete plan to fulfill the obligations such that the value of the insurance obligations is minimized;
- After the one-year SST period, assets can only be bought/sold if a reliable market value exists;
- Existing reinsurance and retrocessions can be considered, including renewals completed up to one year subsequent to the one-year SST period.

We observe intensive discussions in life companies regarding the interpretation and consequences of the new specific assumptions given how the impact on solvency requirements may be. These discussions now continue as part of the development of the new group life standard model. As the new group life model has not yet been released and due to implementation efforts required for the new model, there is a transition period for the new requirements until 1 January 2020. As the non-life business is already valued from a strict run-off perspective, we expect only minor implications for the market value margin calculation.

Definition of SST ratio

The SST ratio will in the future be defined in line with Solvency II as

$$\text{SST ratio} = \frac{\text{RBC-MVM}/(1+r)}{\text{TC-MVM}/(1+r)}$$

(RBC = risk-bearing capital at SST date, TC = target capital, MVM = market value margin, r = one-year risk-free interest rate)

The SST ratio is currently defined as RBC/TC, where the MVM is considered part of the target capital. The new definition increases the SST ratio for companies with an SST ratio above 100% and reduces it for companies with an SST ratio below 100%.

Currency of balance sheet

The currency of the balance sheet must be in the currency of the majority of assets and liabilities at the end of the one-year SST period. As companies were previously free to choose the currency, this change may impact those that used an alternative currency for their balance sheet.

(Ceded) reinsurance and retrocessions

The best estimates of (ceded) reinsurance and retrocessions are reported as an asset. This was previously considered a negative liability. This change does not impact the solvency ratio.

Capital and risk transfer instruments

FINMA lists criteria upon the fulfillment of which capital and risk transfer instruments can be considered in the target capital, depending upon the SST ratio of the contractual partner.

Materiality

The quantitative materiality limit is defined by a relative change of 10% of the SST ratio. The difference is that it previously referred to a relative change of 10% of the SST ratio and either of the risk bearing capital or target capital.



REPORTING

SST reporting

A greater emphasis is placed by FINMA on the following points as part of the yearly SST report:

- qualitative and quantitative description of the expected development of the balance sheet positions over the one-year SST period
- consequent comparison with the prior year’s SST figures and comments on the rationales for changes
- statement of all material parameters used in the SST model, and comments on the changes compared to last year and
- disclosure of assumptions and opinions based on expert judgment
- including a paragraph on the expected development of the risk situation over the one-year SST period
- FINMA will define a minimal structure for market, credit and insurance risk.

Most of the listed points above already coincide with current FINMA practice.

Stress test reporting

FINMA may demand additional SST calculations and stress test analysis. The new circular states that a company must submit a corresponding report on the consequences and potential measures in the event of an occurrence of the stress events. FINMA has not yet announced how frequently and to what extent it will require these additional calculations and reports.

GOVERNANCE

The following new guidelines come into force:

- If the company outsources the determination of the SST, it must review the outsourced work (and retain formal documentation to this effect) prior to submission; and
- Projections must be in line with internal business forecasts and with ORSA.

There is one modification:

- Outstanding events must be immediately reported to FINMA. If the SST ratio is above 190%, they must be reported if the relative change of the SST ratio is greater than 33%. At an SST ratio of less than 190%, the limit is a relative change of the SST ratio of 20%. Previously, the threshold was 150%.

STANDARD MODELS

FINMA states clearly the following:

- The use of modelling techniques which are not described in the standard model need the antecedent approval of FINMA; and
- FINMA decides on an individual basis whether or not a modelling technique is considered an internal model (and therefore subject to approval).

These points are merely clarifications of how FINMA already operates in practice.

INTERNAL MODELS

Internal model documentation

The internal model requires additional technical documentation:

- a document describing the risk profile and the main risk drivers
- a model governance document and
- a guidance document describing the validation process of the internal model.

The technical documentation must be structured in line with the model. It must be comprehensive, self-contained, clear and unambiguous.

Material model changes

A material model change is now defined as being when one of the following conditions is fulfilled:

- relative change of the SST ratio of more than 5% or
- conceptual changes, new methods, data or business areas.

Material model changes are subject to the internal model application process. Previously, the material model change materiality threshold was a relative change of 10% of the SST ratio.

Internal model application process

The process holds:

- for the initial use of a (partial) internal model
- for the unconditional approval of a conditionally approved internal model and
- for material internal model changes.

As already included in the new guidance published in February 2016 regarding the approval process for an internal model, a validation report is now required as part of the model application package.

FINMA’S RESPONSIBILITIES

The new circular contains two points describing specific responsibilities of FINMA:

- FINMA can only force a company to change a fully approved internal model based on a material audit or a significant change of the risk situation.
- FINMA must inform companies at least six months before the next SST deadline if it has further requirements on data to be submitted, content or structure of the report.

CONCLUSION

The new SST circular introduces significant changes that will impact the SST 2017 and beyond. Some of the major changes are completely new (valuation at the end of the SST period and extended internal model documentation). For others already included in other documents (stress tests in ISO, internal model application process in guidance), the new circular goes into greater specifics or slightly adapts the existing documents.

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# ORSA: AN INTEGRATED PROCESS, NOT A REPORT

At the same time as the EU market submits its first official Own Risk and Solvency Assessment (ORSA) report, the Swiss market also faces challenges introduced by the new Swiss ORSA circular. As with its equivalents in other jurisdictions, the Swiss ORSA framework can be seen as a revolution in risk management. It impacts not only the management and monitoring of risks, but also the organization's strategy and business-related decision processes.



From a first ORSA dry run to a fully integrated process and decision tool, the effort, internal skills and expertise required should not be underestimated. An efficient and well integrated ORSA process involves real cultural change within the organization, along with a deep review or enhancement of various processes, systems and people’s awareness of risk and controls.

Considering the ORSA exercise as a key internal process and not only a regulatory report will therefore heavily influence the effectiveness of the organization’s implementation approach.

ORSA IN THEORY: THE REQUIREMENTS

ORSA builds on the foundation of sound risk and capital management, drawing strategy and business planning closer to this basis. It is an integrated framework that aims to answer a fundamental question: Do we have enough capital under normal and stressed conditions to continue to pursue our business strategy over the life of the business plan taking into account our risk appetite framework and external environment?

The major challenge underlying this is that this question should be addressed over the horizon of the business plan. In other words, organizations need to develop tools and frameworks to assess their solvency needs and related capital in a prospective manner. Under the ORSA, business or strategic decisions cannot be taken without ensuring that sufficient own funds will be available to ensure overall solvency needs are met at all times.

The effective establishment of this framework within (re)insurance companies should be done through the design of an ‘ORSA process’ regulated under an ‘ORSA policy’. Its outcomes should be documented in an ‘ORSA report’ that needs to be approved and validated by the Board.

To date, and due to several reasons such as timing constraints, lack of trust in the value of the framework and sometimes poor or immature risk management frameworks, many companies appear to view the ORSA requirements as more of a compliance exercise or simply ‘producing an ORSA report’.

In fact, it should be a robust process where the undertaking engages to assess all risks inherent in its business in order to assess its corresponding capital needs both now and in the future.

ORSA IN PRACTICE: IMPLEMENTATION AND RELATED CHALLENGES

Similar to the second pillar of the Solvency II directive, Swiss ORSA is a principle-based requirement. The main challenge insurers face is often the lack of clear guidelines on how an ORSA report should look or how it should be approached. From a regulatory perspective, however, ORSA should not be viewed as a regulatory report but rather as an internal decision report. Organizations are thus expected to have the adequate skills and expertise to translate the requirements into a tailored own solution.

A key component driving an organization’s ability to effectively address ORSA requirements is the maturity of its enterprise risk management (ERM) and capital management frameworks already in place. Indeed, ORSA should be viewed as a risk management tool that relies on and brings together various key internal processes such as risk management, capital management, business planning and stress testing.

*With regard to implementing the Swiss ORSA requirements, we observe two key dynamics in the Swiss market that lead to disparate levels of sophistication and readiness:*

- **International players** *which are part of a group covered by Solvency II and which plan to fully replicate the group Solvency II ORSA at company level. These companies generally display a well-established risk management framework inspired by EU guidelines and best practices. It should not be overlooked though that even if replicating the group framework can clearly ease the initial ORSA set up and dry run exercises, integrating the ORSA process within the local risk management framework and using this for local decision making may still require significant effort and changes to business processes.*
- **Local players** *which have to build the overall ORSA framework by themselves and need to conduct in parallel a gap analysis on their overall risk management framework to ensure compliance with the ORSA requirements. For these players, minimum compliance is often a realistic objective in a first step.*

Apart from the maturity of the enterprise risk framework, fundamental to the ORSA is that the ORSA is forward-looking. This can be an area of significant challenge for standard model users. Projection requires quantitative analytics ranging from an effective use of Excel to more complicated stochastic models.

Stress testing also forms an important part of the regulatory expectations for all insurance undertakings. Unlike Solvency II, the Swiss Solvency Test already includes several scenarios which may help insurers. However, FINMA considers the SST scenarios to be insufficient and they only cover one period. Additional scenarios should therefore also be considered such as strategic, reputational and operational risks that are not included in SST framework, and – as far as possible – multi-period scenarios such as continued low interest rates.

Despite the apparent complexity inherent in its implementation, ORSA nevertheless offers insurers the freedom to define a framework that is appropriate to the nature, scale and complexity of their own organization. Whatever the extent of the existing frameworks or internal capabilities, however, in our experience insurers are frequently referring to ORSA as a regulatory document instead of a management tool, and are promoting not only minimum compliance but sometimes minimum effort.

ORSA AS A ‘BUSINESS AS USUAL’ PROCESS EMBEDDED IN THE BUSINESS

When looking at the ORSA process, only a few organizations are at this stage really thinking about building new processes or tools to perform their ORSA. Given the new reporting requirements, and to enable the ORSA report to be used as a decision tool, insurers will have to embed their ORSA process to fulfill both internal and external reporting requirements. The next consideration insurers will therefore have to focus on is the expected implications of ORSA becoming a ‘business as usual’ process.

Managing the ORSA process together with other internal processes underlying regulatory or business requirements will create challenges related to data quality and governance, as well as internal process efficiency. These challenges include ensuring the business applies efficient data controls or procedures, ensuring the effectiveness of the internal control framework, having adequate IT systems, and making sure that people undertaking a data governance role have the appropriate skills.

The requirement to embed the ORSA in the business means executing the ORSA process each time the internal strategy impacts one of the organization’s core processes (product development, reinsurance strategy, investment strategy, new market entry, M&A...); and that the related ORSA results are considered to support the Board’s decision process. It is easy to imagine that this objective will not be reached without a significant change in the behaviors of all internal stakeholders when dealing with risk and return, and in the organization’s overall risk culture in general.

# Tax challenges ahead!

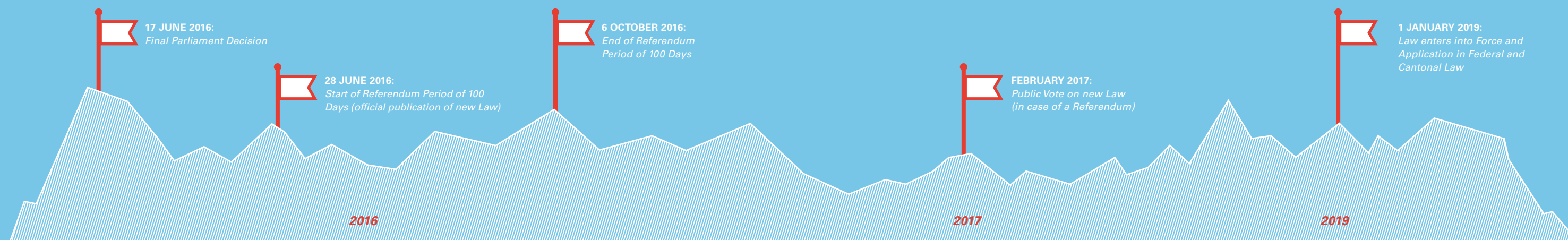
It is not just the convenient location in the heart of Europe, but a number of other reasons that make Switzerland a very attractive location for carrying out insurance business.

Apart from its favorable taxation system, it is very commerce-friendly with a high-quality infrastructure, robust rule of law, recognized as a stronghold of insurance and reinsurance companies and possesses a concentration of experienced and well-educated workers.

Various upcoming initiatives and regulatory changes will materially affect Switzerland's taxation landscape over the next few years, however. These challenges and their impact on Swiss insurance companies need to be analyzed carefully to turn them into opportunities; the upcoming changes described here must be aligned in order to not miss out on any occasion.



## Corporate Tax Reform III – General Background

DEVELOPMENTS IN THE ZURICH INSURANCE  
TAX PRACTICE

A considerable proportion of Swiss insurance companies are located in the canton of Zurich. The Zurich cantonal tax authorities published a new bulletin in November 2015 which strengthens the tax practice regarding the building of lump-sum provisions on securities. Previously accepted lump-sum provisions on securities (10 percent on Swiss bonds, 20 percent on other securities) will no longer be acceptable from a tax point of view and consequently have to be dissolved. Conditions for the provision release – in particular the timeline – are not defined in the new bulletin. Companies are recommended to address the details of the release upfront with the cantonal tax authorities; taking into account the company's general loss situation and business projections and, notably, the upcoming Swiss Corporate Tax Reform III.

## SWISS CORPORATE TAX REFORM III (CTR III)

On 17 June 2016 the Swiss parliament decided on the final content of the CTR III, an important reform package to retain and enhance Switzerland's competitiveness as a business location in light of far-reaching international developments. Aside from the abolition of the privileged tax status currently in place (e.g. holding, mixed, principal company, finance branch regime), the opportunities of the CTR III lie within the implementation of new internationally accepted tax incentives.

Irrespective of the referendum announced by the Social Democratic Party, it is planned that the new legislation will enter into force on 1 January 2019 (see table on page 58 for timeline).

Three measures to be implemented are likely to  
impact insurance companies:

- **Step-up:** Swiss reinsurance and captive companies with an international business focus often benefit from the mixed company status, which allows for a reduction of the taxable basis on cantonal/communal level. The abolition of this status will result in a 'fiscal shock' as a higher tax rate on the future release of hidden reserves and goodwill is applicable. In order to absorb this fiscal shock, a transitional measure called 'step-up' is introduced. The step-up will allow an insurance company in a transitional period to continue the low tax regime on future releases of hidden reserves and goodwill. As several step-up possibilities are available, each company needs to decide which option is best tailored to its business needs. The new practice of the Zurich tax authorities regarding lump-sum provisions on securities needs to be taken into account as well when deciding on the best step-up alternative.
- **Notional Interest Deduction (NID):** NID accounts for the fact that interest payments on debt are tax deductible, but not dividend payments on equity, by granting a deemed interest expense on certain equity.

## The NID is calculated as follows:

**NID = excess equity \* interest rate.**

- NID is limited to a defined excess equity basis; no NID is granted on the 'core capital'. Core capital is determined according to fixed quotas per asset category to be published by authorities in a circular letter. Certain asset categories, e.g. investments in subsidiaries, non-operating assets and capitalized step-up, do not qualify for NID.

- The interest rate is based on long-term interest rates of Swiss Federal bonds (safe harbor rate will be published by the authorities). In the current negative interest rate environment, no NID would be granted. However, the interest rate can be increased to arm's length rates to the extent that the excess equity relates to loans from related parties (group financing; margin taxation). The arm's length interest rate application might be of specific interest for holding entities within a Swiss insurance group.
- **Reduction of cantonal corporate income tax rates:** Cantons are free to lower their ordinary tax rates, taking into account the anticipated effect of the CTR III on their budget. Some cantons have already announced effective income tax rates as low as 12% to 13% (see table on the next page for a comparison of current and announced effective tax rates).  
The Zurich cantonal government decided to reduce its ordinary tax rate from the current 21.1% to 18.2% (effective tax rate for federal, cantonal and communal tax purposes) which is ultimately beneficial to all Zurich companies. The cantonal parliament, and probably the Zurich people, have the final vote. As soon as the proposed low tax rate is enacted, all insurance companies will have to consider the new tax rate not only for current, but also deferred, tax calculations – probably resulting in a substantial one-off tax impact.

Corporate Tax Reform III – General Background

Announced reductions of Tax Rate (1/2)

| Canton                 | Effective income tax rate 2016 | Announced tax rate as of 1 January 2019 |
|------------------------|--------------------------------|---|
| Aargau                 | 18.61 %                        | Reduction planned                       |
| Appenzell Ausserrhoden | 13.04 %                        | No info                                 |
| Appenzell Innerrhoden  | 14.16 %                        | No info                                 |
| Basel-Landschaft       | 20.70 %                        | Reduction planned (15%)                 |
| Basel-Stadt            | 22.18 %                        | Reduction planned (13%–16%)             |
| Bern                   | 21.64 %                        | 16.4%–17.7 %                            |
| Fribourg               | 19.86 %                        | 13.7 %                                  |
| Glarus                 | 15.70 %                        | Reduction supposable                    |
| Geneva                 | 24.16 %                        | 13.0 %                                  |
| Graubünden             | 16.68 %                        | No info                                 |
| Jura                   | 20.66 %                        | Reduction planned                       |
| Luzern                 | 12.32 %                        | No further reduction                    |
| Neuchâtel              | 15.61 %                        | 15.6 %                                  |

Corporate Tax Reform III – General Background

Announced reductions of Tax Rate (2/2)

| Canton       | Effective income tax rate 2016 | Announced tax rate as of 1 January 2019 |
|--------------|--------------------------------|---|
| Nidwalden    | 12.66 %                        | No further reduction                    |
| Obwalden     | 12.66 %                        | No info                                 |
| Schaffhausen | 16.04 %                        | 12.0%–12.5 %                            |
| Schwyz       | 15.27 %                        | No info                                 |
| Solothurn    | 21.85 %                        | Reduction planned                       |
| St. Gallen   | 17.40 %                        | <15 %                                   |
| Thurgau      | 16.43 %                        | Reduction planned                       |
| Ticino       | 20.67 %                        | 17.5 %                                  |
| Uri          | 15.01 %                        | No info                                 |
| Vaud         | 22.09 %                        | 13.8 % (enacted)                        |
| Wallis       | 21.74 %                        | Reduction planned                       |
| Zug          | 14.60 %                        | 12 %                                    |
| Zurich       | 21.15 %                        | 18.2 %                                  |

BASE EROSION AND PROFIT SHIFTING (BEPS)

BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where the organization has little or no economic activity, resulting in little or no overall corporate tax being paid.

The BEPS initiative initiated by the OECD developed 15 actions on how BEPS can be effectively avoided in the future. More than 90 countries including Switzerland have announced their political commitment to its implementation. Insurance companies are explicitly referred to under action 4 which seeks to establish specific rules in connection with financing and interest deductibility. Thereby, insurance companies (as well as banking companies) – due to the peculiarities of their business – may be excluded from the scope of one of the basic measures of action 4, which is the fixed ratio rule (restricts an entity’s net interest deductions to a fixed percentage of its earnings before interest, taxes, depreciation and amortization). Instead, according to a recently published discussion draft, it is suggested that countries separately evaluate the risk of excessive leverage of insurance companies in their jurisdiction and consider introducing specific tax rules to deal with this; no need was identified to develop a single common (OECD) approach.

In general, two BEPS actions that have recently enjoyed increased attention are the automatic information exchange (of rulings) as part of action 5 and the country-by-country reporting (CBCR) as part of action 13:

- Likely from 2018 onwards, Switzerland will conduct a (spontaneous) exchange of information with other countries concerning tax rulings. Rulings with regard to a privileged tax regime or with respect to the creation of permanent establishments and respective profit allocation abroad will be especially affected. This is applicable to tax rulings that were approved from 2010 onwards and that are still in force at the time of the exchange of information. Several Swiss insurance companies have tax rulings in place particularly with regard to the mixed company status and/or with regard to allocation of taxable factors to foreign branches. In order not to be affected by the ruling exchange, respective rulings could be withdrawn in good time before the exchange becomes effective. The pros and cons of a ruling withdrawal need to be carefully analyzed. Whereas the application of the mixed company status (until its abolition in the CTR III) can basically also be applied based on law exclusively, a particular tax treatment – like foreign branch allocations – often has to be agreed in a specific tax ruling.

- CBCR is a new form of (international) tax compliance report for large multinationals, requiring – per country and group entity – the disclosure of key figures such as total revenue, profit before income tax, income tax paid and accrued, number of employees, main business activities etc. It must be filed if a group’s revenues exceed EUR 750 million (translated into CHF 900 million according to current Swiss draft legislation) and will have to be produced for periods starting on or after 1 January 2016 – if already enacted in the specific country. Switzerland will presumably implement CBCR in 2018, meaning that legislation would apply to fiscal years beginning on or after 1 January 2018. However, a Swiss-based group may have to file CBCR abroad for fiscal years beginning on or after 1 January 2016, if one of its subsidiaries is located in a country that has already implemented these rules. Insurance multinationals (with Swiss group companies) have to be prepared to be ready as soon as they will be covered by the CBCR regulations. It is important to design the compliance process to gather data and prepare the CBCR. However, it is even more important to anticipate how the receiving tax administrations in all countries concerned will interpret the information received. And it is recommendable to perform a risk assessment to understand areas that could potentially cause difficulty in their interpretation. To reduce the overall risk, it is imperative to assess how the CBCR aligns with the transfer pricing documentation.

OUTLOOK

The changes described bring many opportunities if implemented properly. From a national point of view, the Swiss CTR III will abolish the currently available tax privileging regimes and introduce new internationally accepted measures that offer attractive incentives. From a more global angle, the OECD BEPS initiative aims to prevent multinationals from avoiding corporation tax by setting standards for tax transparency and international collaboration with regard to exchange of relevant tax information. Accordingly, substance considerations will become more important in the future and offshore jurisdictions/tax havens will find it more difficult to attract companies that so far have not intended to align their functions and risks proposition with their profit allocation methodology. By applying the new internationally required taxation schemes Switzerland will ensure that it is ideally set up to further enhance its competitiveness in the insurance market.



# Modernizing Corporate Governance: the new FINMA circular

On 31 May 2016, FINMA published four circulars that are intended to conclude a series of revisions of the Swiss regulatory regime in order to ensure equivalence with the Solvency II requirements. The circulars will become applicable as of 1 January 2017. Draft Circular 2017/xx 'Corporate Governance Insurance Companies' replaces 2003/32 and aims to revise corporate governance regulations as necessary after the revision of the Insurance Supervisory Ordinance (ISO). In addition, the previous circular 2008/35 on Internal Audit will be superseded by this circular.

CORPORATE GOVERNANCE PRINCIPLES

The ISO revision in 2015 strengthened the principle of checks and balances with a strict separation between the Board of Directors and management. With the introduction of article 216b ISO, a member of the Executive Committee (or Board of Management) can no longer be a member of the Board of Directors. The draft circular reemphasizes the strict separation of operating activities and control activities. Other corporate governance principles include the requirement for an effective, entity-wide risk management system including control functions, a code of conduct, internal reporting and communication guidelines and the documentation of significant management and/or board decisions. In addition, companies will have to implement processes that ensure that the board, executive management and control functions have the required knowledge, experience and qualifications.

BOARD OF DIRECTORS

The professional experience of the board is outlined in chapter IV of the draft circular. The board as a whole must have the required knowledge, experience and qualifications and each board member must contribute to the knowledge and the ability that – together with the other members of the board – allow for an appropriate oversight of the company’s operations. The board needs to consist of a minimum of three members – and at least one-third of the members needs to be independent.

*Independent board members of the parent company should be able to meet independence criteria of the subsidiary as well. Independence will not be met if the person:*

- *works (or has been working in the last two years) in a different function within the company or the group*
- *had been the leading auditor of the company in the last two years or*
- *has business relationships with the company.*

Even though not enacted, companies need to find strong arguments to appoint internal (and non-independent) board members if the overall composition of the board is not yet in line with the anticipated independence requirements. Transition rules give companies time until 31 December 2019 to become compliant with the new regulations. It has to be seen if it becomes increasingly difficult to find suitable board members in the future, given the new independence requirements in combination with the knowledge and experience needs.

Insurance companies in supervisory category 2 and 3 will need to have an audit committee and a risk committee. Category 3 companies may combine such committees. The draft circular currently foresees that the president of the Board of Directors cannot chair either of the committees. In addition, the above-mentioned independence and knowledge criteria also apply to each committee. Insurance companies in supervisory category 4 or 5 that have such a committee on a voluntary basis will also have to be in compliance with the circular even though generally exempted.

RISK MANAGEMENT AND INTERNAL CONTROLS SYSTEM

Article 27 of the Insurance Supervisory Act requires an effective internal controls system. The effectiveness is not limited to internal controls over financial reporting but includes operations, legal and compliance. The rules have already been applicable in the past (circular 2008/32, no. 7) and continue to be relevant as per the new draft circular.

The control functions of the company are Risk Management and Compliance as ‘second lines of defense’ and Internal Audit as the ‘third line of defense’. All three are independent of the daily operations of the company and report to the Board of Directors.

INTERNAL AUDIT

Internal Audit is required to use a multi-year audit approach that ensures that all business activities become subject to audit within a reasonable timeframe, considering the inherent risk of the underlying audit area. As a result, we expect an increase in the need for Internal Audit resources; this includes in particular internal auditors with an actuarial, valuation or IT background. Companies still have the possibility to outsource Internal Audit within the group or to an audit firm registered with the FAOA or to another service provider. In this context, the draft circular reemphasizes article 7 paragraph 1 letter f of the FINMA Financial Market Auditing Ordinance which prohibits the auditor of the company from performing such services.

OUTSOURCING

The requirements for risk management and the internal controls system with regard to outsourcing arrangements as per the draft circular also cover outsourcing within the group. The insurance company needs to assess the underlying risks prior to outsourcing and the service provider needs to ensure that they have covered the inherent risks in their internal controls system. The service provider confirms compliance in its reporting, which is usually an ISAE 3402 Type 2 report. Outsourced activities will also have to be closely monitored and controlled by the insurance company who will have to designate a responsible person for the oversight of these activities. The overall guidelines as per chapter 4.10 of the explanatory notes to the business plans submitted by insurance companies from 21 April 2016 remain. This ensures that at least one of the core functions (production (i.e. product development, distribution, underwriting), administration of the client base (administration of policies) or claims settlements) may not be outsourced.

CONCLUSION

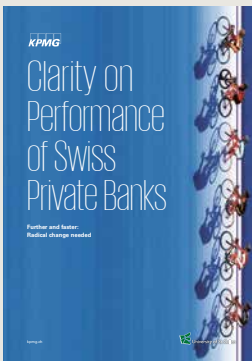
The new draft circular not only combines previous circulars in a single document. Its requirement to introduce a clear three lines of defense model codifies best practice – this will lead to little change at larger companies but may pose challenges for smaller companies. Also, the requirements of the Board of Directors regarding independence, knowledge and experience may become more demanding.



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