Circular 2016/5 Investment Guidelines – Insurance Companies

Investments made for total assets and for tied assets of insurance companies

dated 1 January 2016

FINANCIAL SERVICES

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Circular 2016/5
Investment Guidelines – Insurance Companies

Investments made for total assets and for tied assets of insurance companies

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Annex 1:	Rider issued by the Swiss Bankers Association

Addressees

BA			ISA			SESTA		CISA									AMLA			OTHERS	
Banks	Financial groups and congl.	Other intermediaries	Insurers	Insurance groups and congl.	Insurance intermediaries	Stock exchanges and participants	Securities dealers	Fund management companies	SICAVs	Limited partnerships for CISs	SICAFs	Custodian banks	Asset managers CIS	Distributors	Representatives of foreign CIS	Other intermediaries	SROs	DSFIs	SRO-supervised institutions	Audit firms	Rating agencies
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I. Topic

This circular shall concretize the provisions applicable to the investment activities of supervised insurance companies. Chapters II and III formulate FINMA expectations concerning all of the investment activities, especially the general requirements concerning the management of the tied assets (Article 17 of the Insurance Supervision Act [ISA; SR 961.01]). Chapters IV and V explain the requirements made of the legally permitted assets in the tied assets (Article 79 of the Insurance Oversight Ordinance [ISO; SR 961.011]). 1

II. General Principles Applicable to the Total Assets

A. Investment principles

When selecting its investments, the insurance company shall take into consideration the asset liability management (ALM), the security of investments, an appropriate diversification and the insurer's foreseeable needs for cash. 2

B. Derivatives

a) Using derivative financial instruments

Insurance companies may use derivative financial instruments only to mitigate investments or its liabilities held towards its policyholders or for the efficient management of investments (Article 100 ISO). 3

When using derivatives, the insurance company may not enter into any risks that would be inappropriate for the insurer's scope of business activities or its risk capacity. Moreover, derivatives shall be used for long-term effect. 4

b) Obligation to provide coverage when using derivative instruments

According to Article 100(2) ISO all payables arising from derivative financial transactions shall be covered. These payables shall either be fully covered for the contract volume / notional value by the derivatives' underlying assets (in the case of derivatives with a selling obligation) or by liquidity (in the case of derivatives with a purchase obligation). 5

Liquidity may also consist of cash and cash equivalents. Cash equivalents shall be considered to be cash deposits as defined in margin nos. 181-185, as well as government bonds rated at least 2 and with excellent liquidity. Moreover, receivables defined in margin no. 114, which have been excluded from the counterparty limit may be considered to be cash equivalents. 6

Payables shall be deemed fully covered at all times if: 7

- liquidity and/or cash equivalents are available; 8
- the underlying assets are available in the insurance company's assets without any encumbrances. Securities lending on underlying assets and repos/reverse repos are not permitted in the context 9

of derivative transactions. An exception to this are securities which have been lent and which may be recalled at short notice without restrictions. Adequate consideration shall be given to the heightened operational risk arising from such transactions;

- a double use of liquidity or underlying assets to cover several transactions is excluded. Underlying assets or liquidity may be used simultaneously to cover derivative positions if these bear multiple risks (such as market risk, credit risk or currency risk) but refer to the same underlying asset; 10

- the market value of the cash equivalents or the number of underlying assets covers the entire payable, whereas cash equivalents (with the exception of cash deposits defined in margin nos. 181-185) may be used as cover only up to 90% of the market value amount. 11

In the case of derivatives subject to purchase or acceptance obligations (e.g. long futures, long forwards, short puts) for an underlying asset, such as shares, financial indices, currencies or interest rates, the liquidity necessary for the settlement of the obligation shall be available at all times. 12

In the case of derivatives subject to sell or delivery obligations (e.g. short futures, short forwards, short calls) for an underlying asset, such as shares, currencies or interest rates, the liquidity necessary for the settlement of the obligation shall be available at all times and without restrictions. In the case of index derivatives, obligations are deemed to be covered if there is a considerable and stable correlation between the underlying assets held and the index. 13

If there is a legal entitlement to a cash settlement of an obligation instead of delivery of the deliverable underlying, the underlying physical deliverable shall be held nonetheless. 14

Insurers shall always hold the full liquidity required to satisfy a cash settlement that may arise due to the sale of a derivative where a delivery is not possible physically (e.g. underlying value in the case of weather derivatives). 15

In the case of derivatives involving swaps of cash flows (e.g. interest rate swaps) the payable cash flow shall be covered with the necessary liquidity or the relevant underlying asset. 16

In case of a combination of derivatives the payable of the full combination shall be covered at all times with available underlyings or liquidity. The underlying of the combination shall be identical with the underlying assets used for the cover. 17

c) Organization, know-how and investment process

Insurance companies using derivative financial instruments shall dispose of qualified and expert staff, an investment strategy that foresees such instruments, an investment management that takes into consideration the particular needs, a properly implemented and fully documented investment process, a risk management appropriate for the risks as well as an adequate system infrastructure (margin no. 76). 18

The provisions of margin nos. 57-87 shall be applicable by analogy also to the use of derivative financial instruments. 19

d) Risk analysis when using derivative financial instruments

Counterparty risks arising from the use of derivative financial instruments shall be considered prior to entering into derivative transactions. The risks shall be analyzed as often as the situation on hand requires it, but at least once a week for market risk and once a month for credit risk. An analysis of market and credit risk shall consist of valuing open positions and comparing these to the risk exposure limits defined. The result of the risk analysis shall be submitted to management as often as the situation requires it, but at least once a month for market risk and at least quarterly for credit risk (Article 104 ISO). 20

The insurer's risk management shall ensure that the derivative strategy of the different business units has been captured centrally and that they have been analyzed for interdependencies. Various scenarios shall be calculated in order to ensure that the use of the derivatives in their entirety jeopardizes neither the assets' value retention not the company's solvency. The insurance company shall ensure that the economic impact on the assets and solvency is presented correctly in the various reports to the FINMA. 21

According to Article 108 ISO, the Board of Directors shall receive an activity report on the use of derivative financial instruments at least every six months. 22

III. General Principles Applicable to the Tied Assets

A. Definition, purpose and duty to create [tied assets]

The assets in tied assets shall cover policyholders' claims based on disclosed technical reserves. The tied assets are of great significance in the case of a portfolio transfer and specifically in case of insolvency and the ensuing wind-down of an insurance company. Tied assets shall thus form loss reserves for policyholders that ensure that the claims of such persons arising out of insurance policies will be satisfied before those of any other creditors. 23

Assets allocated to the tied assets shall be secure and unencumbered in the ownership of the insurance company and in the case of the insurance company's bankruptcy, realizable in Switzerland. In order to ensure that policyholders' claims are secured effectively, assets allocated to the tied assets shall be examined for their recoverability and value preservation. 24

B. Principles

a) Investment principles

aa) Security

The investments in tied assets shall be chosen so that policy claims may be fulfilled at all times. 25

The security of investments is deemed to be guaranteed if they are secure from an economic and a legal perspective. Economic security is deemed to be present if capital, i.e. assets, maintain their value; the investments' legal security shall relate to their availability and their realizability. The requirement of economic and legal security shall apply to direct as well as indirect investments. 26

The aspect of value preservation shall consider in particular the following criteria: 27

- the value fluctuations of all the tied assets, whereas the tolerable value fluctuations depend on the extent of the excess cover of the tied assets;
- the quality of the investments;
- a reliable valuation method for the investments.

Legal security shall relate in particular to the following criteria: 28

- full power of disposition;
- the unrestricted realizability and transferability of assets, in particular also in case of the insurance company's bankruptcy.

Assets that jeopardize the value of the tied assets (for instance, because they could cause margin calls at the charge of the tied assets) are not permitted. 29

bb) Asset Liability Management (ALM)

The management of tied assets shall reflect the structure and the expected developments of the insurance obligations that are to be secured. In doing so, the insurance company shall take into consideration both the value development of investments and liabilities as well as the expected cash flows due to investments and obligations . 30

cc) Profitability

The insurance company shall select investments with a return in line with the market. 31

dd) Diversification

The insurance company shall ensure an adequate diversification fit for purpose for every set of tied assets. Risk concentrations shall not be permitted. The insurance company shall obtain an adequate mix of investment categories and diversification of investments in regard to exposures. 32

An adequate mix of investment categories shall consider in particular the following criteria: 33

- The specific risk profile and default risk or impairment risk of investments;
- the investment horizon (i.e. the duration of the investment);
- The correlation of the asset classes.

An adequate investment diversification shall take into consideration at least the following criteria: 34

- Different counterparties;

- Different geographic locations;
- Various industries and sectors.

Investments in high-risk assets may only be made prudentially and in order to gain a reasonable diversification in all of the tied assets. The risk capacity of the insurance company shall be taken into consideration in any case. Investments in securities rated 5 may be made only if the insurance company has expertise pertinent to credit risk. 35

ee) Liquidity

As a rule, the insurance company shall choose investments, which can be sold quickly if necessary, especially if the insurance company were to become insolvent. 36

The realizability of an investment shall depend among other things on its maturity period (bonds, fixed-term deposits, etc.) and the possibility to transfer (sell) these in the market or on a stock exchange. 37

b) Prohibition of encumbering or netting assets

The assets in the tied assets shall be unencumbered (Article 84(2) ISO). As a rule, an encumbrance of tied assets due to being pledged, under lien, subject to netting or similar rights is not permitted. Furthermore, it is prohibited to charge margin calls to the tied assets. Exceptions are listed in Chapters IV and V. 38

c) Realizability in the case of bankruptcy

The assets in the tied assets shall serve only to secure policyholders' claims in case the insurance company undergoes insolvency and liquidation under bankruptcy laws. Therefore, it is imperative that the assets are included in the bankruptcy estate and that they can be sold in the course of a Swiss bankruptcy. 39

The realizability in the case of a bankruptcy shall be secured by the insurance company; it may prove it using one of the following means: 40

- the investment is a security traded on a market with an observable market price; or 41
- the legal framework applicable to the investment recognizes FINMA's insolvency procedures and the seniority of the claim to the tied assets in accordance with Swiss law so that no special enforcement or other interventions by an authority or third parties become necessary. 42

Upon FINMA's request, an insurance company shall have to prove the realizability in accordance with Swiss bankruptcy law. 43

d) Perpetual coverage

The insurance company shall ensure with adequate corporate governance measures that the current required amount according to Articles 56 and 57 or 68 ISO is covered with assets permitted according to Articles 68(2), 79 and 81 ISO. The amount of the current required amount shall be determined on the basis of the current reserves, had financial statements been prepared at that time. 44

If determined during the year, prudent and well-founded estimates may be used instead of a specific calculation of the current reserves if it can be proven with great certainty that the current required amount is actually covered with eligible assets. 45

Like this, the insurance company shall ensure that sufficient assets remain available to cover the required amount of the tied assets, despite events that occurred during the year (such as unexpected losses, the need for further reserving, roll-out of new business or business growth), which require further technical reserves. 46

e) Management of the tied assets

The insurance company shall manage the tied assets by allocating assets. It shall record and earmark these assets in such a manner that it is obvious at all times which assets are part of the tied assets and that the required amounts for each set of tied assets are covered (Article 76(1) ISO). 47

f) Criteria for allocating assets to the tied assets

Assets may be allocated to the tied assets if: 48

- the investment is a permitted asset according to Articles 79 or 68(2) ISO and it is eligible for recognition according to this circular. Assets may not be considered as partially eligible for recognition (e.g. due to non-eligible parts or high risk). Partial eligibility is only possible if the exception has been explicitly stated in this circular (e.g. mortgages, margin no. 312); 49
- the investment can usually be valued easily; 50
- the asset has a high liquidity relative to this particular asset category; 51
- The relevant expertise is available and adequate processes and systems are in place which are required for the professional selection, management and monitoring of the investments made (margin no. 76); 52
- The impact of the investment and its individual risk components are understood so that the financial, legal and operational risk may be evaluated at any time; 53
- The debtors' credit ratings are verifiable (margin nos. 139-152); 54
- The investment is neither encumbered nor subject to a netting agreement with third parties (margin no. 38). 55

These principles are explained in further detail for each investment category in Chapters IV and V. 56

C. Investment strategy

Management shall define the investment strategy and submit this to the Board of Directors for approval (Articles 78(1)(a) and 101 ISO). 57

The investment strategy adequately takes into consideration the type and complexity of the business line engaged in, i.e. the insurance business (Article 102(1) ISO). 58

The investment strategy shall outline the conditions for the use of the various investment categories. All investments shall meet overall requirements of the investment strategy of the entire company. 59

The risk exposure limits shall be defined in accordance with the financial and governance capacities of the insurance company. 60

D. Investment policy

The investment policy shall be issued by Management, a member of Management or the general agent; it defines all investment activities (Articles 78(1)(b) and 106(1) ISO). Investment activities shall be described in detail in one document, which may include specific references to other internal directives. 61

The investment policy's requirements depend on the complexity of investments in the investment universe defined by the insurance company. 62

The insurance company shall regulate at least the following topics in its investment policy: 63

- Internal investment principles and objectives (including ALM); 64
- A description of the investment universe (permitted investments / restrictions); 65
- Investment techniques and their area of use/purpose (e.g. use of derivative financial instruments, securities lending, repos); 66
- A description of the investment process, its monitoring and controls (definition of the tasks, responsibilities, competences, accountability and escalation mechanisms); 67
- Staff requirements (e.g. expertise, experience, integrity). 68

E. Governance and Monitoring

The administration (investment management) and monitoring (risk management) of the investment activity shall be performed by persons independent of each other and be adequate in view of the complexity of business and investment activities (Articles 78 and 106 ISO). 69

Staff must have adequate qualifications and knowledge on the investment classes it invests in and if investing in high-risk investments, dispose of the relevant expertise (Articles 78(1)(c) and 107 ISO). 70

The systems used should be appropriate in view of the size and complexity of the investment portfolio; they should be monitored and dispose of the necessary robustness (Article 106(2) ISO). 71

Administration (investment management) shall ensure and assume at least the following tasks and responsibilities: 72

- the implementation of the investment strategy and the investment policy; 73

- the definition and the documentation of strategic asset allocation and tactical asset allocation that is appropriate for the insurance company's risk capacity, size and complexity, whereas the allocation takes place in consideration of investment categories and other important characteristics, such as duration, sectors, credit ratings and investment styles; 74

- the definition of a system of limits based on individual risk capacity, the monitoring of limits and the definition of measures in case these limits are breached; 75

- the preparation of an investment process which is appropriate in view of the investments' complexity. Using scenario analyses, the insurance company shall ensure that the use of complex investments does not jeopardize the value preservation of the total assets or the tied assets, nor the insurance company's solvency; 76

- monitoring of the valuation of investments; 77

- monitoring and controlling of compliance with regulatory provisions; 78

- monitoring and controlling of significant risks (especially market risk, credit risk, concentration risk, liquidity risk, currency risk, operational risk, legal risk) related to the investment activity; 79

- the measurement and valuation of investment performance; 80

- the definition of internal reporting. 81

Insurance companies mandating a third party with their investment management are not exempted from their responsibility to comply with the provisions on investment management. Specifically, the insurance company shall be able to understand the investment process and the strategy provided and be able to monitor adherence to investment principles as well as verify any transactions from an accounting point of view in a timely manner. 82

Transferring the investment management to a third party is subject to FINMA approval as per Article 4(2)(j) ISA. 83

Controlling (risk management) shall ensure and assume at least the following tasks and responsibilities: 84

- monitoring and controlling the adherence to investment principles in accordance with margin no. 64 and other internal directives of the insurance company; 85

- monitoring and controlling of compliance with regulatory provisions; 86

- monitoring and controlling of significant risks (especially market risk, credit risk, concentration risk, liquidity risk, currency risk, operational risk, legal risk) related to the investment activity. 87

F. Further Provisions

a) Segregated sets of tied assets

Segregated sets of tied assets shall be managed for (Article 77(1) ISO): 88

- insurance for occupational benefit plans;
- Insurance claims arising from unit-linked policies or capitalization transactions (insurance classes A2.1, A2.2, A2.3 and A6.1);
- Insurance claims arising from insurance policies or capitalization transactions linked class to internal investment funds or other reference values (insurance classes A2.4, A2.5, A2.6 and A6.2).

Other sets of tied assets may be managed (Article 77(2) ISO) and may be ordered by the FINMA in justified cases (3).

Article 77(1)(b) and (c) ISO does not only refer to the savings part of insurance policies but to all insurance claims. The reason for this is that it wants to avoid the separation of the securing of savings and guaranteed parts in place up to now. 89

This circular shall apply to all segregated sets of tied assets. In particular, the defined limits, the obligation to provide coverage and the qualitative requirements applicable to the individual sets of tied assets are to be considered. However, some exceptions regarding the limits (cf. margin no. 122) apply to segregated tied assets for unit-linked life insurance and capitalization transactions (insurance sectors A2.1–A2.6 as well as A6.1 and A6.2). 90

b) Foreign insurance portfolio

The insurance company is not obliged to guarantee its foreign insurance portfolio if an equivalent security is required abroad for this purpose (Article 17(2) ISA). If no equivalent security is required abroad, this securing shall take place in Switzerland, where the insurance company may manage these in segregated sets of tied assets (Article 77(2)(b) ISO). 91

As long as no equivalent security has to be made available abroad, the insurance company shall provide additional security in Switzerland. 92

The following criteria are relevant for the equivalence review: 93

- Special funds 94

  There is an obligation to cover the total technical reserves arising from direct insurance with a special fund. In doing so, the technical reserves shall be covered gross (without consideration of reinsurance claims). If insurance companies offering non-life insurance operate a system that recognizes the reinsured parts of reserves (cf. margin nos. 160 – 175), this is deemed to be equal to the gross coverage principle. The insurance company must make certain that only policies are included in the special fund that are fully considered in the required amount.

Instead of a special fund, the insurance company may also consider other forms of security as long as their effect is equivalent to that of a special fund also in the case of the insurance company's bankruptcy. 95

For these other forms, margin nos. 97 and 98 apply in analogy. 96

- Preferred claims under bankruptcy 97

  In the case of a bankruptcy, a special fund serves primarily to satisfy claims arising from insurance policies.

- Investment guidelines 98

  The local supervisory authority shall issue investment guidelines where the objective is to maintain the security and the value preservation of the special fund.

c) Unit-linked life insurance

Unit-linked insurance policies or capitalization transactions shall be linked to assets permitted for the tied assets: in the case of unit-linked policies, these are open-ended collective investment schemes subject to the Collective Investment Schemes Act (CISA; SR 951.31) (Article 125a ISO). In case they are linked to an internal investment portfolio or other reference values these are permitted if they are in accordance with Articles 79 and 81(2) ISO). 99

Investments used as security shall match those underlying the policies (matching cover; Article 81 ISO) as otherwise the insurance company may have to bear additional investment risk. Any guarantees shall be covered with investments in accordance with Article 79 ISO, which replicate the value fluctuations of such guarantees as closely as possible. Other policy components, non-unit-linked reserves and any surcharge to the required amount shall be covered with assets in accordance with Article 79 ISO. 100

Investments used to secure claims arising from unit-linked life insurance policies shall be valued pursuant to Article 93a ISO at no more than market value, regardless of any other recognition values in accordance with Chapter IV. 101

d) Indirect investments: initial acquisition, regrouping of investments

An investment, be it an initial acquisition or due to a regrouping of investments, in so-called indirect investments (for example, funds, equity interest, structured products or bonds issued by special purpose vehicles) may not be used to circumvent the provisions on direct investments of Chapter IV. 102

This circular shall cover the following indirect investments: 103

- collective investment schemes pursuant to margin nos. 484-493;
- single-investor funds pursuant to margin nos. 494-505;
- real estate companies pursuant to margin nos. 256 (in case of investments amounting to 50 % or more) or margin nos. 240 (in case of listed real estate companies);

- structured products and securitized loans as described in margin nos. 197 and 214, respectively;
- alternative investment schemes pursuant to margin nos. 317-350.

Depending on the instrument, it may be subject to specific qualitative requirements as well as high liquidity requirements for the entire investment instrument or a so-called look-through approach. An indirect investment that contains a direct investment not eligible for recognition is only permitted if the specific requirements for indirect investments are met and if based on its characteristics, the disadvantages of the direct investment's ineligibility do not affect the indirect investment as well. 104

Example: An investment in a property which is relatively illiquid and which is difficult to value and therefore is not permitted as an investment in the tied assets may also not be deemed eligible as a permitted investment if it is restructured into an indirect investment. Recognizing it is only possible if the risk situation has factually improved for the investor, as illustrated in the following presentation using an investment in real estate. 105

106

Structure	Eligible for recognition?	Reason
Direct investment: Illiquid, difficult-to-value investment in real estate	No	Realizability and valuation difficult (margin no. 246)
Restructuring into a single-investor fund	No	The look-through approach is used, treated like a direct investment (margin no. 494)
Restructuring into a real estate company	No	The look-through approach is used, treated like a direct investment (margin no. 283)
Creation of a structured product with participation certificate in real estate	No	Every single element of the structured product as well as the underlyings of the derivative transaction must be eligible for recognition (margin no. 199)
Incorporation of an alternative investment, i.e. an investment in an undertaking that itself holds the relevant property in its portfolio.	No	Traditional funds, which are not eligible for recognition as direct investments cannot be reallocated into the category alternative investments (margin o. 331)
Creation of a collective investment scheme in accordance with Article 82(1) ISO	Yes, if criteria are fulfilled	Restrictive requirements apply to collective investment schemes: constant realizability in a liquid market and being subject to an effective fund regulatory authority (margin no. 484). The result is a liquid, diversified and supervised real estate portfolio.

e) Additional securities in case of investments not eligible for recognition

Should an investment contain a single component not eligible for recognition, the entire investment is 107 no longer eligible to be included in the tied assets. If this investment contains an additional security, the investment may be eligible for the tied assets only if the security compensates for the shortcomings of the part that is not eligible.

f) Limits

aa) Generalities

Based on Article 83 ISO, limits are set for specific investment categories. 108

The maximum of investments in a certain investment category is restricted to the indicated limit expressed as a percentage of the permitted assets of each individual sets of tied assets. 109

In doing so both fundamental limits (cf. margin nos. 113-122) as well as specific limits must be observed. 110

An excess of the limit defined shall be allowed in the framework of excess cover of the permitted assets. Limit excesses shall remain within the excess cover if all limits are still adhered to despite the removal of assets from the tied assets and the required amount of the tied assets remains intact. 111

The insurance company shall ensure with appropriate measures that limits are adhered to at all times. Securities which are used for securities lending or repos shall be taken into account when calculating the limits. 112

bb) Counterparty limits

An exposure to a particular counterparty shall not exceed 5% of the required amount in a set of tied assets. If an exposure towards a counterparty is higher, it shall be submitted to FINMA for approval immediately. 113

Receivables from the Swiss Confederation or cantons, cantonal banks with a state guarantee and from Swiss mortgage bond institutions are exempted from the 5% limit. Receivables from debtors that are fully backed by a state government with a credit rating of 1 at all times are also exempted from this limit. 114

In order to determine the net exposure, all of the receivables and capital investment instruments from this counterparty held in the tied assets are to be accumulated. If the insurance company invests in several companies of a particular group, then the total exposure towards this group is of significance. In order to determine the net exposure, the guarantees which have been given to insurance companies (for instance, related to structured products) shall also be counted. Collateral received may be deducted from the exposure. 115

cc) Foreign currency limits

Insurance companies' obligations shall be covered by investments in matching currencies. Investments other than in the reference currency shall be limited to 20 % of the tied assets' required amount. The reference currency is deemed to be the currency in which the insurance company writes policies. 116

dd) Exceptions

An insurance company may request to deviate from the limits set for the categories of shares and other exchange-listed equity securities (margin no. 244), real estate (margin nos. 266-269), mortgages (margin nos. 291-293) as well as the limits set for the net currency exposure (margin no. 116) and ask for a limit specific to its institution. The insurance company may request its own limits under the following circumstances: 117

- The insurance company shall provide a plausible explanation that the requested limits have no negative impact on the company's solvency. 118

- The insurance company shall demonstrate that it has an adequate risk management for the investment categories in question. 119

The insurance company shall be able to prove that it can adhere to the principles of this circular at any given time in regard to the tied assets despite its chosen limits and that it has given sufficient consideration to the possibility that the required amount of a set of tied assets may experience a funding gap due to a marked impairment of the relevant investment category. Therefore, the insurance company shall check with regular tests that stress scenarios applicable to the tied assets do not also lead to a funding gap in the required amount of tied assets if its own limits are applied. This view shall also include the free, unencumbered assets. 120

- The conditions shall be fulfilled at all times, even after the approval has been given. As soon as the conditions for own limits are no longer met, the insurance company shall adhere to the prescribed limits. 121

ee) Unit-linked life insurance

For unit-linked life insurance, the tied assets shall be managed with the assets that make up the underlying assets of the policies. This is why the quantitative limits of this circular do not apply to the segregated sets of tied assets of unit-linked life insurance (Article 77(1)(b) ISO). For the segregated tied assets of life insurance linked to internal investment portfolios or other reference assets (Article 77(1)(c) ISO) only the limits "exposure to counterparty" and "securities lending and repos" shall be considered. However, those limits may be exceeded only if the policyholder has been explicitly informed of the deviation of these limits prior to concluding the policy. 122

g) Respect of investment principles even for small permitted assets

Smaller insurance companies shall also adhere to the investment principles of security, ALM, profitability, diversification and liquidity (cf. margin nos. 25-37). 123

Smaller insurance companies which disclose only a small required amount in tied assets may request to be exempted from the 5% counterparty limit (margin no. 113) if this is justified. Apart from the reasons for the intended deviations from the counterparty limit, the request shall also contain data on the debtors of receivables which make up more than 5% of the required amount of the tied assets as well as the requested limit to the counterparty limits in consideration of the principles of an adequate diversification. 124

h) Ensuring recoverability

The insurance company shall review the recoverability of the individual investments and take into consideration their impairment due to a lowered credit rating. Should the investment's recoverability be jeopardized (necessity of an impairment), the normal valuation method (e.g. amortized cost method for bonds) used to determine the eligibility for recognition in the tied assets must be deviated from; instead, eligibility shall be at market value at most (cf. Article 95(2) ISO). In particular, this may affect the following investment categories: 125

- Cash deposits (cf. margin nos. 181-185) 126
- Bonds, convertible bonds (cf. margin nos. 186-196) 127
- Structured products (cf. margin nos. 197-213) 128
- Other promissory letters (cf. margin nos. 227-239) 129
- Mortgages (cf. margin nos. 288-316) 130
- Derivative financial instruments (cf. margin nos. 351-478) 131

i) Foreign assets

It is possible to allocate foreign assets in accordance with Chapters IV and V if the conditions stipulated in margin nos. 39-43 are met or the special provisions explicitly regulate such an allocation. 132

j) Group-internal relationships

Group-internal investments – in particular equity interests, treasury shares or shares of other group companies, own bonds, bonds issued by other group companies, loans granted to group companies, derivative financial instruments based on transactions with group companies – are not eligible to be recognized in the tied assets, with the exceptions listed below: 133

Loans to investment companies that fulfill the requirements of Article 82(4) ISO may be allocated to the tied assets and included at nominal value if the debtor does not carry any loans granted to group companies in its books. 134

Equity interests in investment companies that fulfill the requirements of Article 82(4) ISO may be allocated to the tied assets at its net asset value (NAV). 135

Loans granted to real estate companies where the granting entity holds more than 50% may be allocated to the tied assets at nominal value, provided the liquidation of the company could be enforced and the debtor does not carry any loans granted to group companies in its books. 136

Equity interests in real estate companies as per Article 79(1)(f) ISO may be allocated to the tied assets at NAV, provided the equity interest amounts to more than 50% and a liquidation could be enforced. 137

This is to avoid that group-internal investments whose liquidity is doubtful in case of a bankruptcy may be allocated to the tied assets. This is also done to avoid double gearing. 138

k) Credit ratings

The following credit ratings are to be used to manage the tied assets: 139

Credit rating 1: 140

Highest grade debtors. The debtor's ability to fulfill its financial obligations is excellent. Even in the long term, the default risk is practically negligible.

Credit rating 2: 141

High grade debtor. The default risk is practically negligible but in the long term it may be more difficult to determine. The debtor's ability to fulfill its financial obligations is good.

Credit rating 3: 142

Upper medium grade debtor. Secure investment, provided there are no unforeseen events that affect the entire economy or industry. The debtor's ability to fulfill its financial obligations is strong but slightly more susceptible to negative influences, such as external circumstances and economic conditions.

Credit rating 4: 143

Lower medium grade debtor. On average good investment. However, if the entire economy deteriorates, this debt will also be affected. The debtor's ability to fulfill its financial obligations is adequate, but more susceptible to negative economic circumstances.

Credit rating 5: 144

All investments that do not fulfill the prerequisites to be assigned a credit rating of 1-4.

For the regulatory purpose of managing the tied assets, the insurance company shall use ratings only of recognized rating agencies in accordance with FINMA circular 2012/1 "Rating agencies" or its own credit ratings. 145

Own credit ratings shall meet the following requirements: 146

- They shall be prepared at own risk in accordance with comprehensible criteria. 147
- They shall present the probability of a default risk from the insurance company's view. 148
- Information sources shall be critically questioned in regard to the origin of their data, their objectivity and reliability. 149
- They shall be reviewed regularly and if necessary, adapted. 150

- The processes used to prepare and use them shall be documented. 151

FINMA shall be informed if the insurance company outsources the process (Article 4(2)(j) ISA). The insurance company shall be responsible for the quality of its credit rating assessments. 152

G. Safekeeping assets

a) Safekeeping assets at own company

Movable assets allocated to the tied assets may be safekept with the insurance company or the Swiss branch office (Article 86(1) ISO). The insurance company shall inform FINMA of the assets it safekeeps at its own company as well as the exact location (address, room number, safe-deposit box number, etc.). 153

b) Safekeeping assets at another company

Safekeeping assets at another company is acceptable if the safekeeping entity is liable for the fulfillment of the safekeeping duties towards the insurance company in Switzerland (Article 87(2) ISO). The insurance company and the safekeeping entity shall sign the rider (see annex) for each of these business relationships (deposits/accounts). FINMA shall be informed of the assets held by a safekeeping entity other than the insurer, the safekeeping entity, the place of safekeeping and the depository and any changes made to these. A copy of the rider shall also be filed. 154

The assets maintained with a safekeeping entity other than the insurer shall be eligible for recognition in the tied assets if they fulfill the formal conditions and after FINMA has been notified. 155

c) Safekeeping abroad

It is permitted to safekeep assets at the insurance company or at a separate entity abroad if the foreign bankruptcy law guarantees the seniority of the claim to the tied assets pursuant to Swiss law (Article 87(3) ISO). The insurance company shall ensure that this condition is fulfilled in case it safekeeps assets abroad. 156

In case it keeps assets abroad, the insurance company shall prove that the conditions of margin no. 156 are fulfilled with an official confirmation or a well-founded legal opinion. 157

d) Modalities of safekeeping

The assets allocated to the tied assets shall be segregated from the insurance company's other assets and segregated by the different sets of tied assets, and labeled as such. The accounts and deposits shall be marked as being related to the tied assets, with an explicit mention of the tied assets. 158

Safekeeping in the form of intermediated securities is permitted. 159

H. Non-life insurance claims made to reinsurers

a) Principles

The reinsured parts of the reserves for the tied assets of non-life insurers shall be eligible for recognition in accordance with Article 68(2) ISO. 160

The eligibility of the reinsured parts of the reserves and their approvals shall depend on the reinsurer not the amounts to be reinsured. Once a reinsurer's eligibility has been approved, the current amount of the reinsured parts shall be eligible for recognition, provided the limits stipulated in margin nos. 162-169 are adhered to. The eligibility of the reinsured parts of the reserves held towards the reinsurer may be requested as soon as a relevant reinsurance policy exists, regardless of whether reinsured parts of the reserves already exist or not. 161

b) Eligibility for recognition and limits

Reserves recoverable from insurers shall be eligible for recognition at 100% of the amount that is current; reinsurers in run-off it shall be 75% of the amount current. In any case, the eligibility for recognition is limited in accordance with the credit ratings stipulated in margin nos. 139 - 144, as follows: 162

- In case the reinsurer's credit rating is 2 or better: 20% of the required amount of the tied assets 163
- In case the reinsurer's credit rating is 3: 10 % of the required amount of the tied assets 164
- In case the reinsurer's credit rating is 4: 5 % of the required amount of the tied assets 165
- Reserves for tied assets reinsured with reinsurers with a credit rating of 5 are not eligible for recognition. 166

For reinsurance recoveries on the reserves arising from policies of captive insurance companies belonging to the same group as the insurance company, these limits are reduced by 50%. 167

Eligible reinsured parts of reserves which concern several reinsurers belonging to the same group, the total of the eligible amount is limited to 1.5 times of the limits (based on the credit rating of the group) (margin nos. 162-166). 168

Upon request, the FINMA may approve an eligibility for recognition exceeding the limits stated, provided this does not jeopardize the tied assets. 169

c) Special reinsurance relationships

Up to 10 % of reinsured parts of reserves related to the Swiss elementary damage pool may be included in the required amount of the tied assets. 170

d) Application and approval procedures

The FINMA-provided form shall be used for applications. If insurance companies have concluded reinsur- 171 ance policies with branch offices of reinsurers, the name and the domicile of the headquarters shall be indicated on the form.

In justified cases, FINMA may limit the approval, i.e. to approvals listed in margin no. 169. 172

Applications are deemed to have been accepted if the FINMA does not begin a review within four weeks. 173

If circumstances change, especially concerning the credit standing of the approved reinsurer, the recognition shall be adjusted according to the limits designated in margin nos. 162-166 and FINMA informed immediately. 174

Should another reinsurer be approved in addition to the already approved ones, the application shall list all of the reinsurers. Outstanding approvals shall be marked accordingly. 175

I. Approvals in accordance with Article 79(3) ISO

Upon request, FINMA may approve the recognition of other assets in the tied assets, if these do not jeopardize the tied assets (Article79(3) ISO). FINMA shall base itself especially on margin nos. 23-159 of this circular when assessing the applications. 176

J. Reporting to FINMA

The insurance company shall inform their audit firms of the required amount in tied assets that they have calculated together with the inventory of the assets within three months after the closing of the accounts. It shall report to FINMA within four months after the closing of the accounts (Article 72(1) ISO). 177

Insurance companies domiciled in Switzerland shall report any insurance portfolios held abroad for which they have to provide a security. 178

Every year, FINMA shall define the parameters and the reporting process for the tied assets. 179

IV. Investment types in tied assets

In addition to the generic principles listed above, the following principles shall apply to investments. 180

A. Cash deposits

a) Permitted assets

Cash and cash deposits, namely cash in bank and fixed-term deposits and other money market investments shall be permitted. Other money market investments shall include short-term money market investments with a maturity period of up to 12 months. 181

b) Special requirements

The rider in accordance with margin no. 154 shall be signed with the counterparty also for cash deposits or 182 account balances. In particular, the rider shall exclude any debtor rights concerning pledging, lien, netting or similar.

For receivables from debtors domiciled abroad, margin no. 132 shall be observed. 183

c) Valuation

Investments in this category shall be valued at most at nominal value, taking into consideration the security and the income (Article 93(2) ISO). 184

Money market book claims shall be included at no more than at market value. If they are not listed, the usual valuation method used by the market shall be applied. 185

B. Bonds, convertible bonds

a) Permitted assets

This category shall include the following assets: 186

- sovereign bonds
- bonds issued by cantons, cities or communities or other public-law entities
- bonds issued by supranational organizations
- special-law mortgage bonds (covered bonds)
- corporate bonds (banks, finance companies and other corporate bonds)
- medium-term notes drawn on a banking institution holding a Swiss license

Moreover, the following types of bonds are also permitted: 187

- convertible bonds with bond characteristics and warrant bonds
- replicating bond portfolios as per margin nos. 422-431

Convertible bonds shall be deemed to be either convertible bonds with bond characteristics or convertible bonds with share characteristics. If the market value of the convertible bond is higher than 130% of the nominal value, it may be allocated to the category "shares" (Article 79(1)(e) ISO). Should the market value fall below 130% of the nominal value at a later date, the convertible bond shall remain in the category "shares". Convertible bonds where a conversion into shares is mandatory (e.g. mandatory convertible bond, mandatory convertibles, contingent convertible bonds [CoCo bonds]) shall be allocated to the category "shares". 188

For shares issued by foreign issuers, margin no. 132 must be taken into account. 189

b) Prohibited assets

Investments are not allocatable if they were issued as bonds but have to be allocated to another category due to characteristics listed in this circular. Examples of this would be bonds issued by special purpose vehicles for the purpose of a risk transfer or securitized debts (ABSs, CDOs, etc.). 190

Insurance-linked securities (e.g. cat bonds) shall be allocated to the category "structured products" (margin no. 197). 191

Write-off bonds cannot be allocated to the tied assets. 192

c) Valuation

The maximum allocation value shall be calculated according to a scientific or linear amortized cost method plus accrued interest (Articles 88(1) and 88a ISO). 193

In the case of the scientific amortized cost method, the difference between the purchase value and redemption value has to be written off or revalued during the residual maturity period on the balance sheet date to the extent that the initial intrinsic interest rate (yield to maturity) may be maintained. In doing so, the purchase cost shall be applied with accrued interest (clean price) (Article 89(1) ISO). 194

In the case of the linear amortized cost method, the difference between purchase value and redemption value shall be apportioned in equal amounts as write-off or revaluation over the residual maturity period. This method shall also use the purchase cost without accrued interest (Article 89(2) ISO). 195

Convertible bonds allocated to bonds according to margin no. 188 shall be included using the amortized cost method. 196

C. Structured products

a) Definition

Structured products are investments in the form of a bond or a debt covenant where a spot instrument (for instance securities bearing fixed-interest) is combined with one or several derivative financial instruments to form a legal and economic unit. The derivative financial instruments shall relate to underlying instruments, such as shares, bonds, interest rates, exchange rates or alternative investments. 197

b) Permitted assets

Structured products shall be permitted if they meet the following requirements: 198

- The individual components (e.g. spot instrument or derivative) meet the requirements of the relevant category in the tied assets; 199
- The structured product may not contain either a delivery or purchase commitment. 200
- No margin calls are allowed. 201

c) Recognition and valuation

Structured products shall be valued and included in the tied assets according to one of the methods below. The selected method shall be maintained until the structured product is sold or redeemed. 202

1. The structured product as a whole (overall view)

The structured product as a whole shall be valued at fair value. 203

Depending on the embedded risks, the structured product as a whole shall be allocated to only one category of the tied assets and be subject to all of the requirements of that particular category. 204

For example, an index certificate consisting of money market investments and long futures drawn on a share index may be allocated to the category "shares" as a whole. 205

Should the structured product contain various embedded risks, the whole shall be allocated to the category with the strictest requirements in regard to recognition and eligibility. 206

For instance, if a spot instrument is combined with several different derivatives that participate in both share indices and commodity indices, it shall in its entirety be allocated to the category "alternative investments". 207

2. Breaking down structured products into individual components

Should a structured product be broken down into components eligible for recognition, these individual components shall be included in the relevant investment categories. In doing so, the valuation and eligibility requirements of the relevant investment category for the tied assets shall apply. 208

For instance, a zero bond combined with a long call option may be broken down into the categories "Bonds" and "derivatives". The valuation of the zero bonds shall take place at amortized cost, the option is allocated at market value. 209

d) Special requirements

The requirements applicable to foreign counterparties shall be taken into consideration (margin no. 132). 210

Investments in insurance-linked securities shall be permitted as long as the risks arising from these investments do not have a positive correlation with the insurance company's own risk. 211

e) Limits

The limits of each category to which they are allocated in accordance with margin no. 199 shall apply to structured products or their individual components if broken down. 212

f) Organization, know-how and investment process

Insurance companies investing in structured products shall have qualified and expert staff, an investment 213 strategy that foresees such instruments, an investment management that takes into consideration the particular needs, a properly implemented and fully documented investment process, an appropriate risk management as well as an adequate system infrastructure (margin no. 76).

D. Securitized debt

a) Definition

Securitized debts are risk transfer instruments that transfer the credit risk from exposures brought into a pool of debt instruments to the buyers of the securitized debts. Securitized debt may be broken down into different tranches (senior, junior and equity tranches). The pool of debt instruments may have a standardized or a mixed composition and consist of physical or synthetic (structured) receivables. Examples of securitized debts are Asset Backed Securities (ABS), Mortgage Backed Securities (MBS, RMBS, CMBS) and Collateralized Debt Obligations (CDO, CBO, CLO, CMO, SFCDO). 214

b) Permitted assets

An investment in securitized debt shall only be permitted if the insurance company is capable of assessing its transparency, degree of complexity, recoverability (valuation) and risk. 215

c) Prohibited assets

In particular the following values are prohibited: 216

- Intercompany transactions involving securitized debt (margin nos. 133-138). 217

- Investment in the high-risk tranches of a securitized debt, i.e. in particular in the equity tranche, junior tranches or mezzanine tranches. Investments in higher quality tranches (senior tranches, super-senior tranches) are also excluded if their credit rating is lower than 4 after all of the relevant aspects have been taken into consideration. This assessment may not be based on external credit enhancements (e.g. guarantees or pledges). Therefore, the assessment of the underlying assets is relevant. Structural credit enhancements (e.g. excess spreads, escrow accounts, over-collateralization) may be included in the analysis. The assessment process must meet the requirements stated in margin nos. 221-224. 218

  Investments in securitized debt, where the receivables pool is actively managed (managed CDOs) if this limits the insurance company's ability to assess risks and recoverability. Investments in managed CDOs are permitted if the investment restrictions and the management of the pool of debt instruments is designed in a way that the insurance company can trace the impact of changes in the composition on risks and recoverability in a timely manner. 219

- CDOs of CDOs and similarly complex structures. 220

d) Organization, know-how and investment process

Insurance companies investing in securitized debt shall have qualified and expert staff, an investment strategy that foresees such instruments, an investment management that takes into consideration the 221 particular needs, a properly implemented and fully documented investment process, an appropriate risk management as well as an adequate system infrastructure (margin no. 76).

The insurance company shall analyze the risks of securitized debt and understand these. If third parties are involved in this analysis, any conflicts of interests shall be eliminated beforehand. The underlying pool of debt instruments shall be closely examined for its composition and recoverability (assumptions regarding the spread of default probability and recovery rates). An understanding of the markets for the debt instruments in the pool of debt instruments is necessary to assess the value developments of a securitized debt. Whether the pool of debt is physically available or synthetic (e.g. created with the help of credit default swaps) shall also be considered, as well as whether the securitization relates to the cash flows or the market values, whether the pool of debt instruments is fixed or actively restructured, etc. A close examination of the structure is imperative in order to determine the recoverability and risks of the securitized debt. An analysis of the securitized debt usually requires a dismantling into the different layers of the securitization. The risks and embedded hedges are to be closely scrutinized at every level in regard to their effect. 222

The volume ratio of the purchased tranche and the portfolio covering the tranche in question (subordination), the size of the subordinated tranches as well as the structure of the cascade shall be examined in depth. 223

The insurance company shall set up a due diligence process which guarantees a comprehensive and in-depth analysis of the structure, underlying risks and framework conditions of the securitized debt. This examination shall serve to ensure that investments are restricted to securitized debt where the recoverability and risks can be traced at all times and where the risks are commensurate with the insurance company's risk policy. 224

e) Limits

The investment in securitized debt shall be limited to 10% of the required amount. The included part for each investment shall not exceed 1% of the required amount. 225

f) Valuation

At maximum, securitized debt shall be included at market value. Upon determining the value, the quality of the valuation shall also be reviewed (e.g. regarding the market's liquidity). 226

E. Other promissory letters

a) Permitted assets

For this category, promissory letters granted to the following may be included: 227

- Swiss public-law entities; 228
- Banks domiciled in Switzerland; 229
- Other debtors domiciled in Switzerland with a credit rating of at least 3. 230

The allocation of any other promissory loan notes to the tied assets shall be subject to FINMA's prior approval. 231

b) Prohibited assets

The following promissory letters may in particular not be included in the tied assets: 232

- Loans to private-equity companies (these are to be treated as alternative investments as per Article 79(1)(h) ISO. 233
- Policy loans; 234
- Loans to group companies (cf. margin nos. 133-138); 235
- Guarantees, letters of credit, etc. 236

c) Special requirements

Any promissory letter shall be in writing and legally valid. 237

The debtor shall specifically waive any rights to net, of lien or similar (margin no. 38). 238

d) Valuation

The valuation shall take place taking into consideration the loan's recoverability in relation to the nominal value (cf. margin no. 125). 239

F. Shares and other equity securities

a) Permitted assets

Shares, bonus shares, participation certificates, convertible bonds with share characteristics, share certificates of co-operatives and similar securities shall be permitted. 240

All securities in this category shall be traded on a liquid and regular market and sellable at short notice. Securities listed on a secondary stock market but which are not traded regularly are not permitted. 241

Convertible bonds shall be deemed to be either convertible bonds with bond characteristics or convertible bonds with share characteristics. If the market value of the convertible bond is higher than 130% of the nominal value, it may be allocated to the category "shares". Should the market value fall below 130% of the nominal value at a later date, the convertible bond shall remain in the category "shares". It is mandatory to allocate convertible bonds where a conversion into shares is mandatory (e.g. mandatory convertible bond, mandatory convertibles) to this category. CoCo bonds shall be treated like mandatory convertible bonds. 242

b) Prohibited assets

Shares not traded and shares of affiliated companies are prohibited investments for tied assets (cf. also margin nos. 133-138). 243

c) Limits

At most, 30% of the required amount of the tied assets may be invested in shares and other equity interest securities. 244

d) Valuation

Equity interest securities and convertible bonds with share characteristics can be included at market value at the most (Articles 93(1) and 88(2) ISO). 245

G. Real estate

a) Permitted assets

Objects which are easily realizable and where the valuation is fairly straightforward may be allocated to the tied assets. 246

aa) Direct investments in real estate: Types of buildings

The following types of buildings owned solely by the insurance company may be allocated: 247

- Residential properties: Single-family houses, multi-family buildings and condominiums; 248
- Commercial property: Office and administrative buildings; 249
- Mixed-use properties: Properties with residential and commercial use, as per margin nos. 248 and 249, regardless of the size of their units; 250
- Mixed-use properties with parts that are not eligible for recognition. 251

Objects that, besides a residential or commercial part also have a non-eligible part as per margin no. 258 may nonetheless be fully included based on the full net rental income if the includable part makes up at least 70%. 252

Objects which have a retail surface of more than 30% as per their net rental income may be included if they are located in the center of a city. 253

bb) Leasehold

Should the insurance company be the granter of a leasehold, this may be included if 254

- The building right is registered in the land registry;

- The leasehold provides a regular, long-term, contractually secured income;
- The creditworthiness of the party taking the leasehold is good; and
- The property contains only permissible buildings (margin nos. 247-253).

Should the insurance company be the taker of a leasehold, this may be included if 255

- The building in leasehold is registered in the land registry; and
- The building in leasehold is permissible (margin nos 247-253).

cc) Real estate companies

Units held in companies whose sole purpose is the purchase and sale as well as the renting out and leasing of residential and commercial property held by it, provided more than 50% of all units are held and a liquidation according to company law (Article 736(2) CO) could be enforced. 256

b) Prohibited assets

Objects which are only realizable with difficulty and where the valuation is complex may not be allocated to the tied assets. 257

For example, the following objects do not meet the criteria stipulated in margin no. 246: 258

- Plots of land (although plots where a new building is going up in accordance with margin nos, 247-253 may be included)
- Half-finished buildings
- Production sites, warehouses, distribution centers
- Sports complexes
- Shopping malls if they are located outside city centers
- Hotels, restaurants
- Old-age homes and senior residences
- Schools
- Collectors' and luxury objects, vacation homes
- Objects in co-ownership
- Objects in need of remediation as per the Contaminated Sites Ordinance (Article 2 CSO; SR 814.680)

- Foreclosure objects (if the insurance company has taken over the object as mortgage creditor)

Moreover, the following are not permitted: 259

- Properties abroad - independent of whether these are held directly or indirectly by a real estate company as per margin no. 256. 260

- Any properties that have been encumbered with pledges. 261

In justified cases, an exemption may be made, such as for 262

- Old-age, nursing homes, senior residences 263

  The possibility to repurpose these objects has to be demonstrated with costs and included in the valuation. The value of the property after the repurposing shall be eligible for recognition minus the repurposing costs.

- Foreclosure objects 264

  Details on the valuation and its review are to be submitted with the application.

- Contaminated buildings 265

  The valuation shall include an expert opinion on the expected remediation costs. Both are to be submitted with the application.

  If there are guarantees for the assumption of full remediation costs by the causing party or the government, these are to be submitted at the time when applying for an exemption.

c) Limits

Real estate may be recognized only up to 25% of the required amount. 266

A single property may not make up more than 5% of the required amount. 267

Real estate and mortgages are limited to 35% for recognition in the required amount. 268

When calculating the limit, the units in real estate companies (also see margin no. 256), real estate funds and other instruments, which could increase or decrease the real estate exposure shall also be considered. 269

d) Valuation

aa) General principles

Real estate may be included in the tied assets at a maximum of its market value. 270

The market value shall be deemed the amount at which the object could be sold or purchased in an arm's length transaction in the normal course of business between knowledgeable, willing and independent market participants. 271

The insurance company shall determine the market value of all its held real estate and land plots. The principles of individual valuation and valuation consistency shall be adhered to. 272

The principle of individual valuation requires that each property in a real estate portfolio be valued at market value individually. 273

The principle of valuation continuity states that real estate shall be grouped in groups of comparable properties, taking into consideration the adequate procedure or the market value of that particular grouping and that the valuation method be used consistently and continuously for each group. 274

bb) Direst investments

The market value of a property may be estimated using the following valuation method: 275

- *Discounted cashflow* method (DCF)
- Capitalized earnings method
- Hedonic method

It shall be ensured that the valuation method is on the whole appropriate for the market value (margin nos. 270-274) of each property group. 276

In case the hedonic approach is used, the insurance company shall ensure that the hedonic estimate is based on recognized statistical methods and on well-founded data. 277

If values are available that have been determined in accordance with IFRS, US GAAP or Swiss GAAP FER, which have been audited and that are deemed market values in accordance with margin nos. 270-274, these shall be used. 278

Plots of land in a construction zone shall be recognized at the market value of the plot at most. 279

In special cases, FINMA may grant an exemption. 280

cc) Leasehold properties

The market value of all leaseholds shall be determined with a standardized method. 281

When determining the market value of leasehold properties the special circumstances of the leasehold shall be taken into consideration. 282

dd) Real estate companies

In the case of equity interests of 50% or more, the net asset value (NAV) for this part shall be deemed as the market value. When calculating the NAV, the properties held as direct investments are valued in consideration of any obligations. Properties not eligible for recognition shall carry a value of zero. 283

ee) Reviewing valuations

In order to review the identified market value all properties shall be valued completely individually by a real estate appraiser (including seeing the property in person) at an interval of 10 years. The estimated value shall be based on this person's expertise and shall be neutral. The review shall also serve to update the file. 284

The insurance company shall document the review process and ensure that information gained in this review of the estimated value of individual properties also flows into the definition of the parameters of models. 285

Should the insurance company have another concept to periodically review the values, it may submit this to FINMA for approval. 286

e) Documentation

Each insurance company shall keep files on the objects recognized which are complete, current, understandable and verifiable. These must allow independent third parties to determine the current condition of the property, the contractual basis, the income, any encumbrances as well as the fundamental data of the current valuation. 287

H. Mortgage loans

a) Permitted assets

Mortgage loans (mortgages) may be included in the tied assets, provided the real estate security is a property in accordance with margin nos. 247-253 or a building in leasehold (cf. margin nos. 254 and 255). 288

b) Prohibited assets

Mortgage loans relating to non-allocatable real estate securities may not be allocated to the tied assets. Exceptions are listed in the provisions on real estate (margin nos. 257-258, 260). 289

Mortgage loans are not allocatable to the tied assets if they are subordinated to other mortgage-backed receivables. An exception exists for legal mortgage liens that have been recorded retroactively and for mortgages that are recognized in the same tied assets. 290

c) Limits

Mortgages may be recognized only up to 25% of the required amount. 291

A single mortgage may be recognized only up to 5% of the required amount. 292

Real estate and mortgages recognized in the required amount cannot exceed 35%. 293

d) Credit review and loan feasibility

Prior to granting a credit, the insurance company is obliged to perform a credit review. This includes the review of the debtor's credit standing (creditworthiness and borrowing power) as well as of the securities provided. These shall be defined in an understandable and conclusive manner in the insurance company's internal directives. 294

Calculations of the feasibility shall be based on the long-term income and expenditures of the debtor in case of owner-occupied residential properties or income and cost components for investment properties, respectively. The assessments shall be documented and stored for the duration of the mortgage. 295

The insurance company shall guarantee that the assessments of the credit standing and feasibility are performed systematically. 296

The insurance company shall define the procedure in internal directives. These define how the credit standing and feasibility are to be proven and documented. They shall also define the imputed long-term mortgage rate as well as the maximum lending limit for the feasibility calculation to be used. 297

e) Valuation of real estate liens

The insurance company shall determine the market value of the real estate lien diligently, systematically and periodically using standardized principles and in consideration of all relevant information. 298

Should the purchase value be higher than the market value, the market value is of relevance. 299

aa) Permitted determination procedures

A real estate appraiser shall determine the market value of the mortgaged property. The estimated value shall be based on this person's expertise and be independent of instructions. 300

The estimate of the object in question's value may be performed as follows: 301

- *Discounted cashflow* method (DCF)
- Capitalized earnings method
- Hedonic method
- Mean value method

bb) Mortgages for leasehold properties

When determining the market value of leasehold properties, the special circumstances shall be taken into consideration. 302

f) Loan monitoring

aa) Re-assessment of credit standing and feasibility

If events that could affect the creditworthiness become known, the institution shall perform a re-assessment and, based on these, define appropriate measures. 303

bb) Monitoring and reviews of market value of mortgaged properties

The insurance company shall periodically (at least every 10 years) review the market value of mortgaged properties where the loan-to-value ratio exceeds 20% or CHF 100,000. The periodicity and methodology shall be defined by objective criteria that the insurance company has defined internally. The insurance company shall document the monitoring process internally. 304

g) Valuation and recognition

aa) At nominal value

The valuation and recognition of mortgage loans is at nominal value at most. 305

bb) Lending limits

The full recognition in the tied assets may be at the lending limits listed below for each property: 306

- for residential and commercial properties as per margin nos. 248 and 249: 66 2/3% of the real estate lien's market value. 307
- for mixed-use properties as per margin no. 250: 66 2/3% of the real estate lien's market value, provided the part that is not allocatable (relative to the income) is 30% or less. 308
- for mixed-use properties as per margin no. 253 situated in an urban center with the retail part as measured in net rental income exceeds 30%: 66 2/3% of the real security's market value. However, the higher credit risk which such types of properties bear shall be taken into consideration. 309
- for residential properties with a residential part of at least 70%: 80% of the market value if the parties have agreed on a regular, market-consistent amortization for the part above 66 2/3%. The amortization may also take place indirectly. 310
- More than 80% of the real estate lien's market value for residential properties with a residential part of at least 70% if additional collateral has been provided for the part above 80% (e.g. pledged insurance policies) and the parties have agreed on a regular, market-consistent amortization for the part above 66 2/3%. The surrender values of the additional collateral may not be subject to negative value fluctuations. 311

cc) Adjusted recognition value

Should mortgages ranked equal or senior be in excess of the lending limits described in margin nos. 306-311, the mortgage shall be included only in part and up to the lending limit. 312

Should a mortgage debtor be in arrears for more than 7 months with agreed-upon interest and amortization payments, a corresponding value adjustment must be made for this mortgage. 313

Arrears of more than 12 months shall make that mortgage ineligible for recognition. 314

h) Documentation

The credit relationship shall be documented in a file so it is complete, up-to-date, understandable and verifiable. This concerns all documents that were used at the time the loan was granted as well as for the credit monitoring and renewal, i.e. the relevant documents showing the borrower's personal situation as well as information on the real security (including valuation method used and the results of the valuation) shall be in the file and accessible. 315

The results from the review of the borrower's creditworthiness as well as the periodic valuation of the real estate lien shall be documented. The documentation shall be maintained in such a way that they allow a third party to be able to judge the real security, the loan decisions and the loan monitoring. 316

I. Alternative investments

a) Definition

Alternative investments may be summarized as investment possibilities which go beyond traditional investments. A characteristic is the alternative investment character, i.e. the more flexible investment possibilities, such as the possibility of short sales, leveraging, the use of more complex strategies and investment in less liquid assets. Alternative investments are usually subject to less stringent supervision and exhibit lower liquidity and transparency. 317

An insurance company may use alternative investments to further diversify its investment portfolio. 318

In view of these particularities, the generic principles of the tied assets shall have only limited application to alternative investments. Alternative investments do not have to be securitized, dispose of a liquid market or be subject to an effective supervision. 319

b) Permitted assets

aa) Permitted investment universe

The following sub-categories are deemed to be alternative investments: 320

- *Hedge funds*
- *Private equity*

- *Private debt*, including *senior secured loans*

- Commodities, including gold

Investments in infrastructure may be made in the investment category alternative investments in the form of private equity and/or private debt. Infrastructure investments may also be allocated to other investment categories of the tied assets if the relevant conditions are met. 321

bb) Structure of the investments

Investments in fund solutions are permitted. Investments in the listed sub-categories may also be achieved by investing in collective investment schemes as per Article 71 CISA (other funds for alternative investments) as well as foreign on-shore and off-shore fund structures. 322

Investments tracking indices, exchange-traded funds (ETFs) and baskets may be used as long as the investments are diversified and highly liquid. The transparency regarding the framework on which the investment is based shall be guaranteed so that the special requirements specified in margin nos. 334-342 are fulfilled also for these investments. 323

Structured products relative to alternative investments may be used. 324

The tied assets may include gold ingots which meet the requirements of the Good Delivery Rules of the London Bullion Market Association. Gold ingots safekept on own or others' premises shall be kept separately for each tied assets and identifiable with the producer name, the serial number and the smelting year. 325

Investments in other investment structures shall be approved by FINMA beforehand. At that time, insurance companies shall prove to FINMA that all of the provisions listed in margin nos. 317-350 are maintained at all times. 326

cc) Special characteristics

To be allocatable to the tied assets, alternative investments shall have the following characteristics: 327

- Investments in alternative investments may be made in the sub-categories listed in margin no. 320. However, each of the sub-categories shall be diversified in itself, with the exception of investments made in gold. 328

- Divesting individual alternative investments is possible within customary deadlines or within 24 months at a maximum. With investments in private equity and private debt, longer deadlines apply. Nonetheless, the insurance companies shall take care to consider the commitments in their liquidity planning so that they have sufficient liquidity at all times. 329

- Investments in alternative investments may not cause any remargining or other liabilities to insurance companies. This shall also apply in the case of insolvency. Moreover, the agreement shall preclude any netting with the debts of the insurance company. Commitments entered into contractually and limited in amounts are not deemed to be remargining. 330

c) Prohibited assets

Investments in other (traditional) investment categories without characteristics of alternative investment or investments that do not fulfill the conditions stipulated in this circular may not be allocated to the tied assets as alternative investments. 331

Direct investments (e.g. in specific private equity or infrastructure companies) may not be allocated. 332

Physical investments in commodities (with the exception of gold) are not permitted. 333

d) Special requirements

aa) Concept regarding alternative investments

Any insurance company wishing to invest in alternative investments shall submit its alternative investment concept to FINMA beforehand. It demonstrates how the provisions and requirements and duties of this circular can be fulfilled. 334

The insurance company shall define in the concept which alternative investments it plans to engage in. 335

FINMA shall be notified of significant changes to already submitted concepts prior to the entry into force of internal directives with which the concept would be implemented internally. 336

bb) Organization, know-how and investment process

Insurance companies investing in alternative investments shall dispose of qualified and expert staff, an investment strategy that foresees such instruments, an investment management, which takes into consideration the particular needs, a properly implemented and fully documented investment process, a risk management appropriate for the risks as well as an adequate system infrastructure (cf. margin no. 76). 337

Investments in single funds is more demanding in regard to organization, know-how and investment processes than investments in diversified funds of funds structures. 338

cc) Due Diligence

Investments in specialized and managed investments, such as hedge funds or private equity require a comprehensive and in-depth review. A review shall require an investment-specific as well as operational due diligence. For this, the insurance company shall perform a structured interview of the investment manager as well as an assessment of the product documentation and its risks. A due diligence report shall summarize all findings and results. In general, a due diligence questionnaire is not sufficient for this. 339

The insurance company shall have quantitative analysis instruments as well as a documented due diligence concept so that both the selection as well as the continuous supervision of the investment take place in accordance with recognized and accepted standards. 340

It is imperative that the requirements listed in margin nos. 317-350 be effectively adhered to. 341

The due diligence may also be performed by an external expert. 342

e) Limits

The following limits shall apply to this investment category: 343

- The total of alternative investments may not exceed 15% of the tied assets. 344
- The recognized part for each sub-category (margin no. 320) may not exceed 10% of the required amount. 345
- The recognized part for each fund of funds shall not exceed 5% of the tied assets. 346
- For all other investments, the recognized part in the required amount may not exceed 1% for each investment. This limit does not apply to physical gold. 347

The insurance company shall ensure that commitments do not exceed these limits in the subsequent years. 348

f) Valuation

According to Article 93(1) ISO, alternative investments shall be included only up to their market value. The insurance company shall receive the net asset values (NAV) for hedge funds at least on a monthly basis and for private equity and private debt investments on a quarterly basis. 349

g) Foreign assets

The general provisions on foreign assets (margin no. 132) do not have to be observed for alternative investments. 350

J. Derivatives

a) General provisions regarding permitted values

aa) Permitted derivatives

According to Article 79 ISO, derivatives shall be permitted in the tied assets if 351

- The derivatives' underlying assets are permitted as per Article 79(1) ISO. 352

  Underlying assets not only include direct investments (e.g. shares or receivables) but also assets that track indices or interest rates. However, the condition that the underlying assets have to be permitted for the tied assets shall also apply to index transactions. 353

  Credit Default Swaps (CDS) shall be permitted in the tied assets solely for the strategies defined in margin nos. 373–446. No other credit derivatives may be allocated to the tied assets. The market liquidity of a CDS must be reviewed before using it and during its entire term to maturity. 354

- They do not have a leverage effect on the tied assets; provisions of Article 79(2) ISO remain applicable. 355

  A leverage effect takes place if the relative change in value of the derivative is larger than the relative value of the underlying asset. 356

  In order to avoid the financial impact from leverage effects on the tied assets, derivatives shall be covered with liquidity and/or available underlying assets. 357

  A negative leverage effect on the tied assets shall be excluded, i.e. a possible sale of a bond used in the tied assets may not lead to a deficit of the required amount. 358

- They adhere to the principles stated in margin nos. 3-22. 359

bb) Permitted combinations

The combination of several basic types of derivatives which relate to the same underlying asset is permitted. However, the following conditions apply: 360

- The various components of the combination must be split and valued separately. 361
- The individual components of the combination - after their splitting - must be allocated to one of the strategies mentioned below (margin nos. 373–446). 362
- The obligation to provide cover according to margin nos. 5–17 must be adhered to. 363

cc) Not permitted values and transactions

The following derivative transactions may not be allocated to the tied assets: 364

- Derivatives which are not covered by underlying assets or liquidity. 365
- Derivatives based on prohibited underlying assets according to Article 79(1) ISO. 366
- Short sales, i.e. a forward sale of the underlying asset without actually owning it at contract date. 367
- Transactions that on the whole have a leverage effect on the tied assets; the provisions of Article 79(2) ISO remain applicable. 368

dd) Recognizing exposures in limits applicable to the underlying assets

Derivatives shall be considered when calculating the limits for a certain underlying instrument . The limits applicable to derivative transactions are in addition to other limits in the tied assets. 369

ee) Valuation

Derivative financial instruments may be recognized at most up to their market value in the tied assets. For exchange-traded derivatives (ETDs) the market value is the stock exchange value, for over-the-counter 370 derivatives (OTC derivatives) the market value is the price at which the instrument can be closed-out/settled. Therefore, the amount to be recognized in the tied assets shall be the positive or negative replacement value.

If no current prices are available for derivatives or if no market values are available for OTC derivatives, these must be calculated with the help of valuation models, which are adequate and recognized by the practice based on the market values of the derivatives' underlying assets. The valuations must be documented and verifiable at all times. 371

The amount recognized for the derivatives and the underlying asset must reflect the position's true value at all times: for example, for short-call options, the negative value of the derivatives shall be deducted from the underlying asset. The combination of eligible derivative and eligible asset shall at best be recognized in the tied assets at exercise price or strike price, respectively. 372

b) Derivative instruments for hedging assets

aa) Permitted derivatives

Hedging strategies shall serve to mitigate or eliminate the risks of price fluctuations, insolvency or currency fluctuations on the value of assets. 373

Derivative instruments may be used as hedges only if they meet the following conditions: 374

- The hedged underlying asset is included in the tied assets. 375
- The obligations entered into is covered at all times by the underlying assets in the tied assets. 376
- Market fluctuations shall be mirrored in the recognition of the underlying asset in the tied assets. 377
  For derivatives related to interest or credit risk, also see margin nos. 386-399 and 400-405.
- The hedge used shall allow an actual hedging of the market value of the underlying asset, i.e. the 378
  absolute market value development of the underlying asset is compensated with the hedge. The use of derivatives may not generate short positions after the underlying asset has been deducted from the derivative, i.e. overhedging is not allowed.
- The instruments used may not leverage the tied assets. 379

A downside exposure may be effectively hedged with the following instruments: 380

- Long put options
- Short futures
- Short forwards
- Swaps

Instruments used to finance hedges but which themselves are not actual hedges, such as short-call options, may not be allocated to this category (see margin nos. 438-442). 381

Strategies which in their entirety represent a hedge (e.g. risk reversals, put spreads) may be allocated if the following conditions are met: 382

- The underlying asset of the long and the short position shall be identical;
- The time to maturity of the short option shall be shorter or identical to the one of the long put (hedging) option;
- The net position from the underlying asset and the hedging strategy shall never lead to a short position in the net;
- The counterparties of the strategy's option transactions shall be identical and the transactions subject to the same netting agreement.

Derivatives on indices (e.g. short SMI futures, long SMI put options) may also be deemed as a hedge for the tied assets. In such a case, it must be ensured that the structure of the hedged assets of the portfolio is materially consistent with the structure of the index and that the portfolio yields correlate closely to the index yields. As such, the hedged positions shall correlate closely with the index. 383

Hedging foreign currencies with a third currency (i.e. proxy hedge) is not acceptable as hedging. However, if the insurance company internally documents a proxy hedge it happened to conclude and if it can present plausibly that it was done for hedging purposes, the derivative may be allocated to the tied assets in the relevant category of the reference currency. 384

bb) Limits

There are no limits as per margin nos. 373-405 for derivatives used to hedge assets. 385

cc) Derivatives used to hedge interest rate risk

Interest rate hedges for bonds valued with the amortized cost method may not be allocated to this strategy, as they do not fulfill the conditions regarding the traceability of market fluctuations (margin no. 377). Should interest rate derivatives nonetheless use the same master agreement as the tied assets (see margin nos. 447-465), the company should choose the method described in margin nos. 387-399: 386

According to Articles 88 and 89 ISO, a security bearing fixed-interest may be recognized at a maximum of the value determined with the amortized cost method. In doing so, the purchase value of the security shall be written down or up to the redemption value for its remaining maturity term. According to Article 79(1)(i) ISO, hedging instruments that hedge an underlying shall not be recognized if the recognition in the tied assets does not track market fluctuations. This means that a combined recognition of hedging instrument (derivative) and underlying (bond) may not exceed the value determined with the amortized cost method. 387

If the hedged value exceeds the value determined by the amortized cost method (or if it is equal), the 388 interest rate derivative may be recognized in the tied assets at zero. This method meets the requirements of both Articles 79(1)(i) and 88(1) ISO.

If the hedged market value lies below the calculated value according to the amortized cost method at the time of the hedging transaction this shall be deemed an impairment triggered by the purchase of the hedging instrument (cf. margin nos. 125-131). In this case, the following alternatives may be applied: 389

- The value recognized for the bond shall be adjusted downwards to meet the hedged market value. This new initial value of the security shall be written down or up to the redemption value for its remaining maturity term. The derivative shall be recognized with a value of zero. 390

- Derivative transactions shall be settled with non-tied assets. 391

If concluding a macro hedge, the correction described above may cause technical problems for individual securities. In such cases, it is allowed to apply the method described above at portfolio level, provided the following conditions are met: 392

- The hedged assets shall be included in the tied assets. The obligations entered shall be covered at all times with the respective underlying assets in the tied assets. The hedging instrument used allows an effective hedging of the interest rate of the underlying assets (cf. margin no. 378). 393

- The insurance company shall flag the hedged bonds in the internal portfolio. 394

- The derivative shall be recognized at zero. 395

- Upon concluding the derivative transaction, the insurance company shall review whether the sale of a hedged security would cause a deficit in the tied assets. 396

Such a test shall take place as follows: 397

[sum of hedged market values*] - [sum of all assets recognized in the AMC*]

* only bonds affected by the macro-hedge shall be taken into account.

- Should the test difference be negative, the tied assets have to show an excess of at least this difference at all times up to the de-hedging. 398

- In its annual reports on the tied assets for the attention of the FINMA, the insurance company shall disclose these test results (with up-to-date values). 399

dd) Derivatives used to hedge credit risk

In order to hedge the credit risk of the investment portfolios, the following credit default swaps (CDS) shall be allowed: 400

- CDS for individual securities if the insurance company is a protection buyer 401

- CDS for an index if the insurance company is a protection buyer 402

A CDS may be allocated to the tied assets as a hedge only if, in view of a credit event payment, the definition of credit event and reference obligation have been designed in such a way as to provide a high hedging security. If a portfolio is hedged with a CDS on an index, it must be assured that there is a high correlation between the portfolio to be hedged and the index portfolio as far as the composition and the portfolio weighting are concerned. Should the portfolio to be hedged and the index portfolio differ in composition and/or portfolio weighting so that a stable correlation is not a given, and thus the hedging effect can be maintained only to a certain degree (proxy hedge or cross hedge), this hedging instrument cannot be allocated to this strategy. 403

CDS drawn on a single security may be recorded at market value at most only if the bond (underlying) has been value-impaired in the long term (cf. margin nos. 125-131 and the CDS therefore has lost its hedging effectiveness. Should the underlying security be valued with the amortized cost method, the CDS is recognized at zero in the tied assets. 404

A CDS on indices used to hedge instruments shall always be recognized at zero in the tied assets. 405

c) Derivative instruments for hedging cash flows from actuarial commitments

aa) Permitted derivatives

aaa) Synthetic bonds

Synthetic bonds are investments that have the characteristics of fixed-interest securities. They are a combination of financial instruments (e.g. fixed-term deposits and variable interest rates from a receiver swap). Insurance companies are thus in a position to make investments with maturity terms that are not available on the market in the form of fixed-interest securities. 406

The same provisions shall apply to synthetic bonds as to derivatives with a replicating strategy (margin nos. 422-431). 407

bbb) Other derivatives

Swaptions and options that function like a long swaption (options on bonds with fixed coupons) may be allocated to the tied assets. 408

Permitted options may be allocated under the following conditions: 409

- A hedging of the expected underwriting liabilities can be achieved. The need for a hedge may be calculated for the entire portfolio (macro hedge). 410

- It is probable that the derivatives may be held to maturity. If derivatives are closed out prior to their due date, this shall be justified in an internal report. 411

- A documentation of the transaction shall be submitted to FINMA that specifically shows that there was no overhedge at the time the transaction was concluded. 412

- The use of these derivatives must strive for a long-term effect; specifically, derivative contracts may not be concluded for speculative purposes. 413

Recognizing other instruments shall be permitted only if a concept has been submitted to FINMA beforehand. 414

bb) Limits

Premiums paid for open derivative financial instruments used to hedge cash flows from underwriting liabilities (options as described in margin nos. 408–414) shall be limited to 5 % of the required amount of the tied assets. 415

cc) Valuation

Swaptions and similar derivatives used to hedge underwriting liabilities may be recognized at a maximum at the value determined with the amortized cost method (the amortization shall cover the period between the time of acquisition until it is exercised). 416

The replicating strategies described in margin nos. 406-407 and 422-431 shall be valued according to the categories to which they have been allocated. 417

In the case of synthetic bonds, fixed-term deposits may be valued and recognized at nominal value at most. The recognition is done separately in a sub-category of securities bearing fixed-interest. The receiver swap is recognized using the amortized cost method (Article 88(3) ISO). Should the receiver swap be valued at zero at the time of the conclusion, it shall be included at zero for the entire time to maturity. However, the swap may be settled under the same netting agreements as used for other derivatives of the tied assets. 418

d) Derivatives used to prepare for an acquisition

aa) Permitted derivatives

The derivative strategy may foresee either the future purchase of certain underlying assets (preparations for acquisition, margin nos. 420, 421) or the purchase of an underlying asset with derivatives to replicate a strategy (replicating strategy; liquidity combined with a derivative, margin nos. 422-431). 419

aaa) Preparations for the acquisition

The obligation to provide cover with liquidity according to margin nos. 5–17 must be fulfilled. 420

The following instruments shall be permitted: 421

- *Long call options*
- *Short put options*

bbb) Replicating strategy

Only derivatives fulfilling the following conditions are permitted for replicating a strategy: 422

- The combination of the derivative and liquidity shall have a similar market risk profile and at least the same market liquidity as the replicated investment. 423

- The purpose of purchasing the derivative shall be to replicate the underlying asset. The insurance company shall define the strategy internally and document it. The combination of the derivative and liquidity shall be allocated to the relevant category (e.g. the combination of money market investment and stock futures would be allocated to shares). 424

- The contract volume or the nominal value shall be covered with liquidity at 100 % (margin nos. 5-17). 425

- The transaction involving derivatives shall not generate extra costs in comparison to the purchase of a direct investment. 426

Specifically, the following instruments shall be permitted: 427

- *Long futures*

- *Long forwards*

- *Swaps*

For the purpose of replicating corporate bonds or a portfolio of corporate bonds, specifically the following instruments shall be permitted: 428

- CDS on individual securities if the insurance company is a protection seller 429

- CDS on an index if the insurance company is a protection seller 430

As an instrument of a replicating strategy, a CDS may be allocated to the tied assets only if it is designed in regard to credit event payment, credit event definition and reference obligation in such a way that a corporate bond or corporate bond portfolio is replicated sufficiently accurate. When selecting the respective CDS or CDS index, the insurance company shall make sure that the arising position is in line with the company's investment policy. Specifically, it shall ensure that the arising synthetic corporate bond or portfolio of corporate bonds has a minimum credit rating of 4. 431

bb) Limits

Open derivative financial instruments used for the purposes of preparing an acquisition (margin nos. 419-431) and increasing earnings (margin nos. 438-442) shall be limited to 10 % of the tied assets. 432

Derivatives used to replicate a strategy (margin nos. 422-431), synthetic bonds (margin nos. 406-414) and derivative financial instruments within hedging strategies are excepted from this limit, provided all of the 433 conditions stipulated in margin no. 382 are fulfilled.

The 10 % limit refers to the open contract volumes or the nominal values of the underlying assets. The amount of the contract volume is the result of multiplying the market value of the underlying asset, the number of contracts and the multiplier. Delta-adjusted notional value shall be used to show the value of an option. 434

Synthetic bonds shall be allocated to the fixed-interest securities. The value of fixed-term deposits and any positive replacement value of the swap shall be considered when calculating the counterparty risk (net exposure held against a debtor, margin nos. 113-115). 435

cc) Valuation

The assets from replicating strategies in accordance with margin nos. 406, 407 and 422-431 shall be valued according to the categories to which they have been allocated. 436

In the case of synthetic bonds, fixed-term deposits may be valued and recognized at nominal value at most. The recognition is done separately in a sub-category of fixed-interest securities. Receiver swaps shall be recognized using the amortized cost method (the amortization starts at the time of purchase and ends upon maturity). Should the receiver swap be valued at zero at the time of the conclusion, it shall be included at zero for the entire time to maturity. However, the swap may be settled under the same netting agreements as used for other derivatives of the tied assets. 437

e) Derivatives used to increase earnings

aa) Permitted derivatives

The purpose of the strategy of increasing earnings shall be to generate additional income from existing assets. Only derivative contracts that are covered at all times as per margin nos. 3-17 shall be permitted for this purpose. 438

The following instruments shall be permitted: 439

- *Call* and *put* options 440
- CDS on individual securities if the insurance company is in the position of protection buyer and the CDS does not qualify as a hedge. 441
- CDS on an index if the insurance company is in the position of protection buyer and the CDS does not qualify as a hedge. 442

bb) Limits

Open derivative financial instruments used for the purposes of preparing an acquisition (margin nos. 419-431) and increasing earnings (margin nos. 438-442) shall be limited to 10 % of the tied assets. 443

Derivatives used to replicate a strategy (margin nos. 422-431), synthetic bonds (margin nos. 406-414) and 444 derivative financial instruments within hedging strategies are excepted from this limit, provided all of the conditions stipulated in margin no. 382 are fulfilled.

The 10 % limit refers to the open contract volume or the nominal values of the underlying assets. The amount of the contract volume is the result of multiplying the market value of the underlying asset, the number of contracts and the multiplier. Delta-adjusted notional value shall be used to show the value of an option. 445

Synthetic bonds shall be allocated to the fixed-interest securities. The value of fixed-term deposits and any positive replacements of the swap shall be considered when calculating the counterparty risk (net exposure held against a debtor, 5 % limit). 446

f) Conditions

aa) Exchange traded derivatives, ETDs

Insurance companies are exempted from adhering to the provisions of margin nos. 448-475 if they trade with derivatives solely on a regulated stock exchange (exchange-traded derivatives, ETDs). 447

bb) Over-the-counter derivatives

The provisions of margin nos. 449-475 apply also for OTC derivatives that are not settled through a central counterparty. 448

aaa) Netting agreements

Netting all derivative transactions subject to a master agreement shall be permitted only if such a master agreement was concluded separately for each set of tied assets. Negative positions arising from such agreements shall be deducted from the tied assets. 449

Close-out nettings as foreseen in ISDA agreements are permitted in the tied assets only if the master agreement meets FINMA conditions and refers to a single set of tied assets (Article 91(3) ISO). 450

As assets allocated to the tied assets may not be netted in general, derivative transactions from the non-tied assets may not be netted with those in the tied assets. Therefore, it must be clear to which master agreement confirmations refer to. 451

Collateral and margin accounts that have to be provided to a counterparty from tied assets due to master agreements described in Article 91(3) ISO, do not have to be taken out of the tied assets if they track the fluctuations of the derivative positions (variation margins), as the negative net positions from derivative transactions have already been deducted. 452

Security provided to the counterparty in the form of collateral and margin accounts from the tied assets shall be at the full disposal of the counterparty as realizable assets, provided it is used exclusively to cover the obligations arising from transactions related to the respective set of tied assets that refer to the corresponding master agreement. 453

bbb) Netting opinions

Master agreements may be concluded only if relevant legal opinions confirm that the netting clause and the netting agreement are legally enforceable according to the applicable law. Moreover, a master agreement may be concluded only with a counterparty that is domiciled in a jurisdiction where the legal enforceability of the netting as agreed in the relevant master agreement has been confirmed in a legal opinion. This shall also apply to Swiss counterparties, as certain special cases are excluded in the netting opinions. For important counterparties not covered in general opinions, there may be additional opinions or industry opinions. 454

Such a legal opinion on a netting agreement must confirm that the close-out netting is recognized and enforceable in the following jurisdictions: 455

- the law of the country/countries where the counterparty is domiciled and in which an involved branch office is domiciled; 456
- the law applicable to the transaction; and 457
- the law applicable to the netting agreement. 458

ISDA has confirmed the legal enforceability of master agreements by means of legal opinions for numerous countries. 459

ccc) Permitted master agreements

Only master agreements where the legal enforceability of the close-out netting can be proven with a netting opinion (margin nos. 454-459) shall be permitted. 460

The most common, standardized master agreements in Switzerland can be found in ‚Over-the-counter (OTC) derivatives' issued by the Swiss Bankers Association and in the 'ISDA Master Agreements' issued by the International Swaps and Derivatives Association Inc. 461

Every master agreement relating to assets in the tied assets must explicitly state that the counterparty will abstain from netting with receivables that are not governed in this master agreement. This abstention shall also be declared to be binding in the case of the insurance company's insolvency. 462

For the 1992 ISDA Master Agreements, the method selected for calculating the close-out amount shall always be the "second method". 463

In a master agreement, "automatic termination" shall be selected for the Swiss party. 464

If collateral is agreed upon, an agreement shall be set up to determine that the refund claim on the collateral belongs to the tied assets. This is not necessary if the collateral is provided from non-tied assets. 465

cc) Provision of collateral

For derivative transactions, both sides of the transaction shall provide collateral. The actual availability 466 of such collateral and its full inclusion in the close-out netting process shall be ensured. Any third-party claims against the insurance company may not jeopardize access to the collateral. This shall also apply in the case of insolvency of both parties.

When concluding derivative transactions, it shall be permitted to provide collateral using the assets from the tied assets. This shall apply for initial margin payments as well as variation margin payments (Article 91a(1) ISO). 467

Collateral may be provided in the form of regular rights of lien or irregular rights of lien according to Swiss law or a jurisdiction comparable to Swiss law, provided the initial margin payment is deposited with an independent third-party custodian and thus kept fully segregated from other assets. In such a case, it must be contractually ensured that the initial margin payment may be used only to net open claims held against the insurance company arising from the derivative transaction concluded through a central counterparty or clearing broker (Article 91a(2) ISO). 468

The collateral received from the insurance company shall be safekept in the name of the latter. 469

The custodian bank safekeeping the collateral received from the insurance company shall respect the directives on the holding of assets (margin nos. 154-159) and sign the corresponding rider to the agreement. 470

Collateral received shall fulfill the investment regulations for direct investments in the tied assets. This collateral shall exhibit characteristics that allow daily valuations and daily trading; it may not have been issued by the counterparty or refer to the counterparty. 471

Collateral received may not be pledged, lent, sold or used in any other way in the course of securities lending, repo transactions or other derivative transactions. 472

Threshold amounts which must be reached before collateral is provided must be kept as low as possible. Such thresholds must be defined by both sides in consideration of the counterparty's creditworthiness. 473

Minimum Transfer Amounts (MTA) that need to be attained before collateral must be provided or reclaimed, shall be kept as low as possible. In case MTAs have been agreed upon, in principle, these must be identical for both parties. Different MTAs may occur only because of the different levels of creditworthiness of each counterparty. 474

The collateral received shall be allocated to the tied assets. The counterparty shall have an automatic redemption right. Collateral may not be recognized when calculating coverage of tied assets as the positive net value of all derivative transactions has been recognized. Collateral must be flagged in such a way so that even third parties may identify it as part of the tied assets. 475

dd) Presentation of derivative transactions

The underlying asset shall be valued according to ISO provisions. 476

Individual financial derivatives allocated to the tied assets shall also be valued according to ISO. The tied assets portfolio shall list the individual derivative transactions (not the net amount). If the value of a deriv- 477 ative contract concluded under a master agreement is negative, this negative amount shall be included in the tied assets portfolio.

Upon the conclusion of a derivative transaction, the insurance company shall indicate to which master agreement this transaction belongs. The insurance company shall organize its business in such a way as to enable an allocation of derivative transactions to the corresponding master agreement at all times. The tied assets portfolio may contain only derivative transactions governed in a master agreement concluded for the relevant set of tied assets. The insurance company shall ensure that the counterparties can distinguish the derivative transactions according to their destination. 478

K. Collective investment schemes and single-investor funds

a) Permitted assets

The following assets listed in this chapter may be allocated to the tied assets: 479

- Securities funds (Article 53 et seqq. CISA)
- Real estate funds (Article 58 et seqq. CISA)
- Other funds for traditional investments (Article 70 CISA)
- Single-investor funds (Article 82(2) ISO)
- Foreign collective investment schemes

Collective investment schemes and single-investor funds must hold the status of special funds (i.e. segregated to the benefit of the investor in case of a bankruptcy). 480

Margin no. 479 shall apply in analogy also to foreign collective investment schemes (e.g. UCITS funds). 481

Funds for alternative investments as per Article 71 CISA shall be deemed to be alternative investments (margin no. 322). 482

Equity interest in investment companies not traded on a regulated market may be allocated to the tied assets as collective investment schemes or single-investor funds (Article 82(4) ISO). 483

b) Collective investment schemes

aa) Special requirements applicable to collective investment schemes

Share certificates in collective investment schemes may be allocated to and recognized in the tied assets if these are subject to effective supervision and traded on a regulated, liquid market or if they can be sold at any time (Articles 79 and 82(1) ISO). 484

Foreign collective investment schemes shall require a supervision that is equivalent to the one in Switzerland. 485

bb) Limits

In order to monitor the limits applicable to the tied assets, the net asset value of the collective investment schemes shall be divided into the relevant categories on a pro-rated basis. 486

The investment for each collective investment scheme shall be limited to 5 % of the required amount. This limit shall not apply if the insurance company can confirm to FINMA that the following aspects are ensured and addressed in a contract: 487

- The liquidity of investments is high and the redemption and payout of units can be demanded at any time. 488
- A collective investment scheme shall invest only in the money market, in domestic and foreign bonds with a high rating as well as in Swiss and foreign shares; currency hedging within the fund shall be permitted. High-risk investments (e.g. emerging market shares and bonds, high-yield bonds, convertible bonds, real estate, hedge funds, private equity, structured products) are prohibited. 489
- The adherence to the basic principles concerning the tied assets, i.e. the exclusion of liability, debiting and netting of fund assets for the benefit of third parties and the prohibition of leveraging the tied assets shall be defined contractually between the parties. 490
- The contractual agreement shall also contain a clause that the asset manager is subject to the duty to provide FINMA with information, analogous to Article 29 FINMASA. 491
- On the closing date 31.12., the insurance company shall receive a report from the collective investment schemes at the level of the individual securities. 492

cc) Valuation

Collective investment schemes shall be valued and recognized at market value at most or, if share certificates are not listed, at net asset value (Article 92 ISO). 493

a) Single-investor fund

aa) General provisions

Single-investor funds may be allocated and recognized in the tied assets if they are subject to an effective supervision, are held at 100 % by the insurance company, access to the fund's individual investment is guaranteed at all time, the investment was made in accordance with Article 79 ISO and the FINMA circulars, and the fund meets the safekeeping requirements stipulated in Article 87 ISO (Article 82 ISO). 494

Launching a single-investor fund means the outsourcing of material functions (Article 4(2)(j) ISA). The launch of a fund and any later changes of its organization or service providers and service agreements shall be reported to FINMA in accordance with Article 5(2) ISA. 495

bb) Special provisions

The insurance company shall be responsible for taking into consideration the provisions of the insurance supervision law as well as the requirements of this circular in the contractual clauses; it shall forward to FINMA the relevant documents prior to launching the fund and in case of every amendment of the information. 496

The insurance company shall ensure the supervision of the fund and shall define the duties, competences and responsibilities of that particular office. 497

The insurance company shall remain responsible for adhering to regulatory requirements. In particular, it shall ensure adherence to the qualitative rules and quantitative limits of this circular. 498

The fund management company shall be contractually liable to observe insurance supervisory law and in particular the specifics of this circular. The fund management company shall therefore monitor the adherence to the regulatory requirements on a daily basis and in case of a breach, immediately issue countermeasures and inform the insurance company. 499

The fund may not leverage any investments, with the exception of margin calls for the single-investor fund (e.g. short-term liquidity). 500

The insurance company shall have the right to demand the redemption of units and their payment in cash or tangible fixed assets at any time. 501

Should the custodian bank be located abroad, the provisions on safekeeping assets abroad shall apply (margin nos. 156, 157). 502

The fund management company, the fund administrator, the custodian bank and any other service providers are subject to the duty to provide information to FINMA (Article 29 FINMASA) and shall allow FINMA inspections of their premises. A contractual agreement shall stipulate that the fund management company, the fund administration, the custodian bank and any other service providers are subject to the duty to provide information to FINMA as per Article 29 FINMASA and that they are to allow FINMA inspections on their premises. 503

cc) Limits

Investments in each single-investor fund shall not be restricted. Direct investments in funds shall be listed in the tied assets portfolio and allocated to the relevant categories. They are subject to the limits applicable to direct investments. 504

dd) Valuation

The look-through approach shall be used for the recognition and valuation of single-investor funds. The tied assets portfolio must list the individual funds included in the single-investor fund and allocate these to the categories in accordance with Article 79 ISO. The valuation shall be based on the principles defined in Articles 88-95 ISO. 505

V. Additional provisions on tied assets

A. Securities lending

a) Definition

Securities lending shall be defined as a legal transaction where the insurance company loans securities to a borrower in the form of a loan in kind while the borrower is under the obligation to return securities of the same type, quality and quantity, and to transfer income to the lender for the duration of the securities lending transaction. 506

The insurance company shall remain the beneficial owner of the securities loaned. The lending insurance company is entitled to the interest and dividend payments becoming due. As beneficial owner, the insurance company shall carry the fluctuation risks and take this into consideration when recognizing the loaned securities in the tied assets. 507

b) Permitted transactions

aa) Framework conditions

Securities lending shall be possible only under the following circumstances: 508

- Master agreement 509

  The insurance company shall conclude a master agreement with the counterparty of the securities lending transaction (margin nos. 519-523).

- Counterparty / borrower 510

  The insurance company shall undertake securities lending only with first-grade, supervised borrowers who engage in this type of transaction on a professional basis as well as authorized and recognized central counterparties and central securities depositories who can assure a flawless securities lending transaction.

- Settlement/wind-down requirements 511

  - Transactions shall be settled in a timely manner (if possible matching payment with delivery).
  - All open positions shall be marked to market at least once a day.
  - Margin calls shall be transferred at least once a day for net exposures.
  - The collateral held shall be fully segregated for each set of tied assets.

- Lendable securities 512

  For securities lending, the insurance company may use only securities that can easily be valued based on generally accessible information.

- Ensuring the return of the securities 513

  Claims from the insurance company to return the borrowed securities shall be guaranteed with the depositing of a corresponding amount in cash or other assets recognizable in the tied assets to the benefit of the insurance company (margin nos. 524-529).

- Liquidity 514

  Securities lending shall only be permitted if the insurance company retains sufficient liquidity.

- Maturity period 515

  The insurance company may demand the borrowed securities back from the counterparty at any time; however, for the delivery of the securities the relevant value deadlines / delivery deadlines must be respected. If the counterparties agree on a cancellation period, it may not exceed seven bank working days.

c) Prohibited deals

Securities that were assumed as collateral in the course of repo transactions, securities lending or similar 516
transactions may not be used for securities lending.

Because of the requirement to keep the obligations covered in full at all times, the underlying assets of a 517
derivative transaction must be available in the insurance company's assets without restrictions. Therefore, a simultaneous securities lending based on the same underlying assets shall be prohibited.

d) Special requirements

aa) Requirements in regard to securities lending

Insurance companies engaging in securities lending shall have qualified and expert staff, an investment 518
strategy that foresees such instruments, an investment management that takes into consideration the particular needs, a properly implemented and fully documented investment process, a risk management appropriate for the risks as well as an adequate system infrastructure (cf. margin no. 76).

bb) Master agreements

The standardized master agreement between the insurance company and the borrower must meet the 519
normal international standards and at least address and/or adhere to the following topics:

- The set of tied assets to which the master agreement refers to must be indicated. Moreover, the 520
  underlying assets available or excluded for securities lending shall be mentioned. It is prohibited to lend underlying assets contained in a different set of tied assets or in the non-tied assets under the same master agreement.

- The provision of collateral must be agreed upon with the borrower for every securities lending transaction and the relevant provisions must be adhered to regarding collateral in accordance with margin nos. 524-529. 521

- The agreement shall address the timely and unrestricted repayment of the income generated during the lending period (interest and dividends) and the financial compensation to be paid, the enforcement of other rights (e.g. conversion or subscription rights) as well as the return of the borrowed securities according to contract, i.e. of the same type, quantity and quality. 522

- The possibility to net receivables of all involved counterparties towards the insurance company with the securities loaned or the collateral must be explicitly excluded. This abstention shall also be declared to be binding in the case of the insolvency of the insurance company. 523

cc) Ensuring the return of the securities with collateral

- In order to hedge non-covered claims arising from securities lending, collateral must be delivered to a separate deposit account or account. This deposit shall be established in the name of the insurance company. Collateral shall be delivered simultaneously with the securities. 524

- The custodian bank safekeeping the collateral shall respect the directives on the holding of assets (margin nos. 154-159) and sign the corresponding master agreement. 525

- The value of the collateral shall be adequate and amount to at least 105 percent of the market value of the securities loaned at all times. The value of the collateral shall amount to at least 102 percent of the market value of the securities if bonds with a credit rating of 3 (or higher) are loaned and these are secured with cash or bonds in the same currency with a credit rating of 1. 526

- Collateral shall fulfill the investment regulations for direct investments in the tied assets. This collateral shall exhibit characteristics that allow daily valuations and daily trading, have a credit rating of 3 or higher and may not have been issued by or refer to the counterparty. 527

- Collateral received may not be pledged, loaned, sold or used in any other way for derivative transactions, securities lending or repo transactions. 528

  Cash collateral may be re-invested into highly liquid short-term money market investments or highly liquid bonds with a residual term of a maximum of 12 months. As the borrower is entitled to recall cash collateral deposited at any time, the insurance company shall maintain sufficient liquidity. Strategies and guidelines on the re-investment of cash collateral shall be a part of the insurance company's investment policy and risk management (including stress tests considering various stressed market scenarios); these shall be documented, reviewed periodically and, if necessary, adjusted.

- The agreement must ensure that insurance companies are able to fully and unconditionally access the collateral should the counterparty not return the securities loaned, is late in doing so or returns them only in part. Any third party claims against the insurance company may not jeopardize access to the security. This shall also apply in case of an insolvency. 529

e) Limits

On a gross basis, securities lending and repo transactions together shall be limited to 30 % of the tied assets. 530

Underlying assets loaned shall be considered in relation to the adherence to the limits stipulated in margin nos. 108-122. 531

f) Valuation, recognition and inventory

In order to ensure the return of securities loaned, the receivables and obligations (taking into consideration the accrued interest) as well as any incidental income to which the insurance company is entitled shall be marked to market on a daily basis and the difference is to be remitted on a daily basis. 532

The underlying assets loaned out shall remain in the tied assets. The recognition shall be at the current market value or the maximum recognition value at the time of the lending, if this is lower. 533

The collateral received shall be allocated to the tied assets and flagged as such. As the securities provided as a loan are recognized, collateral may not be recognized when calculating coverage of tied assets. 534

Underlying assets loaned shall be flagged as such in the portfolio. Collateral received shall be disclosed in a separate annex. 535

The following shall be disclosed to the audit firm in an appropriate form: 536

- any securities lending transactions performed in the reporting year
- open positions arising from securities lending
- collateral received

Moreover, the insurance company shall disclose all necessary documents to the audit firm so that the latter may review whether the insurance company has adhered to margin no. 528 at all times. Adherence shall be considered given if the insurance company can prove that the sum of collateral received has never exceeded the portfolio of assets allowed for reinvestment as per margin no. 528. 537

B. Repurchase agreements (repos)

a) Definition

A repurchase agreement (repo) shall be a legal transaction where a party (the repo seller) agrees to transmit ownership of a security to another party (the repo buyer) against payment, whereby upon maturity, the buyer is obliged to repay the seller securities of the same type, quantity and quality, and any income which has accrued during the period of the repo transaction. As the repurchase price is defined beforehand, the repo seller shall bear the price risk of these securities for the duration of the repurchase and reverse repurchase agreements. 538

Reverse repos: The repo transaction from the viewpoint of the repo buyer. 539

Repo interest: the difference between the sales price and the purchasing price of the securities. 540

While in a repo transaction the legal ownership of the securities involved is transferred to the repo buyer, the repo seller shall remain the beneficial owner of the securities. Any interest income or dividends generated in the course of the repo transaction shall be owed to the repo seller. If this has been agreed upon in a contract, the repo seller may repurchase the sold securities before the expiry of the repo duration; however, the relevant value dates and delivery periods must be respected. As beneficial owner, the insurance company shall bear the fluctuation risks and take this into consideration when recognizing the repo securities in the tied assets. 541

b) Purpose

Repo transactions serve to obtain short-term liquidity. Reverse repos is a way to invest excessive liquidity in a short-term secured investment. 542

c) Permitted transactions

Repo transactions shall be permitted under following conditions: 543

- Master agreement 544

The insurance company shall conclude a master agreement with the counterparty of the repo transaction (margin nos. 552-557).

- Repo trading platforms and settlement systems 545

  Repo transactions must be settled on an established repo trading platform, which meets the following conditions:

  - the multilateral agreement system is subject to central administration;
  - the transaction must be settled simultaneously;
  - processes must be mapped in real time;
  - valuations (mark-to-market at least once a day) of all open repo positions take place daily and
  - net exposures are balanced at least daily using automated margin calls.

- Securities allowed for repos 546

  For repo transactions, the insurance company may use only securities that can easily be valued based on generally accessible information.

- Liquidity 547

Repo transactions are only permitted if the insurance company maintains sufficient liquidity.

- Maturity period 548

  Repo transactions with securities in the tied assets may not have a maturity period exceeding 12 months.

d) Prohibited transactions

Securities that were assumed as collateral in the course of reverse repo transactions, securities lending or similar may not be used for repos. 549

Because of the requirement to keep the obligations covered in full at all times, the underlying assets of a derivative transaction must be available and accessible in the insurance company's assets without restrictions. Therefore, simultaneous repo transactions based on the same underlying assets are prohibited. 550

e) Special requirements

aa) Organization, know-how and investment process

Insurance companies engaging in repo transactions shall have qualified and expert staff, an investment strategy that foresees such instruments, an investment management, which takes into consideration the particular needs, a properly implemented and fully documented investment process, a risk management appropriate for the risks as well as an adequate system infrastructure (margin no. 76). 551

bb) Master agreements

The standardized master agreement between the insurance company and the counterparty must meet the relevant international standards and at least address the following topics and/or adhere to the provisions: 552

- The set of tied assets to which the master agreement refers to must be indicated. Moreover, the underlying assets available or excluded for repo transactions are to be flagged. It is prohibited to use underlying assets contained in a different set of tied assets or in the non-tied assets for repo transactions under the same master agreement. 553

- In derogation of margin no. 553, SIX/SIS SNB repo transactions must also indicate for which set of tied assets repo transactions may be performed in addition to the repo platform master agreement. The underlying assets available for repo transactions must be marked and segregated for the set of tied assets in question. An explicit and definite allocation to the respective set of tied assets must be guaranteed for assets related to a repo transaction (e.g. cash on SIC accounts or assets transferred for a repo transaction). 554

- The provision of collateral must be agreed upon with the repo buyer for every repo transaction and the relevant provisions must be adhered to regarding collateral (margin nos. 558-563). 555

- The agreement shall address the timely and unrestricted repayment of the income generated during 556 the repo period (interest and dividends) and the financial compensation to be paid, the enforcement of other rights (e.g. conversion or subscription rights) as well as the return of the securities according to contract of the same type, quantity and quality.

- The possibility to net receivables of all involved counterparties towards the insurance company with the securities loaned or the collateral must be explicitly excluded. This exclusion shall also be declared to be binding in the case of insolvency of the insurance company. 557

cc) Ensuring the reimbursement claims with collateral

In order to hedge non-covered claims arising from repo transactions, collateral must be delivered to a separate deposit account or account with a central settlement system. This deposit shall be established in the name of the insurance company. Collateral shall be delivered simultaneously with the securities. 558

The custodian bank safekeeping the collateral shall respect the guidelines on the holding of assets (margin nos. 154-159) and sign the corresponding master agreement. 559

Collateral shall fulfill the investment regulations for direct investments in the tied assets. This collateral shall exhibit characteristics that allow daily valuations and daily trading, have a credit rating of 3 or higher and may not have been issued by or refer to the counterparty. 560

Assets received for the reverse repo may not be pledged, loaned, sold or used in any other way in derivative transactions, securities lending or repo transactions. 561

Cash collateral may be re-invested into highly liquid short-term money market investments or highly liquid bonds with a residual term of a maximum of 12 months. In view of the borrower's possibility to recall cash deposited by the repo buyer, the insurance company shall maintain sufficient liquidity at all times. Strategies and guidelines on the re-investment of cash collateral shall be a part of the insurance company's investment policy and risk management (including stress tests considering various stressed market scenarios); these shall be documented, reviewed periodically and, if necessary, adjusted. 562

The agreement must ensure that the repo buyer is able to fully and unconditionally access the collateral should the repo seller not be able to buy back the securities, is late in doing so or does so only in part. Any third party claims against the insurance company may not jeopardize access to the security. This shall apply also if one or several participants becomes insolvent. 563

f) Limits

Gross, repo transactions and securities lending together shall be limited to 30 % of the required amount. No quantitative limits shall apply to reverse repo transactions. 564

Securities sold due to repo transactions must be considered for the adherence to the limits stipulated in margin nos. 108-122. 565

g) Valuation, recognition and inventory

In order to ensure reclaims from repo transactions, the receivables and obligations (taking into consider- 566 ation the accrued interest) as well as any incidental income to which the insurance company is entitled shall be marked to market on a daily basis and the difference is to be remitted on a daily basis.

Securities sold due to repo transactions remain allocated to the tied assets. The recognition is at the current market value or the maximum recognition value at the time of the transaction, if this is lower. 567

The collateral received due to reverse repos is allocated to the tied assets. However, the counterparty may repurchase the underlying assets at any time, adhering to the cancellation period. Collateral may not be taken into consideration when calculating the coverage of the tied assets. 568

Securities sold due to repo transactions shall be flagged in the portfolio as "repo'd". Securities received due to a reverse repo shall be disclosed in a separate annex. 569

The following shall be disclosed to the audit firm in an appropriate form: 570

- any repo transactions engaged in during the reporting year,
- outstanding repo transactions, and
- collateral received.

Moreover, the insurance company shall disclose all necessary documents with which the audit firm may review whether the insurance company has adhered to margin no. 562 at all times. Adherence shall be considered given if the insurance company can prove that the sum of collateral received has never exceeded the portfolio of assets allowed for reinvestment as per margin no. 562. 571

VI. Transitional provisions

Up to 31 December 2017 at the latest, the insurance company may base itself on the ratings provided by non-certified rating providers (e.g. banks) when determining its own credit rating (margin no. 145), provided it applies the necessary prudence. 572

If the allocation of reinsured parts to the tied assets is based on an authorization that is still valid, this shall remain valid according to the authorization conditions but at the most until 31 December 2016. 573

Concerning the allocation of reinsured parts to the reserves from group-internal reinsurance relationships [captives] as per margin no. 167, adjustments have to be made by 31 December 2016 at the latest. 574

Should assets be safekept abroad, the first time the insurance company shall provide proof as per margin no. 157 will be by 31 December 2016. 575

Annex

Rider[1]

Supplementary provisions on the business relationships (deposit accounts/bank accounts) between Bank X (custodian bank) and Insurance Company Y (depositor) concerning the safekeeping of assets that belong to the "tied assets" of the depositor.

The present agreement shall apply in supplement to the above-stated business relationship and shall override any derogatory provisions stated in the contract drawn up between these two parties.

1. The assets of the tied assets may be safekept and/or recorded individually or collectively (collective custody) by the custodian bank on its own premises, with a domestic correspondent bank, with a domestic or international clearing house (e.g.: SIS SegaInterSettle AG, Euroclear Bank, Clearstream) or with a custodian abroad.

   The custodian bank shall remain liable to the depositor for assets which the former has transferred to a correspondent bank, a clearing house or a custodian, as stipulated in Article 399(2) CO.

2. The custodian bank shall mark assets deposited with it in deposit accounts/bank accounts as "tied assets".

   The depositor shall ensure that only assets belonging to the tied assets are placed in such accounts.

3. The custodian bank acknowledges that values safekept and recorded as per Clause 2 shall be used to secure the depositor's policyholder claims. Therefore, it shall explicitly declare that it will not enforce any collateral, retention, netting or similar rights, even if the depositor should become insolvent after it has transferred these assets or allocated them to the tied assets. The assertion of these rights remains applicable solely for claims arising from the keeping of such deposit accounts/bank accounts (costs, fees, commissions, etc.).

   Should a third party (including correspondent banks, clearing house or custodian) assert claims to the tied assets, the custodian bank shall notify the depositor immediately.

   Should the depositor wish to record in deposit accounts/bank accounts assets to which the custodian bank already holds a right as collateral, the custodian bank may refuse to transfer the bookings, require a replacement collateral or demand a release of the collateral.

4. The depositor shall remain the sole responsible for the adherence of regulatory provisions, especially concerning the minimum size, the assets permitted for and their composition for a set of tied assets.

Place/date	Signature of the insurance company	Signature of the custodian bank
______________________	______________________	______________________

[1] Revised annex to Circular No. 771 D provided by SwissBanking, dating to 9.4.1987

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