Clarity on

Winter Issue 2015

Life Insurance matters

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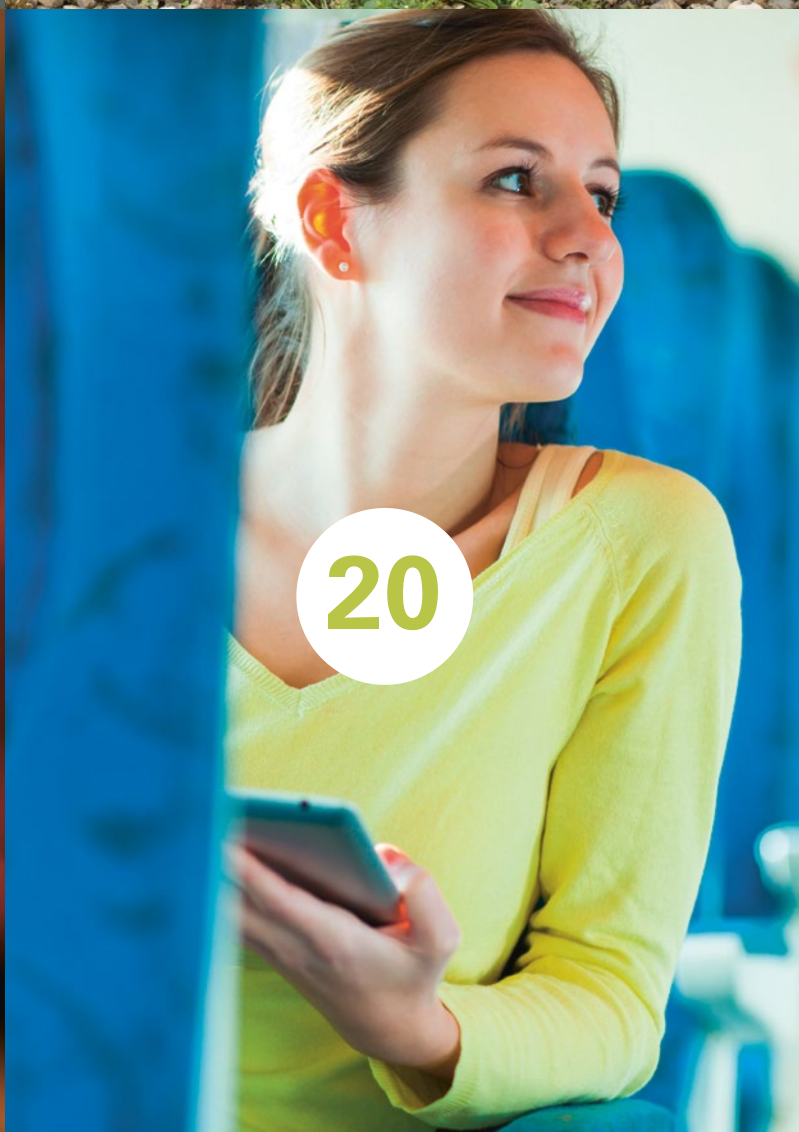
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EDITORIAL

Hieronymus T. Dormann
Sector Head Insurance, Switzerland

2015 – low claims and healthy investment returns

Dear reader,

Reflecting on last year's trends and considering where the next few months will lead us, I feel confident that this year the Swiss insurance market will deliver again healthy short-term results. The industry is also very well positioned for long-term, sustainable success. It will not be all plain sailing, of course. The challenges for life insurance are substantial. Preparing for the implications of the Altersvorsorge 2020, responding to EU-influenced regulations and dealing with a stubbornly low interest rate environment, to name just a few.

And then the SNB throws a curveball: insurers holding Euro assets, and life companies in particular, will be working through the implications of the falls in the Euro and interest rates.

Yet plenty of opportunities present themselves. Technical innovation and product development in particular will help drive the industry forward. Providing a competitive advantage and helping customers recognize the long-term value over alternatives such as real estate.

It is vital to maintain trust in the insurance industry and broader financial services. Putting our clients at the heart of what we do – from greater transparency over results to simpler products that are easier to understand. It is against this backdrop that we are pleased to present a series of articles addressing some of the hottest topics we face

- Perspectives from Swiss Life and AXA Winterthur on market developments in Life insurance.
- Insights into the Automatic Exchange of Information.
- The need for risk-adjusted pricing models.
- … and much more.

We hope you find this publication interesting and thought provoking, and we would be delighted to discuss with you any of the issues raised.

Ivo Furrer, CEO Swiss Life Switzerland and Thomas Gerber, Head of Life at AXA Winterthur, share their views and expectations in an interview in which we covered a wide range of current topics regarding the current state of – and the future prospects for – the Swiss life insurance industry.

ADAPTING TO CHANGE: LIFE INSURANCE IN SWITZERLAND

Hieronymus T. Dormann

Bill Schiller

Oliver Windhör

Of which of your achievements in the life business are you most proud?

Ivo Furrer (IF): I would say that, despite the low-interest environment, we've managed to move Swiss Life back to sustainable profitability and growth at the same time. I think a substantial part of our accomplishment is due to the successful realignment of our strategy and the manner in which we interact with our clients. Our employees are proud to work for Swiss Life.

Thomas Gerber (TG): As demographic influences change financial markets, we've gained a much better understanding of our customers in recent years and the choices they face. As a result, our individual life products combine both security and upside based on state of the art advice. We also recognize we must revisit existing customers' needs in order to review their circumstances and requirements arising from the current distinctive interest rate environment. We advise our customers on real choices. In short, we have moved from product financial analysis to putting ourselves much more in our customers' shoes.

What issues presently occupy most of your time?

TG: We have a firm, clear strategy for the coming years which is in sync with the record low interest environment. We have clearly confirmed our support for reforming the pension system, as we operate in a very long-term business and this needs far-sighted planning. At the moment, we are taking actions as first mover to shape the future of our market, such as developing a comprehensive advice concept for alternative solutions for our customer as well as reducing the conversion rate for non-mandatory insurance. It's not always comfortable to move first, but I'm clear that if nobody moves, the whole system fails to develop. It is our role as a market leader to ensure that the industry stays relevant to our customers' needs not just now, but also decades into the future.

I'm also busy thinking about the life business in 2020 and beyond due to the long-term nature of our business (for me, this has a time horizon up to 2030). It must reflect broader changes within the financial services industry, including the needs of our existing and potential distribution partners. And of course it needs to reflect our ultimate objectives of providing true value to our customers.

IF: As CEO I devote my attention primarily to issues concerning the future of our business. Ongoing digitalization will require us life insurers to adapt our business models. Dealing with large volumes of data is complex and challenging and will lead to entirely new conditions for customers as well as new distribution channels. The second major issue on my agenda relates to "Altersvorsorge 2020". We believe that reforms are imperative, but they need to be appropriately developed and implemented. Hence, we are strongly engaged with the relating political process.

How do you differentiate yourselves from your competitors?

TG: At a macro level, our life business in Switzerland is part of AXA Group's global life business. As a Swiss market leader, we can contribute to these global perspectives on diversification, risk management and insights into how the life business will develop, as well as leveraging our colleagues' insights from abroad. We further have a comprehensive understanding of financial and insurance protection and, as a holistic insurer, an effective distribution model, customer segmentation and positioning. That's an incredibly strong proposition. It has the ultimate impact of ensuring we know our customers and not needing to push sales. Quite often, our customer relationships start on the non-life side and grow from there. This is very rewarding, as we place a strong emphasis on the long-term nature of our business. Transparency and the creation of trust are core elements of this vision.

IF: We adhere to a multi-channel set up, meaning that we offer clients different means of getting in touch with us. With around 1,200 – 1,300 employees, Swiss Life's distribution capacity is significant and very well developed. We are presently devoting considerable efforts to strengthening it further. We have strong relationships with brokers and partners. In addition, we are investing heavily in digital distribution. Another strength is the considerable independence our Swiss entities enjoy within the group – we live the multi-office approach. We have short decision-making processes that allow us to act swiftly and with great agility compared to our competitors.

Where do you see growth opportunities in the life insurance industry?

IF: Life insurance as a product is losing market share, but the pension segment is gaining momentum on account of the emerging demographic trends. Today, there are a number of clever solutions and products beyond simple life insurance achieving the same objectives. Typical examples are banking investments and similar products, products pertaining to the third pillar segment, but also real estate can be considered as part of a pension plan scheme. In this context we want to generate overall added value for our customers.

TG: Growth opportunities in the life insurance industry are closely related to the demographic development. Not accounting for migration impacting higher volume of potential business,

"WE SEEK TO ADVISE OUR CUSTOMERS ON REAL CHOICES."

Thomas Gerber, Head of Life at AXA Winterthur there is also a greater need in the 50+ years old customer group for more detailed pension planning for the coming 15 years. As life expectancy increases, financial requirements must remain flexible. As people reach retirement, we have the expertise to grow their pension and to help customers meet their personal needs in this active part of their life. Not to mention the prospect of early retirement or flexible retirement. We truly understand the various life cycles of saving and protection needs, and this is an attractive market we expect to continue expanding. To help us fulfil this, we interact much more proactively with customers than many insurers have in the past, and we therefore have attractive overall offerings. This is especially the case on the life side, as life advice is extremely complex. Customer-orientation and regular interaction are critical. In essence, we strive to provide value in a very transparent way, such that the customer responds well and we keep him or her for the long term.

Ageing is one of the biggest challenges presently facing life insurance. How is your business addressing this and the persistently low interest rate environment?

IF: We are actually well positioned for this and have for the past four years pursued sustainable margin and capital management. By mapping and evaluating each product individually, we can react with suitable repricing measures to either rising or falling interest rates. This sort of monitoring is carried out on a monthly basis, with each product being individually analysed, unlike our competitors who I suppose only assess their clients' overall portfolios. There is no room for compromise in terms of profitability as guarantor, as it were, for meeting our long-term commitments.
We observe a similar scenario in Japan, where they had to deal with deflation. The Japanese have become used to low interest rates, as have the Swiss. As an investor I get a return of 0.2% for a savings account – clearly, life insurance is a very viable alternative!

TG: We are the specialists for all age groups. It's down to us to provide solutions for our customers. Guarantees remain important to our business and to our customers amid low interest rates. You could say we have fully financed the guarantee we've given in individual life, and we have the requisite capital. In group life we are extremely transparent. It's all about providing long-term security – in capital terms for our business, but also of course indirectly for our customers. The very low interest rate environment requires firm decisions and actions, which are entirely achievable.

A major political initiative is the „Altersvorsorge 2020" or „AHV +". Where do you see the greatest risks and challenges?

TG: In my view, it should happen in a way that does not weaken the three pillar system, as I believe this is one of the best systems. In terms of reform of the three pillars, it's very much a question of fairness. We must be fair in not placing an excessive burden on the younger generation. Young people are not especially interested in pension planning, but you see in countries without strong pillars of employee benefit and individual life in their pension system, that the economic burden is high.

IF: I lived abroad for ten years and participated in many discussions regarding social security systems. I have come to the conclusion that Switzerland's social security system is excellent. We must explain to the Swiss people that it is imperative to take care for the 3-pillar-concept. However, equity between generations requires reforms. It is correct that the concept of generational solidarity leads to a working population supporting the retired population. By contrast, it is unacceptable that the employed ought to contribute an average of CHF 1000.– to 1500.– per year to retirees simply because the conversion rate of the second pillar is too high. Not only the older members of the population can be poor, but also young people. This should be made transparent and easy to understand.

A possible increase in the Legal Quote would further reduce return on equity. Where in your view is the pain threshold?

IF: In my opinion the pain threshold is at 90%. We can live well with the framework conditions implemented in 2002. The mandatory percentage rate is key. Whether it is 90% or 92% makes a big difference to the asset manager and risk carrying capacity. If the quote increases to 92% the overall size of the cake will diminish. At first glance, the insured receive more, but on a second look it is actually less. This is counterproductive for the insured as well as bad for insurers.

TG: When the second pillar started, there were 26 companies in this business. Only six are now left. Any change in the Legal Quote will provoke discussions. At AXA we continuously assess the situation and find solutions to effect the changes needed to continue providing customer value, whatever the circumstance. However, I believe if the legal quote is increased, the whole system loses value. We would need to take out risk from our assets. That means the main part of our customers and customers of the life insurance industry who choose the full insurance model (e.g. all the smaller and mid sized companies) would be negatively affected. This is because the guarantee provided in the full insurance model would be more costly and the performance lower.

IF: Our market is highly competitive - flexibility is a must. Financial security and resultant reliability has its price, which our customers understand. We need an enormous amount of capital, more than some foreign insurers consider justifiable; a fact that led to the decision to exit the market on account of the desired return on equity.

Of the regulatory changes facing the industry, which will most affect your business and what is the impact on your business model?

TG: The Swiss Solvency Test (SST), as it is much more demanding than Solvency II in Europe. On the one hand we have grown a stable and healthy capital base. On the other hand it puts pressure on the return on capital. However, we live with this. We discuss it with the regulatory authorities to ensure it serves the purpose for which it was created, and it does not overload capital requirements.

IF: I would draw a distinction between the solvency regime and the more consumer-oriented regulations. With regard to solvency we have always supported the Swiss Solvency Test (SST) although it is clearly more capital-intensive than Solvency II. A defined threshold is necessary, which – for life insurers - manifests itself primarily in the SST. However, comparing SST und Solvency II and then observing the massive variances raises a number of questions. Put differently, excessive capital requirements lead to a clear-cut competitive disadvantage of Swiss insurers.

TG: In terms of FIDLEG: this is a law the insurance industry neither wants nor needs. It was created for the banking industry. The insurance industry already has a good basis in the VVG. Revision of the VVG may give certain improvements from a customer protection or transparency point of view. The introduction of FIDLEG will exclusively create additional bureaucracy in insurance and lead to a loss of clarity and increased cost. I firmly believe transparency will be a key driver of success going forward; we must not jeopardise this.

IF: I am less sceptical about FIDLEG. Insurers and their customer relationships are sufficiently regulated. FIDLEG can only lead to additional protection regarding products. For example, instruction leaflets similar to those used by the pharmaceutical industry, or additional records of advice. I consider this fair – after all, we have a vested interest in satisfied customers; we want to provide them with good advice through our distribution channels, which the client confirms with his or her signature.

Will stronger regulation strengthen customers' trust in market participants?

TG: That's an important question. If we look at our customer surveys, we find a very high level of customer satisfaction. I believe we need to maintain a level of advice that helps to further build customers' trust to strengthen the savings. In terms of the distribution approach, I believe it's a question of promoting the right level of transparency, creating real customer value while allowing a distribution partner to develop his model on a long-term basis.

IF: I consider myself to be liberal and I tend to be sceptical of regulatory measures. Regulations aim at curtailing excesses – excesses that have undisputedly occurred in the past. However, I doubt that this will enhance customers' trust. Experience gained from our daily work indicates that the sources of trust are our agents, our systems and ultimately the Swiss Life brand.

"WE HAVE A GREAT BRAND – WE SERVE OUR CUSTOMERS WITH INNOVATION, SPEED AND PASSION."

Ivo Furrer, CEO Swiss Life Switzerland

Data Analytics is the present buzzword: what is the importance of data analytics, data management and digitalization to your business? How are you specifically addressing the topic?
IF: This is a highly relevant subject for us and reflects one of our strategic approaches. We participate in a project called „Face-To-Customer", which allows customer simulations and drives the finance process via portals. Protection of customers' data and the pertaining rights of the customer are very important when considering digitalization. The customer alone decides which information he or she provides, in which format it will be captured by the portal, who has access to the information and how it may be utilized. If a customer decides to use the portal, we can initiate a dialogue with him or her on the basis of his or her behaviour pattern and develop bespoke offers.

TG: Our primary focus for the next couple of years is very much on the group life side and on services. There's great potential to provide more information in a more efficient manner that will help our customers as well as reduce costs. We should address both the data processing aspects and the customer sales and service aspects. Digital is a great driver of efficiency and effectiveness throughout the value chain.

Traditional products are increasingly being replaced by more complex ones. What is driving this development?
TG: With a traditional product it's easy to say there is a guarantee and a bonus, though the mechanics are complicated. Our individual life product range has a guarantee on one side and on the other an upside that is linked to the development of the financial markets. Across the market, we believe it's better to focus on key products at each stage of the life cycle. You could say that the complexity of the entire product range has been reduced, yielding a clear focus on the offering and advice for the accumulation, protection and retirement phases. In the long-term there seems to be a significant opportunity to reduce complexity where it does not provide any value to the customer. But to be honest it's not an easy area to tackle.

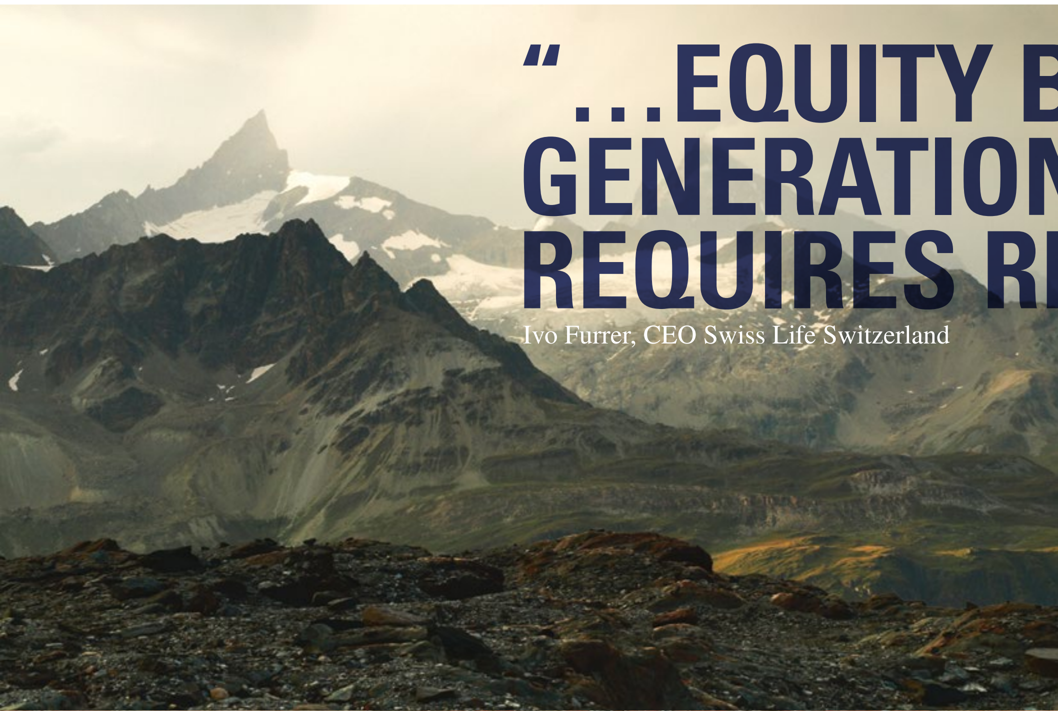
IF: We are creating new and more transparent products, which are more readily understandable to the client. These are replacing traditional products (with full guarantees). We are talking about more flexible, rather than more complex, solutions. The customer decides whether full investment protection or participation, an SMI or SPI-related product or a fixed interest rate will best meet his or her needs. There is the additional option of revising the portfolio structure annually.

Will you opt for a retirement pension or a capital payment?
IF: Actually, I have not yet decided. A hybrid pension scheme is generally not a bad idea, particularly for people who can clearly assess the risk carrying capacity of a capital payment. For me, this is an important prerequisite for managing and investing ones own assets. On the other hand, a pension at a conversion rate of 5.5% or 5% is still pretty good. Where else can one get a secure 5% yield over many years?

TG: I'm probably too young to answer the question today… I will seek advice from one of our advisors. And of course I will consider my wife's opinion.

"THERE'S GREAT POTENTIAL TO PROVIDE MORE INFORMATION IN A MORE EFFICIENT MANNER THAT WILL HELP OUR CUSTOMERS AS WELL AS REDUCE COSTS."

Thomas Gerber, Head of Life at AXA Winterthur



"...EQUITY BETWEEN GENERATIONS REQUIRES REFORMS."

Ivo Furrer, CEO Swiss Life Switzerland

WE ARE TALKING
ABOUT MORE FLEXIBLE, RATHER THAN MORE COMPLEX, SOLUTIONS.

Ivo Furrer, CEO Swiss Life Switzerland

I SEE IT AS OUR ROLE AS A MARKET LEADER TO ENSURE THE INDUSTRY STAYS RELEVANT TO OUR CUSTOMERS' NEEDS NOT JUST NOW, BUT ALSO DECADES INTO THE FUTURE.

Thomas Gerber, Head of Life AXA Winterthur

ONGOING DIGITALIZATION WILL REQUIRE LIFE INSURERS TO ADAPT OUR BUSINESS MODELS… AND WILL LEAD TO ENTIRELY NEW CONDITIONS FOR CUSTOMERS AS WELL AS DISTRIBUTION CHANNELS.

Ivo Furrer, CEO Swiss Life Switzerland

Thoughts on the impact on Swiss life insurers of the recent SNB decision

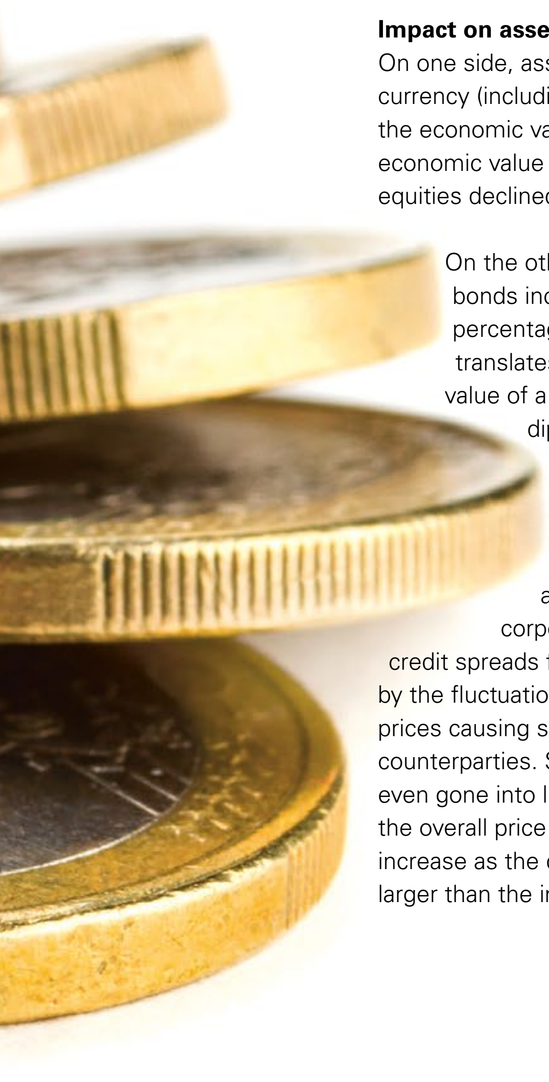
On January 15, 2015, the Swiss National Bank (SNB) ended its three-year-old cap of 1.20 CHF against the Euro, triggering a record rise in the value of the Swiss franc against the Euro and the highest gain against the dollar in this period.

Nick Kinrade

Gion Donat Piras

At the same time, the SNB lowered the interest rate on sight deposit account balances that exceed a given exemption threshold by 0.5 percentage points to –0.75%. The target range for the three-month CHF LIBOR was further lowered into negative territory, to between –1.25% and –0.25%, from the previous range of between –0.75% and 0.25% (from January 22 on). As a consequence of this decision, a significant decline in Swiss equity markets occurred (SMI and SPI as of end of January are still down 9%). Additionally all CHF cross rates considerably lowered (EUR:CHF subsequently closing on average -16%, USD:CHF -13%).

Swiss Government bonds currently yield negative for maturities up to 10 years as seen in the chart on the next page. Due to the quantitative easing decision by the ECB, European Government bond yields also further decreased and are currently negative for maturities up to four years.



Impact on assets

On one side, assets denominated in foreign currency (including assets for future profits and the economic value of foreign subsidiaries on economic value balance sheets) and Swiss equities declined in market value.

On the other side the market value of bonds increased (decline of 0.4% percentage points on a 10 year rate translates into a 4% increase in market value of a 10 year bond). The 10 year rate dipped as low as -30bps, the lowest ever recorded redemption yield. As of end of January the 10 year rate stood at -7bps. However, there was also a relative decrease in some corporate bond prices due to higher credit spreads for some counterparties caused by the fluctuations in FX rates and other market prices causing significant losses on counterparties. Some finance sector firms have even gone into liquidation as a result. However, the overall price movement was in general still an increase as the decrease in the risk-free rate is larger than the increase in the credit spread.

Impact on life liabilities

There are three main economic impacts on the liability side:

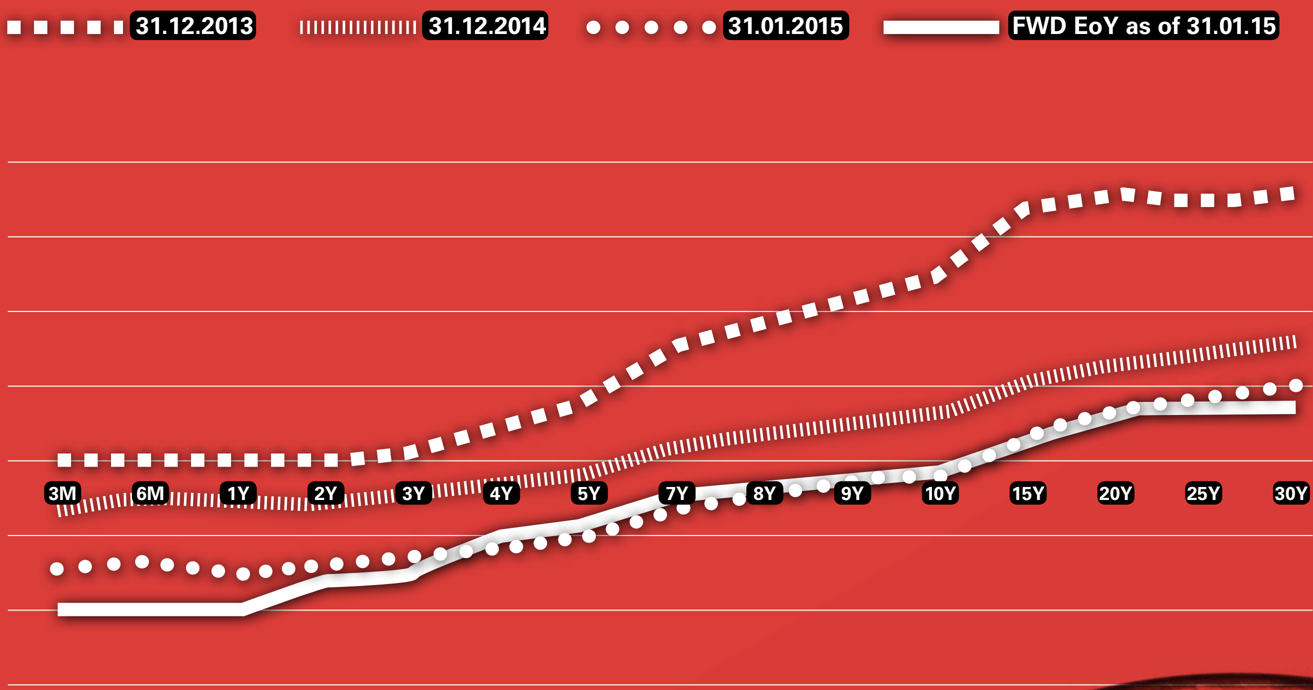
- Inability to earn in the capital markets at least the technical interest rate credited to some business; necessitating allowances for increased reserved.
- Decreased discount rates for long term business (as depending on the valuation basis they are either asset-based or risk-free, both of which will have decreased) leading to higher reserves.
- The impact of options and guarantees e.g. for BVG business with fixed annuity conversion rates (equivalent to guaranteed rates of investment return).

Under the Swiss Code of Obligation ("OR") the increase in life liabilities is limited, as it is not required to establish market-consistent reserves. Potentially, the largest effect would be for Group Life business where pension funds ("Altersguthaben") need to be converted at fixed rates (these guarantees are known as Guaranteed Annuity Options). However, under current practice reserve strengthening/ reinforcement ("Verstärkung") only allows for the impact of these losses for a fixed period, i.e. typically a contract boundary of three to five years is used as it is assumed insurers can choose not to renew the business after this period and thus do not need to establish reserve for cashflows beyond this boundary.

Similarly, the discount rate under OR is in practice set differently by each insurer and market practice varies significantly, however three main features limit the effect:

- OR allows for an asset-based discount rate which reflect expected risk premia in the underlying asset classes in advance (i.e. it is permitted to assume and take up front credit for an expected return on equity of e.g. 6%, despite only having e.g. a 0% risk-free return).
- Expected returns per asset classes are often set as "long term assumptions" i.e. assumptions not consistent with market valuations. Thus the current market conditions are often "smoothed" over a longer term.

SWISS GOVERNMENT BOND YIELD CURVE (IN %)



- The use of book, rather than market, values meaning that insurers holding an asset to maturity are not exposed to market price fluctuations over the course of the holding and thus the impact of the significantly higher bond prices / lower bond reinvestment rates is less pronounced.

Under IFRS the effect is expected to be broadly similar to OR for Swiss companies basing their Insurance IFRS on OR or FER. Finally it should be noted that financial reporting for many insurers only takes places annually or quarterly and thus the valuations will only need be completed next March / December by which time the capital markets may look somewhat different and remedial action may have been, at least partially, implemented. However it is also possible some insurers who have still not completed their year end financials will take these events into account on the reserving side.

Impact on solvency

The already relatively strained SST ratios of life insurers are expected to decrease significantly as liabilities are measured on a market-consistent basis (and life insurers are likely to be rather short than long duration). However under the SST, liabilities are discounted using a swap-rate based risk-free discount rate and it should be noted that CHF swap rates were and continue to be higher than Government bond rates. This use of swap based risk-free rates was introduced in late 2013 as a temporary relaxation in the SST valuation regulations, designed to increase industry solvency ratios.

This increased valuation of liabilities together with suppressed asset side valuations will lead to a large decrease in available capital (risk-bearing capital). Similarly, the required capital (solvency margin, target capital) is likely to increase for most insurers as they need to set aside more capital for market risks due in part to the increased equity market and FX volatilities. This effect will however be less pronounced than the reduction in RBC. Thus this increased required capital together with the significantly reduced available capital will lead to decreased SST/Solvency ratios (available capital / required capital) and an increased likelihood that minimum levels of solvency will be breached and regulatory action from FINMA will take place e.g. enforced closure to new business, decreased freedom to declare policyholder bonuses, enforced de-risking, etc.The above issues will affect insurers with inadequate ALM programmes and insufficient liability replication to a greater extent. Further, these market events will lead insurers using internal solvency models to consider whether the structure of their internal model continues to be plausible. For example, some internal interest rate models used in the market do not allow for negative interest rates. Back-testing such models will prove difficult and the validity of a model giving rise to no negative interest rates in an e.g. 1 in 200 year event will be questioned when even the current rates are negative.

Further reactions

There are number of wider possible impacts of these events. We expect that FINMA will shortly lower the maximal technical interest rate for new products (perhaps to at least 1.00% from the current 1.25%)[1] and that most insurers will considerably lower technical interest rates in advance of any change in regulation from FINMA for new product/tariffs. Life insurers will need to review profitability of their products. Especially strategic options in group life business will need to be revaluated under the current political situation (e.g. further adjustment of tariffs or non-renewal of business). These recent events have only exacerbated the current discussion about the future of the second pillar pensions business (being addressed as part of the Altersvorsorge 2020 initiative). BVG pensions currently in payment are being cross-subsidized by the working population due to insurers being unable to directly finance the high guaranteed annuities (AXA believe the extent of this cross-generational subsidy is in the region of CHF 300 million per year in their portfolio alone)[2]. Mass insurer withdrawal from BVG business is also unlikely to be a politically acceptable or practical solution and other potential options (increase in premiums, decrease in benefits, new types of "products") are also severely restricted by the tight regulation of this business.

Further it is likely that Swiss life insurers will further adjust their asset allocation towards more risky assets (e.g. further expansion to more illiquid assets like real estate or mortgages, investment into lower-rate bonds), where their current solvency position allows.

As in other industries, we see a comparative disadvantage for Swiss-based groups (e.g. Zurich, Swiss Re) or those with substantial corporate group-wide functions based in Switzerland (e.g. AXA, Allianz) potentially leading to increased outsourcing/offshoring or focus on non-Swiss business.

Market valuations of insurers

The impact on market valuations of traded insurers was limited (i.e. lower than average market impact). As was to be expected, insurers with relatively strong life businesses and high CHF denominated expenses but non CHF denominated revenue streams were more severely hit.

[1] http://www.finma.ch/d/beaufsichtigte/versicherungen/lebensversicherungen/Documents/ taux-technique-max-60pc-q4-14-d.pdf
[2] https://www.axa-winterthur.ch/SiteCollectionDocuments/Medienmitteilungen/20140407-axa-ch-komplettanbieter_de.pdf


EXPERIENCE
HEALTHY
SELECTION
IMPACT
EFFICIENCY
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CHANGE
SPECIFIC
WORK
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DATA
SENSITIVITY
ASSESSMENT
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EXECUTIVES
KNOWLEDGE
CONDUCT
INTERNET
SEARCH
EVALUATE
PRICE
POWER
CAUSALITY
AUTOMATED

IMPACT OF TECHNOLOGY ON LIFE INSURANCE

The insurance world is awash with talk of digital, big data, data analytics. The whole insurance value chain is impacted, from distribution to intermediation, risk carriers and service providers. At the center of this transformation into a more connected world are customers, whether consumers or corporates. They expect to be able to select from the products of a vibrant marketplace defined and driven by their needs, preferences and convenience.


Prafull Sharma


Rikard Sandstroem

Insurance executives globally are trying to work out what all this means for their customers, their operating models, their bottom lines. Some of the best are finding ways of harnessing the power of digital to drive change and improve customer experience. Some are struggling. Some have other priorities. We present below seven transformation cases which show the benefits big data analytics can give insurers and the challenges they might have with the transformation to a data-driven organization.

Product individualization
Big data creates increasing knowledge of the customer's needs and behavioral patterns. This can be used to deliver insurance products specially tailored for the individual customer, at an individual premium. Insurance companies doing this have seen improved customer satisfaction and have been able to access previously inaccessible markets. Instead of finding the right customer for the product, insurers are developing the right product for the customer.

Customer retention
Life insurers that can develop a stronger relationship with the customer through quality of services and social media enjoy stronger customer retention. This has already been observed in insurance products using wearables and telematics data to track customer activities and encourage healthy lifestyles to improve longevity and reduce risks.

Conduct risk & compliance
Conduct risk and mis-selling are directly linked to understanding the client needs gained through big data. By combining this knowledge with salesperson statistics the conduct risks can be accurately estimated. KPIs linked to customer satisfaction metrics can be used in addition to sales volume to encourage good sales behavior.

Sales channel optimization
Utilizing detailed information on how users interact with the company website, such as navigation history, time spent on each page etc, can help optimize the structure and layout for the customer, increasing sales.

Marketing campaign selection
Marketing campaigns that target the most valuable segments of the population that are most likely to buy the product give a better return on investment. KPMG has used machine learning to move from correlation to causality, which enables predictions of the efficiency of the marketing campaigns.

Automated underwriting
Through automated underwriting, life insurers can reduce the underwriting overhead and create affordable products to gain access to new markets. Data from multiple sources are combined to evaluate each applicant's risk profile using statistical methods. Insurers already using automated underwriting can reduce the manual labour by 95%.

Price optimization
With an internet search a customer can today in minutes compare her current insurance with competing offers. Price sensitivity is increasing, and the insurer that has the most accurate risk assessment can make the best offer.

What specific challenges do we see globally?
- Assessment in an increasingly digital world
- Making best use of the vast amounts of available data
- Taming the challenge of legacy systems
- Keeping the business secure given increased cyber threats
- Attracting and retaining the people needed to drive the change

Credibility-based pricing – New ways for risk adjusted pricing models in life insurance?

These days, life insurers tend to face pressure on profit margins that commonly results from either continued challenging economic conditions, movements in non-economic assumptions such as biometric, or changes in the regulatory environment. To keep playing at the top of the field and to ensure profitability in a competitive market, life insurers will most likely have to act to enhance their pricing models to remain a competitive and attractive partner for existing and potential clients. In this article, we note how risk-adjusted pricing based on a credibility-type rating may be an appealing alternative. We demonstrate how well-recognized techniques may be applied to the group life & pension market, in particular regarding the pricing of the risk process component (i.e. mortality and disability risk) which is evolving rapidly. Benefits of applying such pricing methods are outlined briefly.

Credibility has been part of actuarial practice since Mowbray in 1914 and has been continuously developed[1] over the last 100 years. Methods and associated modelling processes have become more advanced and refined[2] in recent years, however. In addition, credibility earned prominent recognition in North America in the form of released practice notes[3] (2008) and application standards for actuarial practitioners[4] (2013). Nevertheless, we believe that most recent technical achievements in credibility-type modelling, with its potential benefits in risk pricing and prediction, have not yet attracted adequate attention from the life insurance industry though these may offer new ways for addressing recent challenges.

How application of advanced pricing tools allows you to stop adverse selection

Classical, but at the same time modern and up-to-date, actuarial ratemaking tools such as credibility in the framework of panel data models[5] may offer a range of excellent features for competitive pricing, e.g. of group life contracts regarding the "risk process". In general, credibility-type methods enable diverse options to simultaneously use individual client data and global market data in order to fit the price to the historic loss experience of each risk or client. While the individual premium is the most competitive ("fair") one to be charged, unfortunately it is mostly unknown to the pricing actuary due to a lack of sufficient data and limited availability of reliable experience of an individual risk. Therefore, in order to avoid anti-selection, credibility may serve as an excellent risk-adjusted pricing tool that allows the consideration of available individual risk experience in relation to heterogeneous risk structures within the portfolio. In the following section, we show for illustrative purposes (while not limited to this specific area of application) how the fundamental concept of credibility frameworks could be applied to group life & pension.

Let us consider classical pricing approaches to mortality (or disability) risk where ratemaking for each contract within an entire portfolio is based on the same global statistical data. However, this

[1] Further milestones and pioneers in the 1970s are Bühlmann and Straub, Hachemeister ("regression case"), and Jewell ("hierarchical case"), among others.
[2] For data features including heteroscedasticity, random and fixed effect covariates, outliers, serial correlation, and limited dependent variable bias have been studied in the regression (panel data) context.
[3] American Academy of Actuaries' Life and Valuation Subcommittee, Credibility Practice Note, July 2008.
[4] Actuarial Standards Board, Credibility Procedures, Actuarial Standard of Practice No. 25, December 2013.
[5] Also known as longitudinal data models.

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may lead to adverse selection as risk classes are rarely homogeneous in the portfolio context.

Assume an insurer X allows for price reductions for clients that have a better performance than the global market average on the risks insured, but increases premiums for clients that have a worse performance than the global market average. On the other hand, insurer Y prices all contracts using the global market average data without adjustments for individual performance. This will lead to a move of bad risks from insurer X to insurer Y, putting pressure on the margin of insurer Y.

The application of advanced modern ratemaking tools such as credibility ratemaking and panel data models (i.e., regression-type) have already successfully helped to reduce the problem of adverse selection in insurance practices such as non-life, workers' compensation, medicare and U.S. group term life. With some adaptations, we believe this theory and its practical tools can also be applied to group/corporate life & pension pricing.

The key principle of the credibility-type framework is to use two sources of data for pricing a contract:

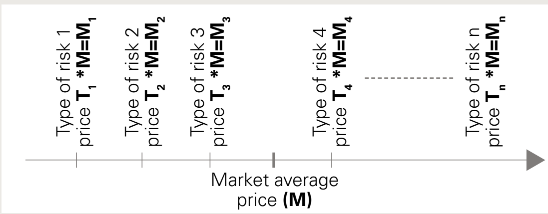
- The **global** (disability and mortality) **experience** of the type of risk the client belongs to, leading to a collective or global price **M** (this data is typically stable, but may not represent the individual client's experience)
- The **client's individual** (disability and mortality) **experience**, leading to a price $\mathbf{P_i}$ (this data represents the individual client's experience, but may be insufficiently stable or potentially unavailable or only partially available)
- The **ultimate price** $\mathbf{UP_i}$ charged to the client is then a mix of **M and** $\mathbf{P_i}$, whereby $\mathbf{P_i}$ becomes more important the higher the quality of the client's own data is in terms of quantity and volatility.

General Credibility Pricing Formula
$$UP_i := a_i * P_i + (1-a_i) * M$$
where $0 < a_i < 1$, some credibility factor depending on structural parameter estimates.

Assuming the presence of hierarchical (client) risk structures, credibility pricing may be performed along the following general three-step process[6], here tailored to our example.

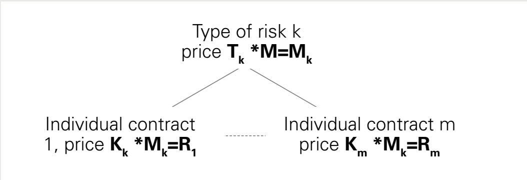
Step 1 – Collective price: Determine the type of risk and its (market) price level

A good example for types of risk **k**, (1<= k <=n) within an entire portfolio of ***n*** risks is the specific industry of the client or corporate. The market average price **M** of the portfolio across all industries is then determined and distributed to sub-portfolios[7] for each type of risk ***k*** by employing weights $\mathbf{T_k}$ such that the market premium weighted with $\mathbf{T_k}$ results the industry- (i.e. client-) specific but still collective sub-portfolio price $\mathbf{M_k}$.



[6] Here we only refer to the model design process component that is part of a more comprehensive product design cycle.
[7] Using common experience rating as for the entire (sub-) portfolio usually, sufficient information is available to find an appropriate and reliable collective "sub-portfolio price".

Step 2 – Individual price: Determine the individual price of the contract in question relative to its type of risk
Next, the loss experience available of the individual contract (***i***)[8] within each industry risk ***k*** is used to determine the price level of the particular individual risk ***i***. It may be characterized by e.g. age, gender, coverage, etc. of the employees of the client risk ***k*** compared to the type of risk (***k***) it belongs to.



The adjustments $\mathbf{K_i}$ for the various individual contracts ***i*** (1<= ***i*** <= m) depend on the loss data of the individual contracts compared to the overall loss level of the corresponding type of risk ***k***. For example, if contract i produces on average (over several years) a loss of 120% compared to the average loss of all contracts in the risk type ***k***, then $\mathbf{K_i}$=120%. Hence, the most competitive (and "true") price is given by $\mathbf{R_i = K_i{*}M_k = K_i{*}T_k{*}M = 120\% {*} T_k{*}M}$. Unfortunately, this estimate often lacks of statistical stability due to limited experience available. Hence, we apply credibility techniques.

Step 3 – Credibility price: Combine prices of steps 1 and 2 to obtain the ultimate price for the contract
The ultimate price of individual contract ***i*** in risk group ***k*** is given by the credibility formula $\mathbf{UP_i := a_i{*}R_i + (1\text{-}a_i) * M_k}$, where ai is a structural parameter (to be estimated from the data). The latter is commonly determined by the volume of the contract (e.g. sum insured, number of persons insured or other), the volatility of the loss experience of the contract, and the volatility of the entire data within the risk type. The credibility factor is constructed in a way such that the larger the volume of the contract and the smaller the volatility of its individual loss experience compared to the volatility of the whole sub-portfolio experience, the closer ai will be to one. In this case, we attain full credibility in the individual's experience, that is, the rate $\mathbf{R_i}$ from step 2 above.

Challenges that force insurers to re-adjust their pricing models

Several external and internal forces can be identified that are presently putting pressure on life insurers' profit margins and, in particular, those operating in the group life & pension sector:

- **Demographic forces:** Mortality and longevity risks are changing. Insurers must be sure to correctly price these long-term risk trends. Disability (morbidity) rates may permanently vary in the long run and even in the short run in accordance with seasonal or cyclical behavior, e.g. depending on the state of the economic environment.
- **Competition:** High competition in the market puts pressure on margins. Some competitors are at the forefront of pricing model development and already acting very successfully in the market. Further, new market entrants enter the group life market and offer (reinsurance) product solutions related to the risk process.
- **Regulatory pressure:** Pricing models must use actuarially sound methods that consider regulatory constraints and are mathematically well recognized and documented.
- **Pricing techniques:** Old fashioned and outdated "historical" pricing techniques have been in place for a long time and therefore often do not properly consider risk characteristics that may result in anti-selection.

Pitfalls and benefits when implementing a new pricing model
Throughout the implementation of newly developed pricing tools, it is imperative to perform diverse general validation & review processes, specifically when pricing the (Swiss) collective life & pension business that has several unique characteristics and (regulatory) constraints that need to be taken into consideration. Some are as follows:

- Group morbidity is a function of diverse distributions: claim frequency, coverage, and the experience variability in claim duration and benefit amounts
- Group disability and mortality is influenced by both individual and group characteristics. An assumption of independence may be inappropriate when systematic dependencies are present
- Ratemaking regarding the risk component should allow for:
  – Calculating new business or renewal case rates based upon the loss experience of specific groups that are heterogeneous and require proper risk differentiation
  – Reflection of the economic circumstances and/or client-specific externalities that impact morbidity rates

[8] For simplicity of notation, we write $_i$ but implicitly mean index k_i.

– Recognition of systematic claim delay effects in pricing that may stem from IBNR claims and other sources
– Fair and transparent pricing that is understandable, justifiable, and can be monitored
– Proper partitioning and classification of homogeneous risks using statistically relevant criteria that are in compliance with regulatory requirements for Swiss group life & pension business and result in unbiased risk premium estimation and consistent risk adjustments between risk classes
– Use of accurate and complete client-specific underwriting data that also considers trends: non-static overall portfolio premium in time, non-linear relationships between predictors and risk premium, etc.

The model change process may be complex and require intensive communication and knowledge sharing between diverse stakeholders, however we expect that pricing models most likely will have to be refined or at least challenged, as the pressure on profit margins will continue to increase further. Controlling the margin and profitability is an inevitable consequence. The use of modernized and robust pricing methods may address these concerns by proper risk classification and provide several desirable benefits. They:

- Bring your pricing model up to date, and comprehensive model documentation will facilitate knowledge transfer and regulatory compliance of your pricing
- May enable you to know what margin and risk you get for each contract by allowing the use of individual historic data for each contract being priced
- Enhance your data analytic process for improved risk-adjusted pricing and risk classification that avoids anti-selection through proper and adequate risk differentiation
- Allow the recognition of latest emerging trends in your pricing within each of the priced risk processes and properly priced outlying risks
- Retain control and help to steer margin by proper rate-making of new or renewed business through enhanced risk classification procedures
- Help you to continue to be at the forefront of the market with trained actuaries and underwriters using modern competitive pricing tools

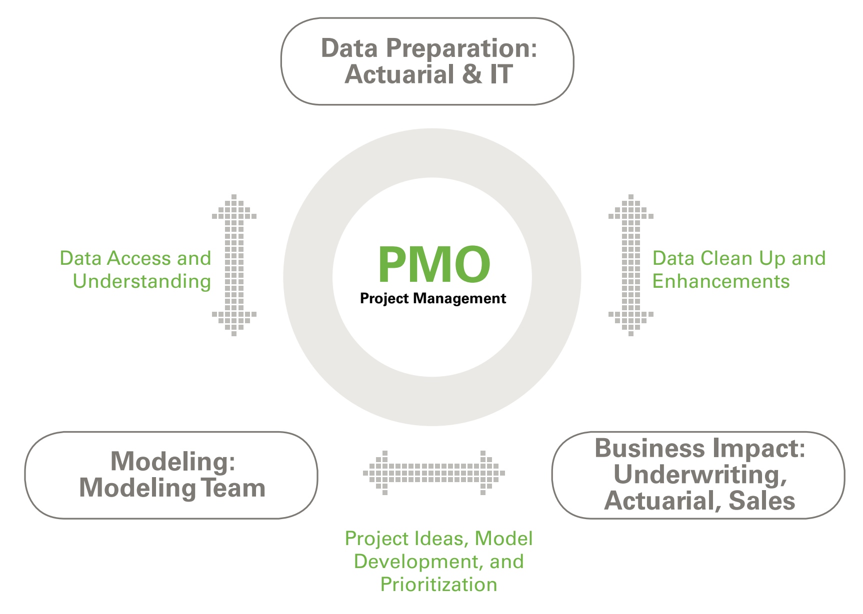


Figure: Communication between all stakeholders will be key

Conclusion

Credibility, particularly in the framework of panel data for risk pricing, is a widely accepted tool in non-life insurance and already finds diverse applications in the health insurance sector. This class of capable pricing and predictive modeling methods are nowadays increasingly used in life insurance. The area of application in life is manifold and practical usage ranges from credibility for mortality and lapse assumption setting, to life reinsurance, medical insurance, group long-term disability pricing, and even reserving. Credibility and panel data (i.e. regression-type) ratemaking are applicable both for new contracts and for the annual renewal of existing contracts.
In summary, we believe that these are sophisticated and proven tools in actuarial practice which allow you to:

- Adjust your price to each client's individual risk situation and obtain risk-adjusted fair premiums
- Prevent adverse selection, helping you to achieve a competitive price advantage for good risks in the market
- Better understand the risk and margin you take with each client by proper risk classification and differentiation

FIDLEG – Implications for insurers

The consultation drafts on FIDLEG and FINIG have triggered controversial debate in the insurance industry, for which implementation would entail significant expenditure. The rules of conduct regarding the distribution of insurance products would be substantially extended. Insurance intermediaries that are considered by FIDLEG to also be client advisors would be directly subject to FIDLEG.

1. Starting position

The Swiss Federal Council opened the consultation period on the Swiss Financial Services Act (FIDLEG) and the Swiss Financial Institutions Act (FINIG) on June 25, 2014. FIDLEG and FINIG, together with FINMAG (Swiss Financial Market Supervisory Authority Act) and FinfraG (Financial Market Infrastructure Act) shall constitute the four pillars of the new architecture of the Swiss Financial Market Law. The following considerations are based on the FIDLEG and FINIG Consultation Drafts ("FIDLEG" and "FINIG") and on the Consultation Drafts of the Insurance Supervisory Act ("VAG") and the Insurance Contract Act ("VVG").

2. Scope

Insurers are affected by FIDLEG in various ways. The FIDLEG regime and the planned amendments to the VAG have an extensive impact on the distribution of insurance products:

- Insurance intermediaries simultaneously acting as a client advisor according to FIDLEG ("client advisors") are directly subject to FIDLEG.
- Distribution of redeemable life insurance products and of collective investment schemes through insurance intermediaries are subject to FIDLEG.
- According to the regulations of FIDLEG and the planned amendments of the VAG the following distinction has to be made:
  - Duties which are applicable to all insurance intermediaries,
  - Additional duties to be fulfilled by client advisors under FIDLEG.

The existing differentiation between independent insurance brokers ("ungebundene Versicherungsvermittler") and tied insurance intermediaries ("gebundener Versicherungs-vermittler") has not been clarified. On the contrary, FIDLEG and the planned amendments of the VAG result in a further categorization of insurance intermediaries. As a result, the regulation of insurance intermediation leads to conflicting results and legal uncertainty.

3. Obligations of all insurance intermediaries

3.1 Registration obligation

All employees of insurance companies are subject to the registration obligation to the extent that they offer and conclude insurance contracts. Concerning the registration obligation, the distinction between independent insurance brokers and tied insurance intermediaries does not apply anymore. The registration obligation extends to all intermediaries.

3.2 Duties of care and loyalty

In the event that insurance intermediaries provide their services based on an independent relationship, they are obliged to consider a sufficient number of generally marketed insurance products. Furthermore, they are not allowed to accept any benefits from third parties, or are obliged to pass these on to their clients. This leads to a de facto prohibition on commissions for insurance intermediaries (Art. 43 VAG in conjunction with Art. 9 FIDLEG). Further, Art. 43 VAG ("duties of care and loyalty") refers to Art. 6(1) FIDLEG (general principles of rules of conduct). As a result, all duties according to Art. 6 to 36 FIDLEG (rules of conduct, organisational requirements, etc.) apply in the same way. Therefore, the rules of conduct of FIDLEG apply (e.g. to the distribution of

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motor vehicle liability insurance, travel insurance, legal expenses insurance, etc.). This reference is not appropriate and has to be corrected. According to Article 6(3) FIDLEG, further stipulations and requirements may apply.

Accordingly, all insurance intermediaries are required to apply all rules and regulations of the Insurance Contract Act (VVG) and the Insurance Supervisory Act (VAG). The regulation of insurance intermediation becomes unclear and a confusing double regulation results.

3.3 Duties to disclose information

In addition to the existing duties to disclose information, insurance intermediaries have to provide information on the services offered and any relevant interests (e.g. the insurance intermediary acts in the interest of the client only), and state whether their advice is based on a well-balanced analysis. Should the advice be based on a well-balanced analysis, it must be supported by an adequate number of marketed insurance contracts and be suited to the client and his/her needs.

3.4 Rules of conduct

Prior to concluding the insurance contract, the insurance intermediaries determine the objectives and needs of the insured person, and if they provide advice, are obliged to explain the basis of their advice. If the insurance intermediaries hold a fiduciary relationship with their clients and are acting on their behalf, they are obliged to adhere to the rules of conduct when accepting any benefits. The rules of conduct pursuant to Art. 45a VAG do not include a clear distinction between independent insurance brokers and tied insurance intermediaries. Therefore, the suggested rules of conduct result in a lack of legal certainty and legal clarity.

3.5 Professional education and development obligations

Insurance intermediaries are obliged to possess adequate knowledge of the rules of conduct according to FIDLEG and of the technical skills required for their professional activities, specifically:

- Knowledge regarding the duties to disclosure information to clients
- Knowledge of the rules of conduct
- Knowledge of whether and how adequacy and suitability assessments are to be carried out
- Knowledge of documentation and accountability obligations
- Knowledge of products

In order to ensure that insurance intermediaries maintain and enhance their knowledge and remain informed about developments in the financial markets and the regulatory environment, regular education is required.

4. Additional client adviser obligations under FIDLEG

4.1 Client segmentation

In line with the Federal Act on Collective Investment Schemes and MiFID II, FIDLEG also provides for client segmentation. FIDLEG differentiates between private clients, professional clients and institutional clients. Institutional clients are a subgroup of professional clients. In order to adequately address client needs, FIDLEG provides for Opting-out and

Opting-in facilities. The scope of the rules of conduct vary for the different client segments. In the area of redeemable life insurance products the majority of clients are likely to belong to the private client segment, to which the rules of conduct are applicable.

4.2 Duties to disclose information

Client advisers' disclosure obligations are stipulated in Article 7 FIDLEG, Article 45 VAG and in Article 3 VVG. The planned architecture of the Financial Markets Legislation means that the disclosure obligation must adhere to three different federal laws. The disclosure obligation must be fulfilled prior to the conclusion of an insurance contract. If conditions have changed since the date of the original disclosure a new obligation of disclosure applies in line with the explanatory report to the consultation draft of June 25, 2014.
If a product is offered as part of a package, the financial services provider must inform the client whether the individual contents may also be acquired separately, and state the cost of each individual item. Unit-linked life insurance products may also be subject to this additional disclosure obligation.

4.3 Suitability and adequacy of financial services

Depending on the type of financial service provided, an assessment of suitability or appropriateness is required. Investment management services and investment advisory services require a suitability assessment. All activities that require a power of attorney to be granted to the financial service provider in order to invest assets on behalf of the client are considered investment management activities. Investment advice is established if the financial service provider recommends to certain clients an investment in, or divestment of, financial instruments.

> "The provision of redeemable life insurance products requires, in most cases, a suitability assessment in accordance with FIDLEG".

For other financial services (i.e. those that are not investment management or investment advisory services) an appropriateness assessment is sufficient. In the case of financial services for professional clients, certain facilitation provisions are set out.

4.4 Documentation and accountability

Financial services providers document the services agreed with their client and the client information they collected; they also document the services provided to the client. If suitability or appropriateness assessments were undertaken, the risk profile and the investment objectives of the client, as well as the basis of the recommendations provided must be documented. The client is to be provided with a copy of the documentation and regular reports on the services provided.

4.5 Transparency and duty of care for client engagements

Financial services providers adhere to the principles of good faith and equal treatment. Furthermore, the law requires the duty of the best possible execution of client instructions and the use of the client's financial instruments.

4.6 Basic information sheet

Insurance products do not represent securities and are therefore not subject to any securities prospectus requirements. For redeemable life insurance products including a further financial instrument (e.g. collective investment schemes), however, a basic information sheet must be prepared. The basic information sheet must be given at the point of sale. The insurer is obliged to regularly review the statements contained in the basic information sheet. In the case of unit-linked life insurance products the basic information sheet must cover, in addition to the provisions relating to the insurance law, those relating to collective investments.

5. Enforcement of legal rights

The consultation draft on FIDLEG stipulates a number of provisions which would facilitate a simplified enforcement of claims. Hence, the reversal of the burden of proof, a strengthened ombudsman office, a court of arbitration or, alternatively, a cost of litigation fund and various instruments of collective redress (collective action and group settlement proceedings) are foreseen.
It is intended that the burden of proof lies with the financial services provider of having fulfilled his/her legal information and disclosure obligations. Failing this, it is assumed that no transaction was executed.

The insurance industry already has an ombudsman office, albeit on a private basis. Over and above this existing ombudsman office, it is suggested that financial services providers join an

ombudsman office in accordance with FIDLEG and provide it with financial support. It is questionable whether a governmental ombudsman office would in actuality improve how policy owners' needs are met.
The means suggested for the enforcement of legal rights will ultimately lead to higher costs. Insurers will try to pass on such costs to their clients in the form of higher premiums. In particular, the suggestions for enforcing legal rights are not supported by the Swiss Insurance Association.

6. Implications of FINIG for insurers
Insurers under VAG are not subject to FINIG rules. However, within FINIG's implementation framework, amendments to the VAG are planned. According to Article 14a VAG the provisions of FINIG with regard to fiscal conformity (Article 11 FINIG) must be correspondingly applied to insurers as well. Insurance companies are obliged to adhere to an extended due diligence with regard to the acceptance of undeclared money, thereby enforcing a white money strategy for all insurance companies. Such provisions should not be considered a FINIG and VAG subject matter and would rather be integrated e.g. into the Anti-Money Laundering Act.

7. Developments in the EU
In the framework of MiFID II, an additional chapter was introduced to Directive 2002/92/EG ("Insurance Mediation Directive" or IMD) regarding insurance investment products, covering general principles on conflicts of interest and client information. The revision of IMD has already consumed considerable time and has not yet been concluded. IMD is expected to be renamed, in future to be called „Insurance Distribution Directive" ("IDD") and will apply to all sectors and distribution channels. In terms of content, similar rules of conduct must be observed as for securities companies in line with MiFID II.
Recital 87 of MiFID II states that, in connection with insurance contracts, it is more meaningful to integrate the MiFID provisions into the IMD (i.e. IDD). From a Swiss point of view, consistency between different financial services providers could also be achieved within the process of revising the VAG and VVG.

"In view of the specific requirements of the insurance industry, a revision of the VAG and the VVG would be more appropriate."

8. Conclusion

Despite FIDLEG and FINIG foregoing a differentiation between dependent and independent intermediaries in connection with registration obligations, two categories of insurance intermediaries are introduced:
- Insurance intermediaries which are not client advisors under FIDLEG,
- Client advisors under FIDLEG

The client advisors under FIDLEG must comply fully with FIDLEG provisions. The insurance intermediaries which are not client advisors under FIDLEG are affected by the regulatory project through the planned amendments to the VAG.
The impacts of FIDLEG and FINIG on the insurance industry would be substantial, and the implementation would result in a significant effort. A revision of the VAG and the VVG would better meet the needs of the insurance industry. The objective of attaining pan-sector coherence could still be achieved.

Implementing the AEoI – the challenges for insurers

The OECD took a decisive step toward international tax transparency when it presented the future standard for the Automatic Exchange of Information (AEoI) on July 21, 2014. The AEoI will significantly affect both banks and insurance companies. This article focuses on the implications for insurers and the challenges they face in implementing AEoI.

Switzerland's path to the AEoI
Switzerland has been under increasing pressure for greater tax transparency since the global financial and economic crisis and the resultant, considerable financing needs of various countries. Prior to 2009, Switzerland provided administrative assistance to foreign states solely in the case of tax fraud. Six years later, group requests are now possible without the need to identify individual foreign taxpayers by name. This trend toward more tax transparency will not stop until the AEoI is established as the global standard.

Switzerland has been involved in the development of the OECD standard in order to avoid being sidelined as a financial center, leveling the playing field instead. On January 14, 2015, the Federal Council launched the consultation on the implementation of the AEoI in Switzerland.

Simple implementation of the AEoI is critical
The AEoI is the ***systematic and periodic transmission of information*** of a taxpayer's assets and income in a country, usually conveyed to the taxpayer's country of domicile. For the tax authority in the country of domicile, it would be most convenient for information to be transmitted in the same format as domestic tax return filings, facilitating the checking of whether taxpayers have correctly declared the relevant revenues in their tax return.

Swiss financial institutions, meanwhile, would prefer it if the information to be transmitted could be easily extracted and prepared. If financial institutions must calculate the taxable income or capital gains for each country according to the applicable tax law, for instance, this would give rise to huge expenditures. The aim of the OECD's proposed standard is to achieve a uniform implementation of the AEoI in all participating countries. This allows Swiss financial institutions to report client data in a consistent way, without having to comply with different rules for each recipient country.

Contents of the presented standard
The presented AEoI standard consists of several elements, including:
- The Multilateral Competent Authority Agreement, MCAA
- A standard that defines the conditions for the exchange of information and client identification rules (Common Reporting Standard, or 'CRS')
- An interpretative commentary
- The basic framework of a reporting format (Common Reporting Standard User Guide).

The MCAA, which is part of the current consultation, serves as a basis for bilateral agreements. It specifies which information must be transmitted and regulates certain transfer methods for the information to be exchanged. In addition, the model agreement governs the cooperation between competent authorities in the case of errors, application issues and differences in interpretation. It guarantees sufficient data protection and compliance with the principle of specialty. This principle ensures the information exchanged is used exclusively for the purpose stipulated in the agreement, in this case for the assessment and collection of taxes. The model agreement further guarantees reciprocity in terms of identical duties and obligations for both countries.

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Life insurers as well as banks must report information under the AEoI

The Common Reporting Standard (CRS), which is an annex of the MCAA and also part of the current consultation, provides clear instructions on who is to transfer what information on which accounts. Financial institutions required to collect their clients' financial data do not only include banks but also certain collective investment instruments and Specified Insurance Companies. A Specified Insurance Company is an entity that issues, or is obligated to make payments with respect to, a Cash Value Insurance Contract or an Annuity Contract. This definition is directly from FATCA (Foreign Accounts Tax Compliance Act). Whoever reports under FATCA will also report under the AEoI.
This impacts the entire pillar 3b life insurance industry, provided the product in question has a repurchase value (all unit linked products are in scope, not just classical "insurance wrappers"). The only exemption is for pure mortality risk covers (term life).

Information to be reported with respect to insurance contracts

In the case of affected Cash Value Insurance Contracts or Annuity Contracts, the Cash/Surrender Value as well as total gross amount paid or credited to the account holder (including the aggregate amount of any redemption payments) during the reporting period need to be reported. The underlying funds backing the policyholder reserves are not reported.

Affected insurance contracts

All Cash Value Insurance Contracts or Annuity Contracts with an account holder resident in an AEoI country are subject to reporting under the AEoI. The definition of the account holder is the same as under FATCA. In other respects, however, there will be significant increases in complexity, due diligence and reporting requirements compared to FATCA. For example, no exemption from pre-existing account review is available for policies with values below USD 250,000. Furthermore, not only US persons are affected but all account holders resident in one of the many future AEoI states.

If the value of an affected insurance contract does not exceed one million USD or CHF (the financial institutions can choose whether to apply the USD or CHF thresholds) generally a electronic record search is required to identify affected insurance policies. If, however, the value exceeds one million USD or CHF, the insurance company is generally required to not only conduct an electronic record search, but also a paper record search as well as a relationship manager inquiry to identify all account holders resident in an AEoI country. If the account holder is a wealth management structure, the beneficial owner of the structure must be identified.

Regularization of past tax obligations is not part of the AEoI standard

Although most insurance contracts subject to reporting are declared by the policyholder in accordance with the tax legislation of his/her state of residence, there may also be undeclared policies or policies with premiums paid for with undeclared funds, especially in Luxembourg or Liechtenstein subsidiaries of Swiss insurance groups set up for cross-border business.

The OECD standard on the AEoI does not include any rules regarding the regularization of any past tax obligations.
Consequently, the only option for clients who did not fully comply with their tax obligations in the past is to submit a voluntary disclosure in the country of residence. It is our experience that some countries offer tax amnesties for a specific period of time while other countries will tighten the rules regarding voluntary disclosures. For this reason, insurance clients with undeclared assets should file a voluntary disclosure as soon as possible. We can assist such clients on a worldwide basis (please see for further information www.kpmg.ch/voluntary-disclosures).

Rapid implementation of the AEoI is on the agenda

Due to pressure from the OECD, EU and G20 countries, the AEoI will prevail as the global standard.
Already in April 2013, France, Germany, Italy, Spain and the UK launched an initiative to adopt the AEoI early. Since this date, around 50 countries, including many EU member states but also financial centers such as Liechtenstein, Bermuda and Jersey have joined the so-called Early Adopters Group. In those countries, the new account opening procedure to record tax residence must be in place from January 1, 2016 and the first exchange of information will take place in September 2017. Switzerland cannot join the Early Adopters Group, as legislative procedures do not allow the AEoI to be introduced before 2017 (first reporting 2018). It would be wrong to conclude from this that there is plenty of time. Most Swiss life insurance groups have branches or subsidiaries in Early Adopter countries, so the only choice is to implement AEoI for the entire group during 2015, or to tackle Switzerland in a second phase.

Impact analysis as a first step towards implementing the AEoI

Given the inevitability of AEoI and the short timeline (particularly considering the Early Adopter countries' timeline), insurance companies should already now assess in detail the impact of the AEoI on their business model and processes.
The gaps and corresponding implementation will be greatest for those insurance companies who implemented FATCA based on manual procedures. The absence of the FATCA pre-existing account review exemptions, the fact that dozens of countries (not just the US) are in scope and that residence can and does change, all mean a significant investment in IT and manpower will be required.
In addition, some policyholders may expect assistance with respect to regularizing the past; at least reliable contacts with tax specialists who can analyze the policyholder's specific tax situation.

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