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THE SWISS APPROACH IN SUPERVISION OF FINANCIAL CONGLOMERATES

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THE SWISS APPROACH IN SUPERVISION OF FINANCIAL CONGLOMERATES

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The private insurance industry faced many changes in the market during the last years. The new market conditions lead to changes in the industry itself. Deregulation and globalisation have increased competition. Its consequences are mergers and interconnections between insurance companies, banks and other enterprises.

What are the concrete problems that may arise for an insurance undertaking, and thus to an insurance supervisor, due to the fact that it is part of a financial conglomerate? You will see how we try and solve the supervisory problems in the case of the largest insurance-dominated financial conglomerate in Switzerland and how we hope to manage these challenges in the future.

I do not tackle the problem of banks, which show similar problems if they belong to a financial conglomerate. These additional problems are not exactly the same due to the technical differences between banks and insurance companies.

The problems of a financial conglomerate

Affiliation of insurance undertakings with conglomerates may cause problems in the following areas:

- Conglomerate companies may be subject to a uniform *finance- and investment policy* of the Board of Directors of the dominant undertaking. This policy must not undermine the insurance-related requirements – e.g. asset-liabilities matching, maturity matching etc. regarding the assets for covering technical provisions.
- The so-called free assets of the insurance company are not subject to the same investment restrictions as it's technical provisions. The management of a conglomerate may invest these assets in other parts of the group where the return perhaps is greater. This exit of free resources weakens the solvency of the insurance company. This may only become apparent when it is too late, if careful attention is not being paid to it.
- The *interconnections* and mutual financial dependencies within the conglomerate may have effects that are not immediately obvious. This applies not only to the so-termed "double gearing". Loans cannot be identified directly, and payment commitments are often only visible when payments are effectively made. In addition, new financial instruments render the transparency of intra-group interconnections even more difficult to monitor.
- The *organisation structure* of the conglomerate may have an effect on the corporate policy of the insurance undertaking and the assurance of its solvency.
- To a large extent, the development and strength of the insurance company rest upon its *underwriting policy.* The management of the dominant conglomerate company may prefer a different policy.
- Insurance consultancy is personnel intensive. The leadership of the conglomerate is, for its part, interested to improve the overall profits and therefore possibly to allocate even more expensive functions or costs of other group undertakings to the insurance company instead of rationalising its administration costs through intra-group collaboration.
- A financial conglomerate benefits from the good *image* of participating companies. The converse, however, is also possible: An insurance company may experience the effects of the poor image of other companies of the group particularly in its external services.

Organisation of the FOPI

What form of organisation is capable of or best suited for tackling these supervisory challenges?
The organisation structure of the Federal Office of Private Insurance (FOPI) has the advantage of flexibility. Some five years ago we created an organisation for monitoring insurance companies in supervisory teams, which are made up of mathematicians, economists and lawyers. The insurance companies are evenly distributed to the teams and to the individual team members, the supervisory commissioners. The supervisory commissioners are responsible for all aspects of the companies assigned to them. Insurance companies belonging to the same corporate group are being monitored within the same team, to identify and take account of interrelations. As you can see, we already have a fair amount of group monitoring in place.
However, we supervise insurance companies only, while it is up to the Federal banking commission to supervise banks. To make it more complicated, the insurance supervisory authority is part of the Ministry of justice and police, while the banking supervisor is part of another Ministry, the Ministry of finance. And since this is a meeting of the Pensions Regulators and Supervisors Network (INPRS) I add that the supervision on pensions is allocated to a third ministry, the Ministry of interior affairs.
Conglomerate monitoring presents similar problems to insurance group monitoring, but with the addition of companies monitored by the banking supervisory authority and of companies not subject to any supervision. We therefore established a cross-team task force three years ago, to heighten employee awareness of the problems of conglomerates and to develop the conglomerate supervisory function. The task force gathers all the necessary expertise, especially the supervisory commissioners responsible for conglomerate companies. It works closely together with the banking supervisory authority.

The Example of ZFSG

The insurance supervision laws do not contain any provisions about conglomerates, and amending a law takes many years in Switzerland. New solutions are never introduced hastily. Accordingly, the introduction of conglomerate supervision in Switzerland has been adopting the traditional pragmatic approach: i.e. Step by step, case by case. A FOPI decree concerning conglomerate supervision came into effect last year, on 1 July, setting out the specific obligations on Zurich Financial Services Group (ZFSG).
The Zurich Financial Services Group is active in over 60 countries in five core sectors: non-life, life and re-insurance, management services and asset management. Zurich Financial Services (ZFS), and all companies controlled by it, including banks, are subject to a consolidated supervision, which is carried out in addition to the existing sector-specific supervision exercised by the insurance supervisor over the insurance companies and the banking supervisor over the banks of the group. All other subsidiaries are allocated to the insurance sector for so long as the main focus of the activities of the ZFS Group continues to be the insurance business.
I am not going to describe the decree in detail. You can download an English version from our website (www.bpv.admin.ch, see: DECREE concerning Consolidated Supervision of the Zurich Financial Services Group of 23 April 2001). A hard copy is also available here in Tallinn. The decree addresses a large number of very detailed obligations to be respected by ZFS. I only summarise some of them with the following key words that reflect the elements for our conglomerate monitoring:

- *Consolidated accounting* and *consolidated reserves* for the entire Group, with six monthly reporting to our office.
- A formal *risk management* has to be submitted to our office for approval. In addition, the ZFS submits a six-monthly report on *catastrophe risks* and on its ten *most important reinsurers*. We annually discuss the *main underwriting risks*. *Cluster risks* are assessed according to the banking principles.
- An *organisation chart* for the whole group is part of the annual reporting. A substantial acquisition must be notified. Any changes regarding the *organisation* of the group must be reported to our office within a month.

- The members of the group administration and the group management are required to be "fit and proper".
- We do have right to get all *information* on the group necessary for supervisory purposes and to *co-operate with the banking supervisor and with foreign supervisory authorities*.

Again: The consolidated supervision does not replace the existing sector-specific supervision exercised by the insurance and the banking supervisor. Our office as the Lead Co-ordinator *additionally* supervises the group holding and all subsidiaries, which are not yet supervised by one of these authorities.

It would be presumptuous for me to assert that after half a year we are already experienced in conglomerate monitoring. But it feels good. Detailed knowledge of the situation at the ZFS, based on supervision to date and the careful preparation of the decree, reassure us that we are on the right track.

Further developments

The elements in the decree addressed to the ZFS have been dealt with in the draft of a new insurance supervision law. This draft will be forwarded to the parliament in the next few months.

I should also mention the report of the expert group entitled "*Financial market regulation and supervision in Switzerland (banks, insurance companies, general finance and financial conglomerates, other financial services)*" of November 2000. The report is also available on our website, in German and French, with an English summery that is distributed with the other documents here in Tallinn). It is known as the "Zufferey Report", since the expert group charged to analyse this issue was chaired by Professor Zufferey. The report addresses, among other things, the problems of financial conglomerates and proposes the creation of an integrated financial market supervisory agency.

Another expert group, chaired by Professor Zimmerli, is charged to study the proposals made in the Zufferey Report and to make organisational suggestions. This further report is due by the end of this year.

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