Revision of the Insurance Supervision Act - Relief, exemptions and opportunities under the new regulatory and supervisory concept

19.11.2021

Pestalozzi Rechtsanwälte AG
Feldeggstrasse 4
CH-8008 Zürich
T +41 44 217 91 11
zrh@pestalozzilaw.com

Pestalozzi Avocats SA
Cours de Rive 13
CH-1204 Genève
T +41 22 999 96 00
gva@pestalozzilaw.com

pestalozzilaw.com

Key takeaways

As of today, the Insurance Supervision Act (ISA) in principle provides an equal level of protection for all types of insureds, meaning that there are no differences between private individuals, small companies and large corporations. As an exception, reinsurance companies are subject to less stringent supervision by the Swiss Financial Market Supervisory Authority (FINMA) (Art. 35 ISA).

The revision of the ISA fundamentally reverses this principle by setting up a new framework for the supervision of insurance companies. This new supervisory regime takes into account developments in the insurance market and adapts the protection of insureds through specific adjustments.

The following changes can be underlined:

- **Extension of the lighter regulatory regime to companies operating in the direct and in the reinsurance business with respect to their reinsurance activities**
- **Introduction of supervisory relief for insurance companies with professional clients with respect to their business with such clients**
- **Exemption from supervision of insurance companies of minor economic importance with innovative business models.**

On 3 May 2021, the draft ISA proposed by the government in October 2020 took a first hurdle in parliament. As one of two parliament chambers, the National Council discussed and adopted, among other changes, the new set of rules on the regulatory regime applicable to insurance companies.

The Council of States as the second chamber of the Swiss parliament is expected to follow the National Council in the adoption of these new rules upon discussion of the draft ISA, scheduled for December 2021. The new law is expected to enter into force in 2023 subject to the outcome of the discussions before the Council of States.

In connection with the above, the Insurance Supervision Ordinance (ISO) will be amended by the Federal Council. Further, the ISA revision triggers a need to revise the FINMA Insurance Supervision Ordinance and a series of FINMA circulars. These changes are expected to enter into force not earlier than beginning of 2024.

See also our legal updates relating to the new rules on insurance intermediation, the new restructuring framework for insurance companies and qualified life insurance products.

The current regulatory framework

The ISA as currently in force is fundamentally based on the principle that all insureds need the same level of protection, and therefore, does not differentiate between the levels of protection required by the different categories of insureds (e.g. private individuals, small and medium-sized enterprises, large customers, primary insurers). Under the current law, only reinsurance companies can benefit from a lighter level of supervision (Art. 35 ISA). As an exception, Art. 2 para. 3 ISA provides that insurers whose insurance activities are of minor economic importance or concern only a small group of insureds may be exempted from supervision by FINMA if justified by special circumstances. However, this exemption from insurance supervision is handled restrictively in practice by FINMA and the Swiss courts and is thus of little relevance.

The proposed new regulation

With the ISA revision, the decisive factor for regulatory and supervisory intensity vis-à-vis insurers will no longer be the purpose of their insurance relationships (primary insurance versus reinsurance), but the need for protection of their policyholders. For this purpose, different segments of insureds are defined as detailed below.

Relief for the insurance of professional insureds

Pursuant to Art. 30a draft ISA, insurers that are exclusively engaged in the insurance of professional policyholders can upon request be granted an exemption by FINMA from the following obligations:

- The duty to hold an organisation fund (Art. 10 draft ISA)
- Requirements regarding tied assets (Art. 17 to 20 draft ISA; Art. 54abis draft ISA)
- The possibility to adjust various categories of insurance contracts differently in the context of a restructuring (Art. 52e para. 2 draft ISA), and
- The duty to affiliate with an ombudsman’s office (Art. 82 to 82i draft ISA; however, these provisions were rejected by the National Council during the deliberations on 3 May 2021 and will thus most likely not be included in the revised ISA).

Professional policyholders are defined with reference to Art. 98a lit. b-f of the revised Insurance Contract Act and will include (i) financial intermediaries under the Federal Banking Act and the Collective Investment Schemes Act, (ii) insurers pursuant to ISA, (iii) foreign policyholders subject to equivalent prudential supervision as the persons referred to in letters (i) and (ii), and (iv) companies (public and private) outside the financial sector if they maintain a professional risk management system.

In order to benefit from this relief, insurers must assess and document the status of their insureds prior to concluding insurance contracts. In addition, insurers must inform their insureds that they are considered professional insureds and convey the legal consequences thereof (Art. 30b and 30c draft ISA).

Insurance companies that have both professional and non-professional clients can also benefit from the relief. However, the relief only applies to their business with professional clients (Art. 30a para. 3 draft ISA).

New rules applicable to captives

Further, Art. 30d draft ISA introduces for captives new exemptions from the following provisions:

- The duty to hold an organisation fund (Art. 10 draft ISA; Art. 15 para. 1 lit. d draft ISA)
- Requirements regarding tied assets (Art. 17 to 20 draft ISA; Art. 54abis draft ISA)
- Various rules applicable to specific types of insurances (Art. 32 to 34 draft ISA; Art. 36 to 39 draft ISA)
- The possibility to adjust various categories of insurance contracts differently in the context of a restructuring (Art. 52e para. 2 draft ISA)
- Additional safeguarding measures applicable to foreign insurers (Art. 57 to 59 draft ISA)
- Rules on portfolio transfers (Art. 62 draft ISA), and
- The duty to affiliate with an ombudsman's office (Art. 82 to 82i draft ISA – however, as mentioned above these provisions will most likely not be included in the revised ISA).

Captives that are subject to these exemptions are (i) insurers that belong to a company, group or conglomerate that is not otherwise engaged in the insurance business and (ii) that insure or reinsure risks of this company, group or conglomerate (Art. 30d para. 2 draft ISA). If such captive also provides insurance to third parties, the above exemptions do not apply to the captive's business with third parties (Art. 30d para. 3 draft ISA).

Exceptions for small insurance businesses and insurtech

The ISA revision further significantly extends possibilities to exempt certain insurers from supervision through the newly added wording in Art. 2 para. 5 lit. b draft ISA. The revised draft grants the Federal Council the power to introduce conditions under which small insurance companies may be exempted from supervision based on their business model, economic importance and the risks of the insurance product for the policyholders concerned, the volume of business and the group of insured persons. Such exemptions shall be subject to certain assurances such as guarantees regarding the registered seat of the company, the proper information of clients, etc.

During the deliberations before the National Council, the wording of Art. 2 para. 5 lit. b draft ISA was slightly amended. The new wording refers to 'insurers' as opposed to 'small insurers' with a possibility of partial or total exemption from supervision (as opposed to just total exemption in the initial draft). Further, the wording now refers to the criteria of minor economic importance and the small risks of the insurance product for the policyholders concerned.

The new regulation aims at safeguarding the future viability of the Swiss financial centre, in particular by offering new opportunities to companies with innovative business models, similar to the regulations in the financial sector.

As mentioned above, the currently applicable exception in Art. 2 para. 3 ISA (deleted in the draft ISA) is in practice interpreted very narrowly and thus of little relevance. With the new wording of Art. 2 para. 5 lit. b draft ISA, an exemption that is expected to be relevant for many small companies and insurtechs is introduced, creating new opportunities for such companies. The impact of this new provision will mainly depend on the Federal Council's regulation in that respect that will be introduced in the expected ISO revision, as well as on FINMA and the Swiss courts' interpretation of the new rules.

Exemption for annex insurance

The newly introduced Art. 2 para. 2 lit. f draft ISA exempts insurance intermediaries from supervision, provided that their intermediary activity relates to insurance that is of minor importance and complements a product or service. This exemption targets so-called annex insurance (eg. a cancellation insurance when booking a trip) similar to the Insurance Distribution Directive (EU Directive 2016/97). The Federal Council will define more precisely under which conditions this exemption applies (Art. 2 para. 4 lit. c draft ISA).

Continued relief for reinsurance into Switzerland

With the ISA revision, foreign insurers that only provide reinsurance in Switzerland remain exempted from FINMA supervision (Art. 2 para. 2 lit. a draft ISA). However, new is that the draft ISA now provides that the Federal Council shall define more precisely what is meant by 'insurance activities in Switzerland', which may lead to minor changes compared to current practice (Art. 2 para. 4 lit. a draft ISA).

Other exemptions

With the introduction of Art. 2 para. 2 lit. bbis draft ISA, foreign state-owned or state-guaranteed export risk insurance companies are newly exempted from FINMA supervision.
In addition, Art. 2 para. 2 lit. e draft ISA provides for a new exemption from supervision for associations, organisations, cooperatives and foundations that enter into security arrangements such as sureties or guarantees with their members provided that (i) their local area of activity is limited to the territory of Switzerland, and (ii) the profit generated is allocated to the respective contracting partners.

Allowed business activities

In its current version, Art. 11 ISA provides that, in principle, insurers may only conduct business that is directly related to their insurance activities. This rule significantly limits development opportunities for insurers in innovative and alternative fields.

With the revised Art. 11 draft ISA, insurers will still, in principle and subject to special FINMA approval, only be allowed to conduct business that is directly related to their insurance

activities.

However, Art. 11 para. 2 draft ISA amends that the Federal Council shall determine the details, taking into account in particular the risks associated with the business or service for the insurer and the policyholders. Depending on the Federal Council's regulations in this respect, possibilities offered to insurers may be slightly extended.

Considering the above restrictions, insurers may want to operate alternative non-insurance activities through subsidiaries that are not subject to FINMA supervision. In such cases, however, insurers will have to consider the required FINMA filings when acquiring certain participations in other companies (Art. 21 draft ISA).

Required business plan amendments

To benefit from the new relief provisions, insurers will have to declare within six months of the entry into effect of the revised ISA whether they conduct wholesale and/or captive business and whether they wish to conclude contracts with non-professional policyholders through an amendment of their business plan (form K) (Art. 90a para. 1 draft ISA).

Authors: Andrea Huber (Partner), Beat Schwarz (Partner), Catherine Hörr (Associate)

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 Attorneys at Law Ltd. or one of the contact persons mentioned in this legal update.

© 2021 Pestalozzi Attorneys at Law Ltd. All rights reserved.

Andrea Huber

Partner
Attorney at law, LL.M.

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 41
andrea.huber@pestalozzilaw.com



Beat Schwarz

Partner
Attorney at law

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 44
beat.schwarz@pestalozzilaw.com

