Legal Pitfalls in Portfolio Transfers

Swiss Run-Off FORUM'19

Dominik Skrobala

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Disclaimer

In this presentation, we will focus on portfolio transfers between direct insurers according to art. 62 ISA.

Some of the legal pitfalls described however also apply in case of portfolio transfer by way of merger or transfer of assets.

Legal basis and juridical back summersaults: Legal basis

Art. 62 par. 1 Swiss Insurance Supervision Act ISA

If an insurance undertaking transfers its Swiss insurance portfolio, in whole or in part, to another insurer pursuant to a contractual agreement, then this agreement requires approval by FINMA. FINMA shall approve the transfer only if the interests of insureds are altogether protected.

Legal basis and juridical back summersaults: The Swiss portfolio

There is no legal definition of the term «Swiss insurance portfolio»

- **Approach #1** - The Swiss insurance portfolio consists of all insurance policies that are to be fulfilled in Switzerland.

- **Approach #2** - Reverse conclusion from art. 73 Insurance Supervision Ordinance ISO (*Pursuant to Article 17 (2) ISA, <u>foreign</u> insurance portfolios include all insurance contracts with <u>policyholders domiciled abroad</u>.*): The Swiss insurance portfolio consists of all insurance policies with policyholders domiciled in Switzerland.

Legal basis and juridical back summersaults: Regulatory practice

The Swiss regulator presently applies **Approach #2**:

- The Swiss insurance portfolio according to art. 62 ISA therefore consists of all insurance policies with policyholders domiciled in Switzerland.
- Consequence: There is no congruence in regulatory risk location and portfolio allocation.
- Example: French domiciled policyholder with buildings and contents insurance for real estate in Switzerland.

Hidden gems and regulatory landmines: Pants down!

- When applying for a portfolio transfer, the regulator will usually ask for an overview of the portfolio incl. the <u>domicile of policyholders</u> and a <u>matching of insurance classes</u> according to Appendix 1 of the Insurance Supervision Ordinance ISO.
- If the insurance portfolio is not in compliance with the Swiss insurance regulator regime, the regulator may ask to have appropriate legal conditions restored before the portfolio can be transferred.

Hidden gems and regulatory landmines:
Best in class?

Potential gems and landmines in the portfolio (examples):

- Non-admitted insurance activities abroad due to policyholders being domiciled abroad.
- Class B2 (Illness): Insufficient reserving and non-tolerated rights of cancellation of the insurer in daily sickness benefit insurance.
- Class B8 (Elemental Perils): Non-compliance with the statutory elemental perils regime.

Is your partner ready for this precious dowry?

- The assuming insurer must be licensed to conduct insurance business in the classes relevant for the transferred portfolio.
- The assuming insurer must demonstrate solvency post-transfer. In case of foreign insurers with Swiss branch operations, solvency must be confirmed by the competent foreign regulator (scope of application of EU-CH Non-Life Agreement and future UK-CH Non-Life Agreement).
- The assuming foreign insurer might require an authorization to conduct «insurance business abroad» from its home regulator.

Don’t forget your other partners!

- Don’t forget other regulators: They might have a say!
- Don’t forget your reinsurers: Outward reinsurance connected to the transferred portfolio will <u>not</u> transfer by operation of Swiss law!
- Don’t forget your bank: The tied assets connected to the transferred insurance portfolio <u>will</u> transfer by operation of law (art. 19 ISA)!
- Don’t forget your service providers: Outsourcing agreements related to the insurance portfolio will <u>not</u> transfer by operation of law!
- Don’t forget the policyholders: The assuming insurer will need to inform policyholders regarding statutory cancellation rights triggered by the transfer!

Finality and breaking up with the regulator: Unwanted guests

- Ideally, the portfolio transfer will result in the transferring insurer transferring the entirety of its insurance portfolio and consequently finality regarding its Swiss business.
- Mind the juridical back summersault: The transferring insurer might end up with policies with policyholders domiciled abroad that cannot be transferred due to the regulator's definition of the Swiss insurance portfolio.
- If such policies are being transferred on an individual basis by way of novation (contract transfer), the regulator will require evidence of the assumption of all rights and obligations by the assuming insurer when discussing finality.

Finality and breaking up with the regulator: Time to say goodbye?

- Don’t assume finality due to the transfer of the entirety of the insurance portfolio: The regulator might ask for a special audit or other means of ascertainment of finality prior to the release from supervision.
- Consequence: The transferring insurer must make sure to hold sufficient tied assets (run-off costs might qualify as ULAE) for the duration of the release from supervision by the regulator.

Questions?

Thank you for your attention!

Dominik Skrobala
Partner
Attorney-at-law, LL.M.
skrobala@gbf-legal.ch

Gerspacher
Bell
Fankhauser
Attorneys-at-law

Hegibachstrasse 47
P.O. Box 1661
CH-8032 Zurich

T +41 43 500 48 50
F +41 43 500 48 60
contact@gbf-legal.ch
www.gbf-legal.ch