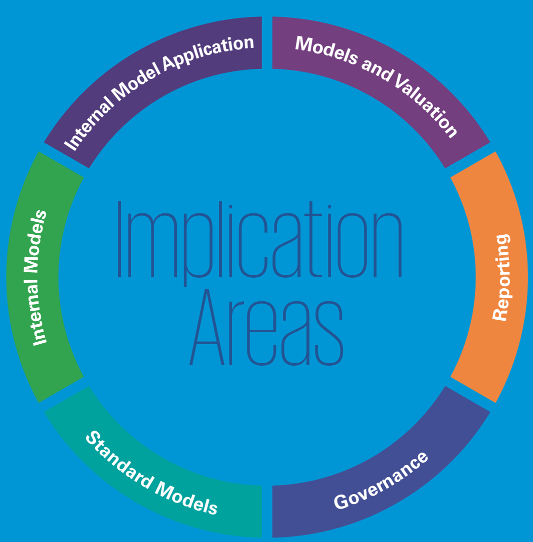
Revision of FINMA's SST Circular

Actuarial and Insurance Risk

kpmg.ch

On 31 May 2016, FINMA opened the consultation phase for the new Swiss Solvency Test circular ("SST circular") which closes on 12 July 2016. The new SST circular will replace the current SST circular 2008/44 from 1 January 2017 and is a complete revision to circular 2008/44. It includes certain major and numerous minor changes. In this fact sheet we summarize the main changes and potential implications.



At a glance

- Clarifications and new specific assumptions to be applied to the valuation at the end of the one-year SST period. Since this may have material impacts – in particular in Group Life business – there will be a transition period until 1 January 2020;
- New SST Ratio definition in line with Solvency II concerning the allocation of the Market Value Margin. This increases the SST Ratio for companies in the green zone;
- Further documents are required for Internal Models and the Internal Model application process;
- Additional reporting of stress tests to FINMA; and
- Various additional minor amendments.

Models and Valuation

Valuation at the End of the one-year SST Period

FINMA rigidly specifies the valuation methodology at the end of the one-year SST period. The valuation has to be consequently based on the principle that the company is in run-off at the end of the one-year SST period. The main assumptions are as follows:

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

These changes may have material impacts, in particular for Group Life business. From our perspective, the interpretation and consequences of the new assumptions require further discussions and a common understanding. Due to implementation efforts (in particular the development of a new Life Standard Model) there is a transition period until 1 January 2020.

Definition of SST Ratio

The SST Ratio is defined in line with Solvency II (RBC= Risk Bearing Capital at SST date, TC = Target Capital, MVM = Market Value Margin, r = one-year risk-free interest rate) as

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

Currently, the SST Ratio is defined as RBC/TC, where the MVM is considered as part of the Target Capital. The new definition will increase the SST Ratio for companies with an SST Ratio above 100%.

Currency of Balance Sheet

The currency of the balance sheet has to be in the currency of the majority of assets and liabilities at the end of the one-year SST period. Previously the companies were free to choose.

(Ceded) Reinsurance and Retrocessions

The best estimate of (ceded) reinsurance and retrocessions are reported as an asset. Formerly it was considered as a negative liability.

Capital and Risk Transfer Instruments

FINMA lists criteria when capital and risk transfer instruments, depending upon the SST Ratio of the contractual partner, can be considered in the Target Capital.

Materiality

The quantitative materiality limit is defined by a relative change of 10% of the SST Ratio. Previously the quantitative materiality limit refered to a relative change of 10% of the SST Ratio and either of the Risk Bearing Capital or Target Capital.

Reporting

SST Reporting

FINMA puts more emphasis on the following points as part of the yearly SST Report:

- Qualitative and quantitative description of the expected development of the balance sheet positions over the one-year SST period;
- Consequent comparison with last year's SST figures and comments on the rationales of changes;
- Statement of all material parameters used in the SST model, and comments on the changes to last year; and
- Disclosure of assumptions and opinions based on expert judgment.

FINMA will define a minimal structure for market, credit and insurance risk.

Stress Test Reporting

FINMA may demand additional stress test analysis. The company submits a corresponding report on the consequences and potential measures in case of the occurrence of such an event.

Governance

There are the following new guidelines:

- If the company outsources the SST calculations, it has to review prior to submission and retain formal documentation thereof; and
- Projections are in line with internal business forecasts and with ORSA.

There is one modification:

- Outstanding events have to be immediately reported to FINMA. If the SST Ratio is above 190%, then they have to be reported if the relative change of the SST Ratio is above 33%. With an SST Ratio below 190%, the limit is a relative change of the SST Ratio of 20%. Previously the threshold was 150%.

Standard Models

FINMA states clearly the following:

- The use of modelling techniques which are not described in the Standard Model need the antecedent approval of FINMA; and
- FINMA decides on an individual basis if a modelling technique is considered as an Internal Model (and therefore subject to approval) or not.

Internal Models

Internal Model Documentation

The Internal Model requires additional documentation to the Technical Documentation:

- Document with a description of the risk profile and the main risk drivers;
- Model governance document; and
- A guidance document describing the validation process of the Internal Model.

Material Model Changes

A material model change occurs if one of the following condition is fulfilled:

- Relative change of the SST Ratio above 5%; or
- Conceptual changes, new methods, data or business areas.

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

Internal Model Application Process

The process holds:

- For the use of a (Partial) Internal Model;
- For the unconditional approval of a conditional approved Internal Model; and
- For material Internal Model changes.

The new SST circular extends the existing guidance that additionally a validation report is required as part of the model application package.

Considerable impact Moderate impact

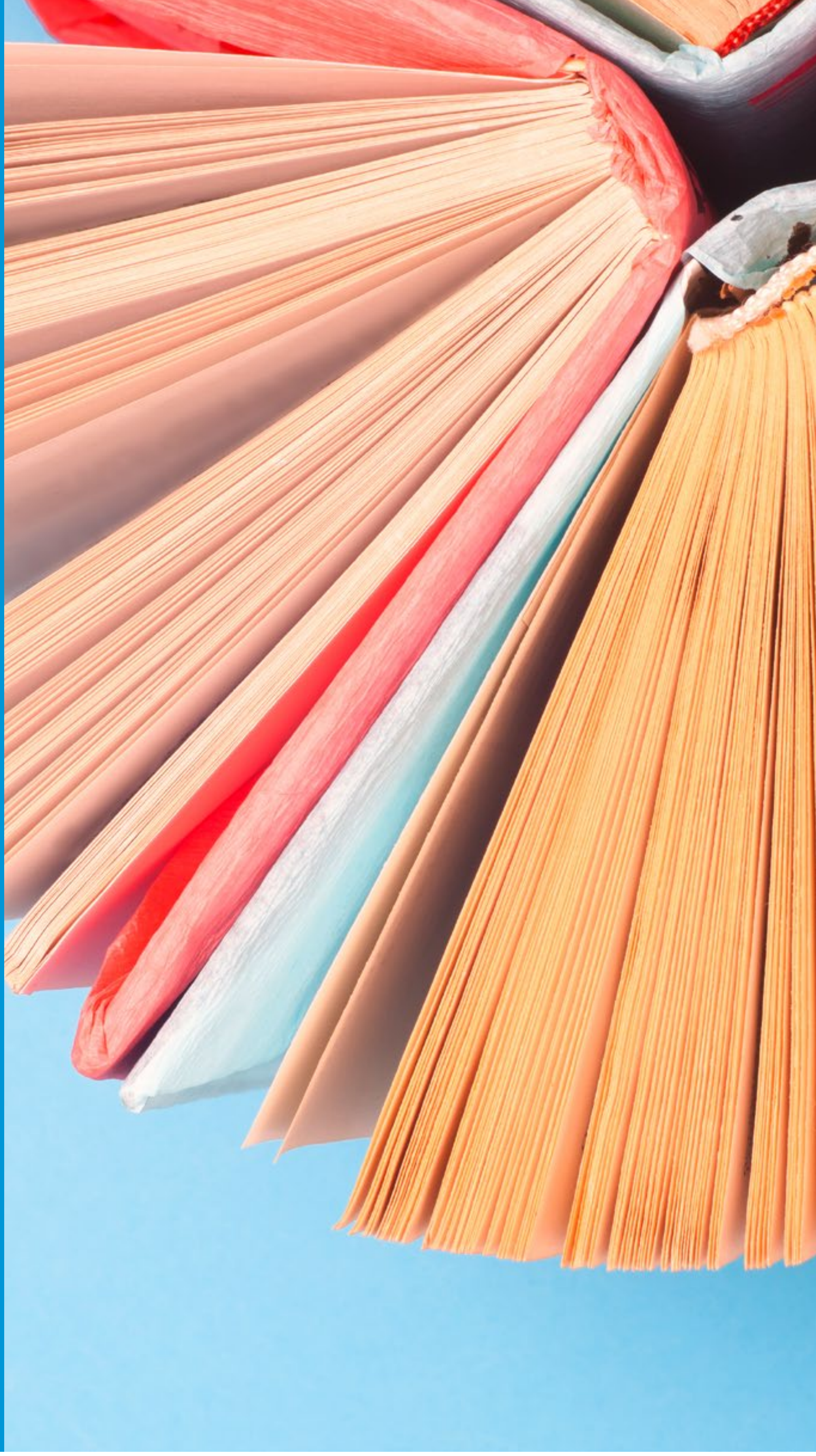
Timeline and Milestones

- 31 May 2016 – 12 July 2016: Consultation phase;
- 1 January 2017: Planned effective date;
- 30 April 2017: Submission of SST 2017 based on the new SST circular (except for the new valuation at the end of the one-year SST period); and
- 1 January 2017 – 1 January 2020: Transition period for the implementation of the new valuation methodology at the end of the one-year SST period.

Other Circulars in Consultation Phase

FINMA opened the consultation phase for further revised and new circulars, which are planned to entry into force as at 1 January 2017:

- "Responsible Actuary" on the requirements for the Responsible Actuary;
- "Corporate Governance Insurers" on corporate governance, risk management and internal control systems; and
- "Business Plans Insurers" on the requirements for the business plans submitted to FINMA.



Contact

KPMG AG
Badenerstrasse 172
PO Box
8036 Zurich

kpmg.ch

Thomas Schneider
Partner
Head Actuarial and Insurance Risk
+41 58 249 54 50
thomasschneider@kpmg.com

Will Southwell
Director
Head Non-Life Actuarial and Insurance Risk
+41 58 249 62 94
wsouthwell@kpmg.com

Harald Dornheim
Senior Manager
Life Actuarial and Insurance Risk
+41 58 249 54 77
hdornheim@kpmg.com

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received, or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. The scope of any potential collaboration with audit clients is defined by regulatory requirements governing auditor independence.

©2016 KPMG AG is a subsidiary of KPMG Holding AG, which is a member of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss legal entity. All rights reserved.