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Revision of the Swiss Insurance Supervision Act – Introduction of a new restructuring framework for insurance companies

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Key takeaways

The revision of the Insurance Supervision Act (ISA) includes new provisions regarding the restructuring framework for insurance companies. Most recently 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 (Nationalrat) discussed and adopted, among other changes, a new set of rules regarding the restructuring of insurance companies that are in financial distress.

As of today, the ISA only provides for limited options if insurance companies face financial distress. The Swiss Financial Market Supervisory Authority (FINMA) can either implement a number of limited protective measures, which usually do not provide for sufficient means in case of significant financial distress, or initiate bankruptcy proceedings causing a liquidation of the insurer. However, there is no middle path between these two options that would allow a significant and sustainable restructuring process similar to that applicable to banks, i.e. enabling financial health to be restored as an alternative to liquidation.

The revision of the ISA:

- **Amends somewhat the existing protective measures and bankruptcy rules; however, the rules already in place are essentially maintained;**
- **Introduces a new restructuring process for insurance companies, similar to the rules applicable to banks, while taking into account specificities of insurance companies;**
- **Updates the set of intervention measures FINMA can use to adequately address each specific case and achieve a suitable solution for insured parties without necessarily allowing the distressed insurance company to survive.**

The Council of States (Ständerat) as the second chamber of the Swiss parliament is also expected to follow the National Council in the adoption of these new rules relating to the restructuring of insurance companies. See also our legal update relating the new rules on insurance intermediaries and the draft ISA in general. The new law is expected to become effective in 2022 at the earliest.

Companies subject to the new restructuring regime

Art. 2a draft ISA provides that the new restructuring regime (including protective measures, restructuring measures and bankruptcy rules) also applies to parent companies of a group or conglomerate that are domiciled in Switzerland, as well as companies that fulfil essential functions for licensed activities (wesentliche Gruppen- und Konglomeratsgesellschaften). The aim of this new provision is to encompass companies whose bankruptcy may well affect the activities of other companies that are subject to FINMA supervision.

Protective measures (whether related to financial distress or to other issues)

As is already the case today, the slightly amended Art. 51 ISA sets forth the existing catalogue of possible protective measures that can be ordered by FINMA if deemed necessary to safeguard the interests of insured persons in case an insurance company fails to comply with the provisions of the ISA, an ordinance or orders issued by FINMA.

Therefore, FINMA can order protective measures even before a risk of insolvency arises, provided the interests of the insured persons are threatened. Protective measures include, for example, the deposit or freezing of assets, the transfer of all or part of the powers vested in the governing bodies of an insurance company to a third party, or a transfer of the insurance portfolio.

With the revision of the ISA, these protective measures are extended to significant group and conglomerate companies. In case of an insolvency risk, protective measures can be ordered independently or in conjunction with a restructuring or a bankruptcy proceeding as outlined below.

Measures in case of insolvency risk

The new law provides for an updated set of possible intervention measures in case of an insolvency risk, meaning that there are justified concerns that the insurance company is overindebted or suffers from serious liquidity problems (Art. 51a para. 1 draft ISA).

In case of an insolvency risk, FINMA can either initiate and order (i) protective measures (Schutzmassnahmen), (ii) a restructuring process (Sanierungsmassnahmen) or (iii) the bankruptcy of the company.
While the bankruptcy proceedings (see section 2.2 below) and protective measures (see section 1 above) already exist today, the revision introduces new restructuring proceedings (see section 2.1 below) that are available on top of these two existing measures.

Focus on the new restructuring proceedings

Much like the measures applicable to financially distressed banks, FINMA may in the near future also initiate restructuring proceedings for insurance companies if there is a reasonable prospect that an insurance company will be fully restructured or that at least parts of the insurer's business can be continued (regardless of whether such business is continued by the financially distressed company itself or by another insurer) (Art. 52a para. 1 draft ISA). The aim of restructuring is first and foremost the continuation of the insurance business and not per se the survival of the distressed company.

Such business continuation can be achieved by transferring the insurance portfolio to another insurance company or through the run-off of the existing insurance contracts in an orderly manner without concluding new business and the subsequent release of the company from insurance supervision.

FINMA can nominate a person responsible for and in charge of the implementation and execution of the restructuring plan (Art. 52a para. 3 draft ISA). The reorganisation plan sets out

how the risk of insolvency of the insurance company will be eliminated and what measures will be ordered for this purpose. In particular, it may provide for measures as described below.

Transfer of portfolio or parts of the insurance undertaking

The option to transfer all or part of the insurance portfolio (and/or other parts of the assets and liabilities of the insurer) as per Art. 52c draft ISA is to a large extent already in place under the current law as part of the protective measures. As a matter of principle, the legal entity taking over the insurance portfolio, or parts thereof, takes over the position of the transferring company, i.e. all rights and liabilities are transferred, following the rules of Art. 62 ISA. This means that the transfer is legally effective with the order of FINMA, whereupon policyholders need to be informed about the transfer and are granted the right to terminate the contracts.

In justified cases, the new law provides that FINMA can grant the company taking over the insurance portfolio certain reliefs with respect to supervisory requirements, provided that any such relief is justifiable with a view to ultimately serve the interests of the insureds.

Capital measures, reduction of liabilities and amendments of terms of insurance contracts

Art. 52d and 52e draft ISA provide for substantial intervention rights that may result in a heavy burden towards policyholders and equity holders, as well as third-party creditors of the insurer.

In case the distressed insurance company is in need of new equity capital, the subscription rights of current shareholders (to subscribe for new shares) may be excluded if the exercise of the subscription rights could jeopardise the restructuring. Further, the restructuring plan may provide for an equity reduction causing the existing shareholders to lose (all or part of) their equity investment.

Also, the restructuring plan may even provide for a forced reduction of existing third-party liabilities towards creditors. This means that the new law even allows a reduction in the amount the insurer owes to a policyholder or to other third-party creditors. Similarly, such liabilities may be converted into equity (debt-to-equity swap). As any such forced reduction or conversion constitutes an utmost heavy burden for any policyholder or other creditor, the new law provides, as a prerequisite before any such conversion or reduction of claims is permissible, that the existing share capital and risk-absorbing capital instruments must be reduced to zero. Thus, the existing shareholders or other equity holders lose their equity in full before any policyholder or other creditor is harmed.

In order to protect certain creditors, the new law defines a particular order of categories of liabilities that have to be reduced or converted as a matter of first priority (e.g. subordinated debt is forced into reduction or conversion before other liabilities). Certain categories of liabilities are even fully excluded from reduction or conversion. These include secured claims or claims from insurance contracts to the extent secured by tied assets (i.e. assets that serve the purpose to cover the liabilities towards policyholders).

Also excluded from conversion or reduction are claims arising from liabilities that the insurance company was permitted to enter into during certain protective measures or FINMA-approved restructuring proceedings. The goal is to protect claims of service providers and other creditors who continue to provide their services to the insurer during protective

measures or restructuring proceedings.

While a debt-to-equity swap is usually a helpful tool to reduce liabilities towards third-party creditors (such as financing banks, etc.), a conversion to equity of any amounts owed to policyholders will often be an inappropriate measure as it would mean that a policyholder suddenly becomes a shareholder of the insurer. A cut in such liabilities towards the insureds (reduction in sum) or the change of insurance terms (see below) is usually more likely to provide an adequate solution.

The restructuring plan may further provide for a forced amendment of insurance contracts in accordance with Art. 52e draft ISA subject to the same prerequisites and rules (including priority order and excluded claims) as those applicable to a reduction or conversion as described above. The adjustment may, for example, relate to the terms of the contracts, premiums, no-claims bonuses or discounts, elective rights, life insurance guarantees, etc. The contract adjustment can be made both before an insured event or thereafter if it has not yet been settled.

Sanctioning of the restructuring plan by FINMA and rights of affected creditors

FINMA approves the restructuring plan if a number of prerequisites are met. In particular, FINMA has to assess whether the creditors are not left worse off than in the event of an immediate bankruptcy (Art. 52j draft ISA).

If the restructuring measures include a reduction or conversion of liabilities or an amendment of the terms of the insurance contract as part of a restructuring plan, the insurance company is obliged to inform the insured persons within 30 days after the reorganisation plan has become legally effective. The insured persons have the right to terminate their insurance contract within three months of receiving this information (Art. 52f draft ISA).

Importantly, in view of the very substantial intervention rights towards policyholders and other creditors, these measures require a certain level of support by the affected creditors. If the restructuring plan affects creditors' rights, FINMA seeks the creditors' consent. In case more than half of the creditors oppose to the restructuring plan, FINMA immediately starts bankruptcy proceedings (Art. 52k draft ISA).

In a similar way to the restructuring process for banks, the draft ISA provides some deviations from the standard rules to avoidance actions applicable to Swiss companies in general under the Debt Collection and Bankruptcy Act (DEBA). After the restructuring plan has been approved by FINMA, creditors are restricted in seeking frustration of certain transactions (as this is usually possible in accordance with the rules of Art. 285-292 DEBA applicable to Swiss companies in general). Avoidance actions against particular creditors which received a beneficial treatment compared to others have to be brought by the insurance company (or the person responsible for the restructuring plan) in the first place and not by the disadvantaged creditor, except to the extent a transaction with (another) creditor was part of the restructuring plan, as such transaction is then shielded from avoidance actions. In cases where the insurer is not eligible to file an avoidance action, the disadvantaged creditors may file themselves avoidance actions provided that they are negatively impacted by the restructuring plan.

Bankruptcy proceedings

If there is no prospect of reorganisation or if such reorganisation has failed, FINMA shall withdraw the insurance company's license, open bankruptcy proceedings and make these public. The rules applicable to such bankruptcy proceedings remain essentially the same as in the current law. As under the current law, the bankruptcy proceedings are governed by Art. 221-270 DEBA applicable to Swiss companies in general, subject to the specific rules set forth in the ISA for insurance undertakings (Art. 54 draft ISA).

Art. 54a para. 1 draft ISA, provides for a general privileging of the insureds in the creditor hierarchy under the DEBA. Under the new law and in deviation from the DEBA, claims of insured persons arising from insurance contracts in bankruptcy are, in principle, assigned to the second class, but are only satisfied from the bankruptcy estate after all other claims of the second class have been satisfied.

As before, the proceeds of the sale of tied assets are allocated as a priority to satisfy claims to be covered by tied assets in accordance with Art. 17 ISA. However, the law newly provides that any surplus must be distributed proportionately among any other tied assets of the insurance company. Any remainder falls to the bankruptcy estate as under the current law (Art. 54abis draft ISA).

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

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