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Selected innovations regarding the partial ISA revisions (Part 1/3): Tied assets

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Key takeaways

- At the same time as the partially revised Insurance Supervision Act (ISA), the downstream implementing provisions, the revised Insurance Supervision Ordinance (ISO) together with the revised FINMA rules, the Insurance Supervision Ordinance-FINMA (ISO-FINMA) and the revised circulars, are to enter into force on January 1, 2024.
- Currently, the total revision of the ISO-FINMA as well as of various FINMA circulars (five will be continued, seven will be repealed) is also taking place. The associated consultation runs from August 22 to November 22, 2023.
- With regard to the investment regulations for the tied assets management, certain elements regarding both the investment limits and the use of derivatives are restated more flexibly.

Introduction

On January 1, 2024, the partially revised Insurance Supervision Act (ISA) will enter into force. This means that the general overhaul of Swiss financial market legislation may be considered (provisionally) complete (see our Legal Update of October 11, 2022 for information on the planned revision of the Financial Market Infrastructure Act (FinMIA), which entered into force in 2016). The new ISA has been amended and updated in certain respects to strengthen the competitiveness of the Swiss insurance center. The main innovations include the revised provisions on solvency, the promotion of innovation through the introduction of a "sandbox," the liberalization of non-insurance business, the targeted strengthening of the Swiss reinsurance hub, and the introduction of a reorganization scheme as an alternative to bankruptcy following the model used in banking legislation. In the course of legislative work on the Financial Services Act (FinSA), Parliament decided that the FinSA rules of conduct would not apply directly to insurance companies but would be incorporated into the ISA. Accordingly, the new ISA contains, among other things, the rules of conduct for insurance intermediaries aimed at strengthening advice at the point of sale.

After Parliament adopted the text of the revised ISA in the final vote on March 18, 2022, work could begin on implementing legal acts. The revised Insurance Supervision Ordinance (ISO), together with the revised FINMA rules, the Insurance Supervision Ordinance-FINMA (ISO-FINMA), and the revised circulars, will also enter into force on January 1, 2024.

Implementing rules with more flexibility

Overview

At the first downstream stage, the Federal Department of Finance (FDF) published the draft of the new ISO on May 17, 2022. The consultation lasted until September 7, 2022, during which interested parties submitted a large number of comments.

The revised ISO is intended to implement the stated objectives of the partial ISA revisions. These revisions include, in particular, the implementation of relief or exemption from supervision for small insurance companies, the introduction of rules of conduct in distributing qualifying life insurance policies, and the specification of requirements for the insurance special purpose entity.

On the second downstream level, the ISO-FINMA and various FINMA circulars are currently being over-hauled. The associated consultation runs from August 22 to November 22, 2023.

FINMA rules

Among other things, FINMA proposes to adjust its requirements for the SST, tied assets, and technical provisions. These topics shall now be regulated mainly in the ISO-FINMA instead of in the relevant circulars. With regard to the SST, this regulation change was initially outlined in the dispatch Botschaft on the partially revised ISA. This would enable FINMA to abolish a total of five circulars, while the remaining seven circulars would be significantly shortened. Furthermore, the work includes adjusting the implementation of the transparency rules for life insurance, technical aspects regarding the supervision of insurance intermediaries (rules of conduct are one of the main additions to the revised ISA), and the tasks of the responsible actuary.

Investment guidelines for tied assets

Among the seven circulars to be repealed as part of the revision work is FINMA Circ. 16/5 "Investment Guidelines - Insurers" of December 3, 2016 (last revised on January 1, 2018).

The provisions on tied assets are generally rooted in Art. 20 ISA and will be retained in a redrafted form. The Prudent Person Principle ("PPP") is newly included (cf., for the EU Art. 132 of the Solvency II Frame-work Directive and for Germany Art. 124 of the Insurance Supervision Act). According to the PPP, insurers may only invest in assets whose risks can be adequately identified, measured, monitored, and managed. All assets must be invested in a manner that ensures the safety, quality, liquidity, and profitability of the entire portfolio. As a consequence of introducing the PPP, the investment, as such, shall no longer be restricted by external quantitative rules (e.g., 20% for foreign currencies, 30% for equities, or 25% for real estate) as was previously the case in FINMA Rs. 16/5. Instead, the insurer shall create an internal investment catalog describing its investment universe and defining its own limits it must adhere to when investing capital.

The new implementing provisions on investments in tied assets are inserted as Art. 75a et seq. ISO. They essentially replace the provisions on investment guidelines from the FINMA circular. According to the revised Art. 79 para. 1 ISO, insurers may now submit a list of assets to FINMA for approval, which may be included in the investment universe for tied assets. Until now, this list has been prescribed by the ordinance. Under the newly worded Art. 83 ISO, these insurers are given the flexibility to determine the quantitative investment limits independently, as long as they can ensure PPP's implementation.

Comparison with provisions of the occupational pension plan

In the area of occupational pensions, extensive investment restrictions are found in Art. 50 et seq. of the Ordinance on Occupational Retirement, Survivors' and Disability Pension Plans (BVV 2), which have been repeatedly supplemented in recent years (e.g., most recently by allowing infrastructure investments). A motion submitted in 2021 entitled "Secure pensions thanks to comprehensively competent management of pension fund assets" envisaged, among other things, to supplement the current principle of risk diversification with comprehensive risk management and with rigid category limits being dropped, as is now the case in the ISA. The introduction of the PPP in occupational pensions could have implemented this idea, but the motion was rejected in 2023. Nevertheless, Art. 50 para. 4bis BVV 2 already offers pension funds a certain degree of flexibility, which is somewhat comparable with the new provision of Art. 83 para. 2 ISO (exceptional approval instead of prior approval).

Derivatives regulations

In principle, derivatives are already permissible for tied assets under current law. The strictly applied coverage principle, however, represents a relatively narrow corset. Both the newly formulated Art. 100 of the revised ISO and the now proposed Art. 65 et seq. of the draft ISO-FINMA are formulated in a more principled manner, so that the regulation, as a whole, is greatly streamlined. Retained is the coverage obligation to avoid a leverage effect on the tied assets (Art. 100 ISO, Art. 65 draft ISO-FINMA). The rules for measuring leverage shall now be largely aligned with the Commitment Approach I under FINMA's Collective Investment Schemes Ordinance (CISO-FINMA), which would lead to greater consistency in the regulation of comparable facts. In particular, opposing exposures may be offset under certain circumstances (Art. 69 para. 2 draft CISO-FINMA).

Next steps

The consultation period on the ISO-FINMA will run until November 22, 2023. In the future, insurers will be required to adapt their investment processes accordingly, i.e., in particular, to document their investment universe if they wish to benefit from the additional flexibility.

In the second installment of our Legal Update on the revised ISA, we will cover the new rules of conduct for insurance intermediaries.

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No legal or tax advice

This legal update provides a high-level overview and does not claim to be comprehensive. It does not represent legal or tax advice. If you have any questions relating to this legal update or would like to have advice concerning your particular circumstances, please get in touch with your contact at Pestalozzi At-torneys at Law Ltd. or one of the contact persons mentioned in this legal update.

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