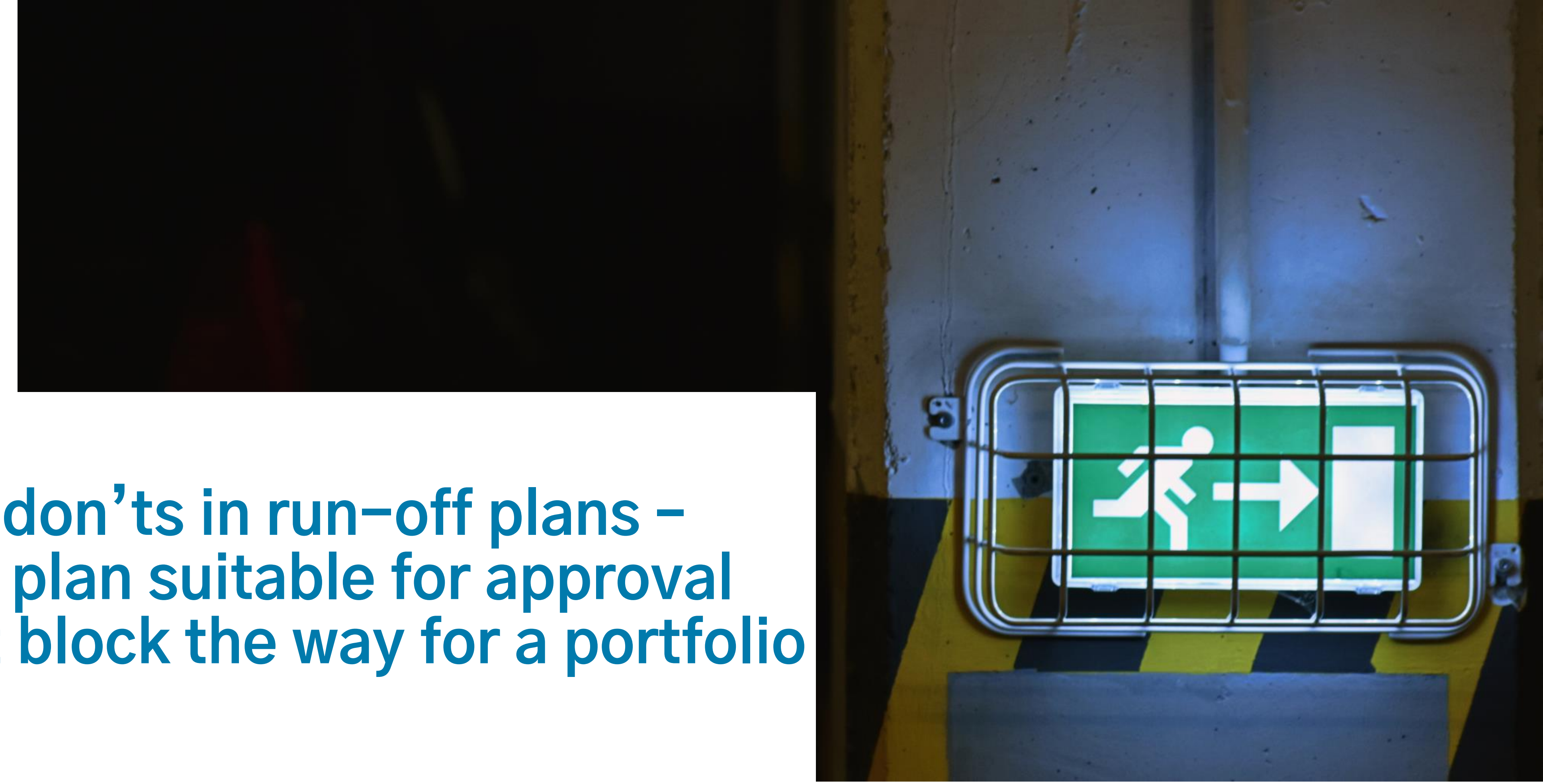

"Do's and don'ts in run-off plans – make your plan suitable for approval and do not block the way for a portfolio transfer"

Swiss Run-Off FORUM 2022

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Introduction

- In this presentation, we will focus on the Swiss run-off regime according to art. 60 of the Swiss Insurance Supervision Act („ISA“).
- We will not go into „run-offs“ (expirations) of individual contracts or books of insurance.
- We will talk about:
  - The structuring of run-off plans;
  - Getting your house in order (and unwanted guests);
  - Degrees of certainty and finality;
  - The trouble with oblivion;
  - Why one must have money; and
  - The dreaded Swiss trap.

Structure of a Swiss Run-Off Plan

Structure of a Swiss Run-Off Plan
Legal Basis

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- A FINMA license is granted for one or more insurance classes (art. 6 par. 3 ISA).
- An insurance company that surrenders a license must submit a run-off plan to FINMA for approval (art. 60 Insurance Supervision Act, „ISA").
- Side note: FINMA may also withdraw an insurance company's licence to operate a particular class of insurance if it does not operate the insurance class in question (art. 61 ISA).
- According to art. 60 ISA, the run-off plan must (only) include information on:
  - The settlement of the financial obligations arising from insurance contracts;
  - The funds allocated for this purpose; and
  - The person responsible for this task.

Structure of a Swiss Run-Off Plan
Principles

- The run-off plan is the central element for the process up to release from supervision.
- It describes how (i.e. with which procedure, the person responsible for this task, in which period of time and with which means) an insurance company intends to bring itself to the state of readiness for release from supervision.
- The run-off plan is a consistent report that includes expected events or projections of the entire run-off period. In this report, important developments should be described and justified in a comprehensible manner.
- Ideally, the run-off plan should include not only best-estimates but also conservative estimates/projections.
- In a nutshell: The run-off plan must ensure the protection of policyholders and insured persons during the run-off period.

Structure of a Swiss Run-Off Plan
Best Practice

- In practice, a certain structure for run-off plans has become the norm, which is now also required by FINMA:
  1. Motivation, run-off strategy, run-off duration;
  2. Description of run-off portfolio;
  3. Financial obligations from insurance contracts;
  4. Financial means/resources;
  5. Projection of tied assets over run-off period;
  6. Solvency; and
  7. Organisation & persons responsible.

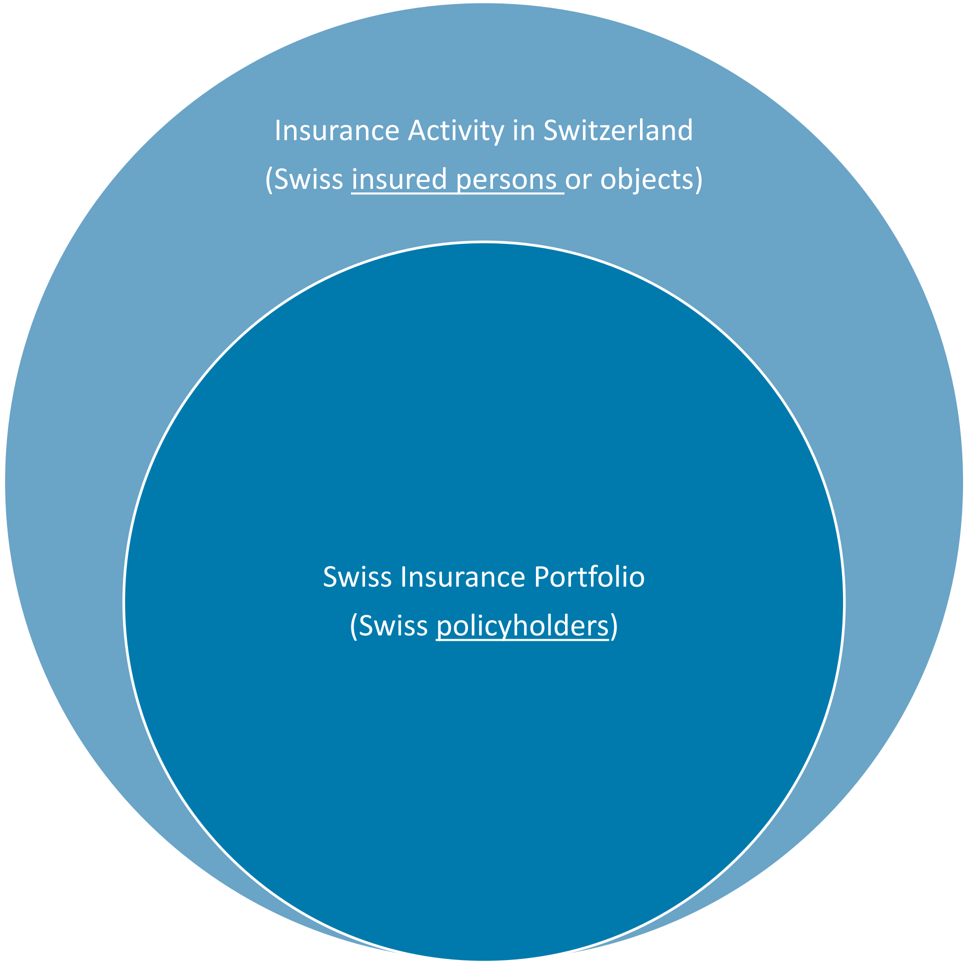
Get Your House in Order

Get Your House in Order

What should be in the run-off portfolio?

- The run-off of Swiss insurance business or a particular class of insurance requires an accurate inventory of the policies that fall into the run-off portfolio.
- Pursuant to FINMA, a Swiss insurance portfolio is defined as all insurance contracts with policyholders domiciled in Switzerland. For a foreign insurer, it would now be obvious to simply run off its Swiss insurance portfolio in order to achieve finality.
- But according to FINMA's (debatable) view, the question of whether a policy is part of a run-off portfolio is determined by the question of insurance activity in Switzerland and not by whether a policy belongs to a Swiss insurance portfolio.
- Are you confused? You should be: A Swiss insurance portfolio is not necessarily congruent with insurance activity in Switzerland!

Get Your House in Order
What should be in the run–off portfolio?



Get Your House in Order

Insurance Activity in Switzerland vs. Swiss Insurance Portfolio

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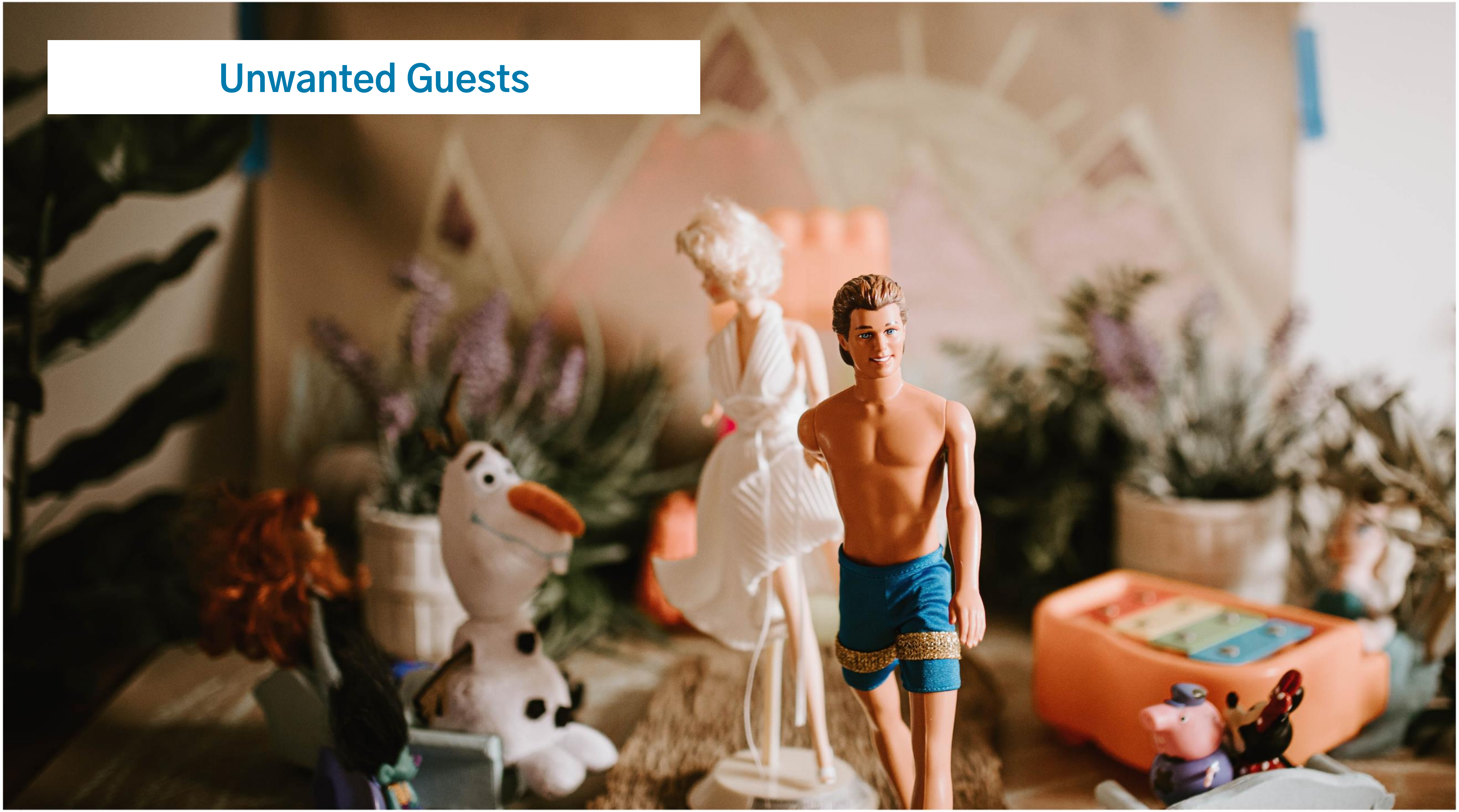
- An insurance activity in Switzerland exists irrespective of the type and place of conclusion of the contract if natural or legal person domiciled in Switzerland is one of the policyholders or insured persons or property located in Switzerland is insured (art. 1 par. 1 Insurance Supervision Ordinance, „ISO“).
- Consequence: The run-off of a Swiss insurance operation or class of insurance requires the inclusion of all policies with policyholders, insured persons and property domiciled or located in Switzerland – even if, for example, the policy has been underwritten by the foreign head office of the insurer with a foreign policyholder and the potential of insured persons in Switzerland.
- In other words: The run-off of a „Swiss insurance portfolio“ is not sufficient if you are aiming for finality in Switzerland!

Get Your House in Order

Insurance Activity in Switzerland vs. Swiss Insurance Portfolio

- This becomes a problem at the latest when finality is sought in Switzerland by means of a Swiss portfolio transfer or if auditors have to confirm unconditionally that finality has been achieved in Switzerland, because you might end up with some <u>unwanted guests</u> in your house.

Unwanted Guests



Unwanted Guests

The toxic mix of foreign law and insurance activities in Switzerland

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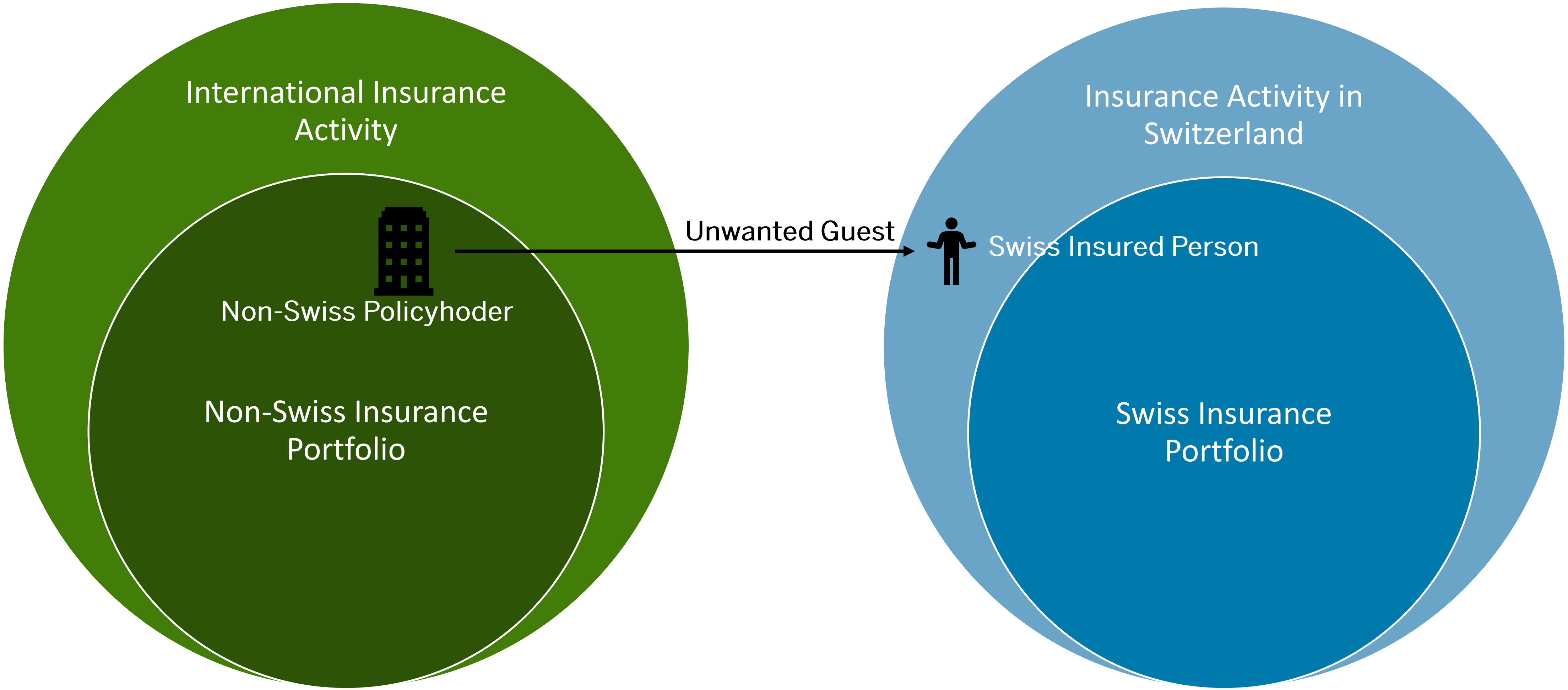
- Remember: For a run-off, the insurance activity in Switzerland in an insurance line is the decisive factor – and not the Swiss insurance portfolio.
- This is why unwanted guests can appear in a run-off. For example, under a D&O policy of a foreign company, insurance coverage may also exist for Swiss subsidiaries and their Swiss domiciled directors and officers.
- Since the possibility of the existence of even one insured person in Switzerland is sufficient for an insurance activity, the appearance of such a „foreign“ policy can lead to a run-off being decidedly prolonged due to the impact of foreign laws.
- In other words: Unwanted guests cause trouble with oblivion.

Get Your House in Order

Insurance Activity in Switzerland vs. Swiss Insurance Portfolio



The Trouble with Oblivion

The Trouble with Oblivion
Degrees of Certainty and Finality

- In FINMA's practice, a *probability bordering on certainty* that no more claims can arise from an insurance portfolio is not sufficient– there must be (absolute) certainty (cf. also Decision of the Federal Administrative Court of 29.1.2008, B-1299/2006).
- The duration of the run-off is hence primarily dependent on the applicable statute of limitations of each policy in the portfolio.
- The duration until possible claims of the last policy remaining in the portfolio becomes time-barred (+ the time for the verification of finality) results in the relevant run-off period, as only from this point on can *certainty* be assumed.

The Trouble with Oblivion

Statute of Limitation

- As a rule, the statute of limitations begins to run upon the occurrence of the fact that gives rise to the obligation to pay benefits under the insurance contract (for example, art. 46 Swiss Insurance Contract Act, „ICA").
- This can lead to completely different durations (simplification):
  - In the case of property insurance, the limitation period begins on the day of the damage to property – regardless of whether the damage was known at that time.
  - In liability insurance, the limitation period for a claim for compensation begins when the liability of the insured is established.
- In order to determine the necessary duration of the run-off, it is hence necessary to identify the law applicable to the policies in the run-off portfolio and its rules on the statute of limitations. In the case of foreign law, FINMA will request a legal opinion.

The Trouble with Oblivion

Actions Interrupting the Limitation Period

- Claims, debt collection demands and other actions interrupting the statute of limitations can decisively prolong a run-off, as this may restart the full limitation period.
- Such events must be reported to FINMA. In this case, the run-off plan must be recalculated and resubmitted to FINMA for approval.
- The relevant (and potentially prolonged) run-off period determines the period for which <u>one must have money</u> to settle all financial obligations and cover the costs of the run-off.

One Must Have Money

One Must Have Money

Run-off period as crucial variable

- Once the run-off portfolio is defined and there is clarity about the run-off duration, finances come into play.
- The run-off plan must provide information on the <u>settlement of the financial obligations</u> arising from insurance contracts and the <u>funds allocated for this purpose</u> for the duration of the run-off.
- Not only financial obligations from insurance contracts are to be taken into account, but also the operational costs of insurance operations.
- This can be painful: it is possible for technical provisions to decrease sharply and tend towards zero, while annual costs for FINMA supervision, auditors and other operational costs are incurred. This combined with a very long run-off period can lead to significant costs.
- In other words: <u>One must have money</u> for a Swiss run-off.

The Swiss Trap

The Swiss Trap

Risks of a run-off in Switzerland

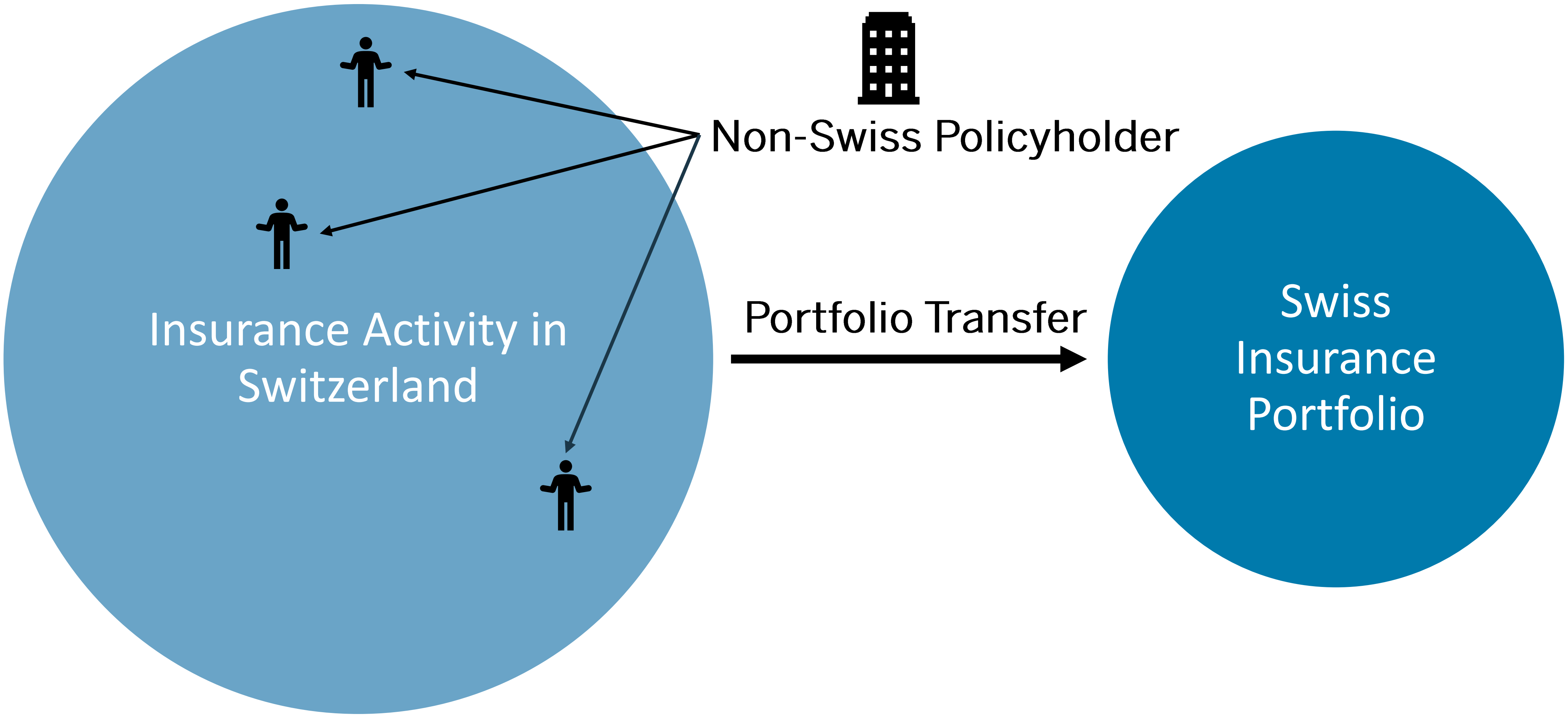
- It is possible that policies that should have been allocated to a portfolio in the past appear when determining a portfolio to be run-off. This can retroactively result in <u>insufficient technical provisions and insufficient tied assets</u>. It is even possible that this constitutes a criminal offence (cf. art. 86 and 87 ISA).
- It is also possible that a run-off plan will only be approved by FINMA with a <u>considerably longer duration</u> and with <u>significantly more financial resources</u> than originally planned.
- It cannot even be ruled out that the run-off plan will make it <u>impossible to transfer the portfolio in question</u> in the future with the aim of achieving finality in Switzerland.
- In summary: Unwanted guests might cause trouble with oblivion and might spring the Swiss trap!

The Swiss Trap
Risks of a run–off in Switzerland

- Why? Well, let’s remember:
  - A Swiss insurance portfolio is not necessarily congruent with insurance activity in Switzerland. The latter is however decisive for the run–off plan.
  - Once approved by FINMA, an insurer is locked into the run–off plan.
  - Due to the wording of art. 62 ISA, FINMA will only approve the transfer of a Swiss insurance portfolio (“If an insurance undertaking transfers its <u>Swiss</u> insurance portfolio, […]”).
  - <u>It is therefore quite possible that after the transfer of a Swiss insurance portfolio, a residue of policies resulting from Swiss insurance activities will remain</u>.
  - This blocks the finality necessary for release from supervision.

Get Your House in Order

What should be in the run-off portfolio?



The Swiss Trap
Possible Solutions

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- The problems described are primarily due to FINMA's interpretation of the law and could be solved as follows:
  - The concept of insurance activity in Switzerland should be merged with the international concept of risk location, at least in case of foreign Insures operating in Switzerland.
  - Art. 2 par. 1 lit. b ISA provides for a reservation for international treaties. There is therefore no reason why the concept of the location of risk should not be defined in accordance with the EU/UK-Switzerland Non-Life Insurance Agreements in case of foreign insurers operating in Switzerland.
  - The correct application of the law would eliminate the problem of unwanted guests. A Swiss run-off or a portfolio transfer would thus become possible without the difficulties described.

The Swiss Trap
Possible Solutions

- But as long as this is not the case, the following should be considered:
  - Do not go into run-off.
  - Only go into run-off once you have certainty regarding the composition of the run-off portfolio.
- And above all: Throw out all uninvited guests before you go into run-off!

Thank you for your attention!

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