

# Credit Rating Levels Clarified

May 19, 2024



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Question: "What are the five credit rating levels that can be assigned for tied assets? Explain each level."

Answers:

Answer 1.:

The five credit rating levels that can be assigned for tied assets are:

1. Credit rating level 1: This is the highest grade, indicating that the debtor has an outstanding ability to meet its financial obligations. The default risk is virtually negligible, even in the longer term.
2. Credit rating level 2: This is a high grade, indicating that the debtor's ability to meet its financial obligations is very strong. The default risk is virtually negligible, but may be somewhat more difficult to assess in the longer term.
3. Credit rating level 3: This is an upper medium grade, indicating that the investment is safe, provided no unforeseen events affect the overall economy or industry. The borrower's ability to meet its financial obligations is strong, but more vulnerable to the adverse effects of changes in external circumstances and economic conditions.
4. Credit rating level 4: This is a lower medium grade, indicating that problems are to be expected if the overall economy deteriorates. The borrower's ability to meet its financial obligations is adequate, but more vulnerable to adverse economic conditions.
5. Credit rating level 5: This is a category for all investments that do not meet the requirements for classification in one of the credit rating categories 1-4.

These credit rating levels are used to assess the risk associated with the tied assets of an insurance company. The higher the credit rating, the lower the risk of default, and the safer the investment. Conversely, lower credit ratings indicate higher risk and potentially less secure investments. The insurance company is required to use recognized rating agencies or its own credit ratings when assigning tied assets to the credit rating categories, ensuring that the assessments are reliable and reflect the true risk associated with the investments.

Answer 2:

The five credit rating levels that can be assigned to tied assets are detailed as follows:

Credit Rating Level 1: This represents the highest grade where the debtor possesses the highest creditworthiness. The default risk is considered virtually negligible, suggesting an outstanding ability of the debtor to meet financial obligations even over a long term.

Credit Rating Level 2: Assigned to high-grade investments, this level indicates that while the default risk remains very low, assessing it might be slightly more challenging over an extended period. The debtor is still very strong in fulfilling financial commitments.

Credit Rating Level 3: This is the upper medium grade, suggesting a secure investment unless affected by unforeseen adverse changes in the economy or industry. The debtor is strong in financial commitments but more susceptible to changes in external conditions and economic downturns.

Credit Rating Level 4: Known as lower medium grade, investments under this category are considered average. Economic downturns could pose significant problems, indicating that the debtor's ability to meet financial obligations, though adequate, is vulnerable to adverse economic conditions.

Credit Rating Level 5: This level covers all other investments that do not qualify under the previous four categories. It implies higher risks and encompasses debtors whose creditworthiness does not meet the standards set from levels 1 to 4.

These ratings help in assessing the security and risk associated with assets tied in the financial sector, especially in contexts like insurance where such assets are crucial for securing claims under policies.



Based on the document provided and its description of credit rating levels for tied assets, here are the evaluations for both answers:

### Answer 1 Evaluation:

**Relevance:** The answer accurately lists the five credit rating levels as described in the document and details each level's implications concerning the debtor's ability and default risk.

**Accuracy:** The descriptions of each credit rating level match the document's specifics accurately, providing a correct representation of the levels 1 through 5.

**Completeness:** Each credit rating level is thoroughly explained with respect to debtor capabilities and risks associated with each level. Additionally, it contextualizes the ratings within the insurance sector's requirements for tied assets, enhancing the user's understanding of the subject matter.

**Clarity:** The answer is well-structured, clearly differentiating each level with organized formatting and straightforward language, making it easy to follow.

**Score: 10/10** - This answer reflects the document's content with high fidelity and contextual clarity.

### Answer 2 Evaluation:

**Relevance:** Similar to Answer 1, this response correctly identifies and explains the five credit rating levels, aligned with the document's specifications.

**Accuracy:** The details provided about the levels closely follow the document's definitions, demonstrating a high degree of accuracy.

**Completeness:** This answer includes a comprehensive discussion of the levels and their implications, and also reflects on the assessment process within the insurance industry, which aligns well with the document's focus.

**Clarity:** The structured format aids readability, and the use of bullet points for each level helps distinguish the specifics effectively.

**Score: 10/10** - This answer also accurately represents the information found in the document, clearly and comprehensively addressing the query.

Both answers excellently represent the information from the document and provide a complete and clear overview of the credit rating levels for tied assets, as specified by the FINMA guidelines.



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Question: "What are the primary investment principles for total assets?"

Answers:

Answer 1:

The primary investment principles for total assets, as outlined in the provided text, are:

1. **\*\*Orientation towards obligations (Asset Liability Management, ALM)\*\*:** The order of the tied assets must be based on the structure and expected development of the insurance obligations to be secured. This involves considering both the performance of investments and liabilities and the expected cash flows from investments and obligations.
2. **\*\*Profitability\*\*:** The insurance company selects investments that generate a return in line with the market.
3. **\*\*Diversification\*\*:** Each tied asset must be sufficiently and appropriately diversified. Cluster risks must be excluded. An appropriate mix in relation to the various investment categories and a spread of investments in relation to the debtors of the assets must be achieved.
4. **\*\*Liquidity\*\*:** The insurance company must choose investments that can be realized quickly if necessary, especially in the event of the insurance company's bankruptcy.
5. **\*\*Specialist knowledge, experience, integrity\*\*:** The staff involved in investment management and control must have adequate qualifications and knowledge of the asset classes invested in, and in the case of investments in riskier investments, appropriate expertise.
6. **\*\*Organization and control\*\*:** The administration (investment management) and control (risk management) of the investment activity must be carried out by independent persons and must be organizationally appropriate to the complexity of the business and investment activity.

These principles are crucial for the insurance company to manage its investments effectively, ensuring that its assets are aligned with its obligations, generating returns, diversified to mitigate risk, liquid enough to meet cash flow needs, and managed by competent and independent staff.

Answer 2:

The primary investment principles for total assets, as outlined in the FINMA Circular 2016/5 for insurers, include the following:

**Asset-Liability Management (ALM):** When selecting investments, an insurance company considers the structure and development of its obligations. This includes matching the assets and liabilities in terms of durations and cash flows to ensure that the investments can meet the future claims and other liabilities when they become due.

**Security of Investments:** The investments chosen must be secure, ensuring that they will be able to fulfill the obligations toward policyholders. This involves investing in assets that are not only financially stable but also legally protected, so they can be readily utilized or liquidated when necessary.

**Appropriate Diversification:** To minimize risks, investments must be appropriately diversified across different asset classes, geographic regions, and issuers. Diversification helps to manage and mitigate potential losses in any single investment or sector.

**Liquidity:** The investment portfolio must maintain sufficient liquidity to meet the insurance company's foreseeable needs. This is crucial for managing claims and other financial obligations without the need to liquidate investments under unfavorable conditions.

**Profitability:** While security and liquidity are paramount, the investments also need to generate a reasonable return. This balances the need to protect the capital with the requirement to grow the assets to cover liabilities and support the profitability of the insurer.

These principles guide the investment strategies to ensure that they align with the company's overall financial health and obligations to policyholders, aiming to achieve an optimal balance between risk and return within the regulatory framework.



Based on the detailed content from the FINMA Circular 2016/5 regarding investment principles for total assets in the insurance sector, here are the evaluations for both answers:

### Answer 1 Evaluation:

**Relevance:** The answer includes relevant principles such as asset-liability management (ALM), profitability, diversification, liquidity, and considerations about expertise and organizational control, which align with the circular.

**Accuracy:** The specifics such as ALM, profitability, and diversification are accurately described and align with the principles listed in the document.

**Completeness:** While it covers all major principles, it could enhance completeness by referencing specific regulations or legal requirements as outlined in the document for added depth.

**Clarity:** The explanation is straightforward and structured in a way that makes the principles easy to understand.

**Score: 9/10** - The answer is thorough and accurate but could include specific references to regulatory requirements for a full score.

## Answer 2 Evaluation:

**Relevance:** This answer similarly covers the fundamental principles such as ALM, the security of investments, diversification, liquidity, and profitability.

**Accuracy:** The details are accurate and closely match the document's descriptions of investment principles. It emphasizes the security of investments and appropriate diversification, which are critical points in the circular.

**Completeness:** The answer touches on all critical points, including the need for investments to be secure to ensure fulfillment of obligations, which is a crucial aspect as per the document. However, it slightly lacks in detailing the expected behaviors and strategic approaches compared to the circular.

**Clarity:** The answer is clear and well-organized, making the principles easy to understand.

**Score: 9/10** - Comprehensive and precise but could slightly elaborate on the strategies within each principle for enhanced completeness.

Both answers provide a robust summary of the primary investment principles for total assets according to the FINMA Circular 2016/5. They are clear, relevant, and mostly complete, reflecting a deep understanding of the document's guidelines.



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Question: "What are the rules for investment in cash deposits?"

Answers:

Answer 1:

The rules for investment in cash deposits are not explicitly stated in the provided text. However, it can be inferred that cash deposits are not mentioned as a specific type of investment in the context of tied assets. The text focuses on the regulations and requirements for the safekeeping of assets, the role of the custodian bank, and the limitations and evaluation of direct investments. It also discusses the concept of securities lending, which is a legal transaction involving the transfer of securities as a loan, but it does not mention cash deposits as a form of securities lending. Therefore, based on the provided text, there is no clear indication of specific rules for investment in cash deposits in the context of tied assets.

Answer 2:

The rules for investment in cash deposits, as outlined in the FINMA Circular 2016/5 for insurers, include the following key points:

Permissible Values: Cash and cash deposits are permissible for investment. This includes bank balances as well as fixed-term deposits and other short-term money market investments that have a

term of up to 12 months.

**Special Requirements:** A supplementary agreement must be signed with the counterparty for cash deposits or account balances, which explicitly excludes any lien, right of retention, right of set-off, or similar rights on the part of the debtor.

**Evaluation:** Investments in this category are valued at no more than their nominal value, taking into account security and income. For money market debt register claims recognized at no more than market value, if they are not listed on a stock exchange, a standard market valuation method must be applied.

These rules ensure that the investments in cash deposits are secure, meet regulatory requirements, and are capable of being liquidated or valued accurately and expediently as needed.



Based on the analysis of the FINMA Circular 2016/5 regarding rules for investment in cash deposits, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** This answer does not specify any details about the rules for cash deposits, indicating they are not mentioned, which is incorrect.

**Accuracy:** Since the rules are clearly outlined in the document, stating that there are no explicit rules for cash deposits is inaccurate.

**Completeness:** The answer fails to address any of the actual stipulations or rules related to cash deposits as outlined in the circular.

**Clarity:** Although the statement is clear, it is misleading because it suggests an absence of information where there is specific detail available in the document.

**Score: 0/10** - The answer is incorrect as it claims there are no rules, directly contradicting the explicit guidelines in the document.

### Answer 2 Evaluation:

**Relevance:** Directly addresses the question by identifying specific rules and guidelines for cash deposits as outlined in the document.

**Accuracy:** The answer correctly summarizes the rules for cash deposits, including details on permissible values, special requirements, and evaluation methods.

**Completeness:** Provides a comprehensive overview of the requirements and valuation for cash deposits, directly reflecting the content of the document.

**Clarity:** Well-structured and clearly outlines the specific guidelines for cash deposits, making it easy to understand the regulatory framework.

**Score: 10/10** - Accurately and comprehensively reflects the document's content on cash deposit investment rules, presented clearly and in a structured manner.

In conclusion, Answer 2 provides an accurate and detailed reflection of the FINMA circular's guidelines on cash deposits, whereas Answer 1 incorrectly states that such rules are not specified in the document.



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Question: "How are bonds and convertible bonds treated?"

Answers:

Answer 1:

Bonds and convertible bonds are treated differently based on their characteristics. Bonds are assigned to specific categories based on their issuer and other characteristics. Convertible bonds, on the other hand, can be assigned to either the "bonds" or "shares" category depending on their market value relative to their nominal value. If the market value is higher than 130% of the nominal value, it can be assigned to the "shares" category. Convertible bonds that must be converted into shares (e.g., mandatory convertible bonds, mandatory convertible bonds, contingent convertible bonds [CoCo bonds]) are also assigned to the "shares" category. With regard to bonds from foreign issuers, margin no. 132 must be observed. Non-permissible values include bonds issued by a special purpose vehicle (SPV) for the purpose of risk transfer and securitized receivables (ABS, CDOs, etc.). Insurance-linked securities (e.g., cat bonds) are assigned to the category "Structured products" (margin no. 197). Bonds with a conditional debt waiver (write-off bonds) cannot be allocated to restricted assets. The evaluation of bonds and convertible bonds is done using either the scientific cost amortization method or the straight-line cost amortization method, as specified in Art. 88 para. 1 and Art. 88a AVO. The maximum imputed value is determined according to these methods plus accrued interest. Convertible bonds that fall into the category of bonds in accordance with margin no. 188 can be accounted for using the cost amortization method. Structured products, which are investments in the form of a bond or debenture in which a cash instrument is linked to one or more derivative financial instruments, are subject to specific conditions for admissibility, crediting, and valuation. These conditions include the individual components meeting the requirements of the corresponding category of tied assets, no delivery or purchase obligations, and no additional funding obligations. The structured products are valued according to one of the methods specified for bonds and convertible bonds, and the selected procedure must be maintained until the structured product is sold or redeemed.

Answer 2:

In the FINMA Circular 2016/5 for insurers, bonds and convertible bonds are treated with specific guidelines to ensure they meet the investment criteria for safety, profitability, and liquidity. Here's how they are generally treated:

Types of Bonds and Convertible Bonds:

Permitted investments include government bonds, bonds issued by cantons, cities, municipalities, and other public corporations, corporate bonds, and medium-term notes issued by a



bank licensed in Switzerland.

Convertible bonds are also permitted and can be divided into two types: those with the character of bonds and those with the character of shares.

#### Convertible Bonds:

Convertible bonds that can be converted into shares (e.g., mandatory convertible bonds, contingent convertible bonds) are typically assigned to the "shares" category if the market value of the convertible bond exceeds 130% of its nominal value. If the value subsequently falls below 130%, the bond remains in the shares category.

#### Valuation:

Bonds are generally valued using either the scientific or straight-line cost amortization method plus accrued interest. This approach ensures that the value recorded reflects the amortized cost, thereby maintaining the initial yield to maturity.

#### Non-Permissible Values:

Certain types of bonds that are structured to transfer risk, like those issued by special purpose vehicles for securitized receivables, are excluded from permissible investments. This includes bonds linked to insurance-linked securities (e.g., catastrophe bonds), which are categorized under "Structured Products."

#### Regulations and Limits:

Bonds from foreign issuers are subject to specific regulations ensuring that they meet Swiss legal and investment standards. The insurance undertaking must follow the guidelines for foreign counterparties as well.

These guidelines ensure that the investments in bonds and convertible bonds align with the overall investment principles of safety, profitability, and liquidity, thereby supporting the insurer's obligations to policyholders and maintaining financial stability.



Based on the detailed content from the FINMA Circular 2016/5 regarding the treatment of bonds and convertible bonds in the insurance sector, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** The answer is highly relevant, addressing specific categories, valuation methods, and regulatory considerations for bonds and convertible bonds as outlined in the document.

**Accuracy:** The descriptions match the document's specifics on how bonds and convertible bonds are categorized and evaluated, including the criteria for when convertible bonds are categorized as shares.

**Completeness:** Provides an extensive overview, including details on permissible and non-permissible values, categorization, and evaluation methods, closely matching the document's content.

**Clarity:** While the answer is detailed, the complexity and volume of information could be overwhelming. It could benefit from a clearer, more concise presentation to improve readability.

**Score: 9/10** - Highly accurate and relevant, but could be clearer in presentation.

### Answer 2 Evaluation:



**Relevance:** Directly addresses the treatment of bonds and convertible bonds, including their categorization, valuation, and specific regulations.

**Accuracy:** The details are mostly accurate, matching the document's description of the treatment of these investment types, including the special conditions under which convertible bonds are assigned to shares.

**Completeness:** Covers the essential aspects of how these instruments are treated under the guidelines, with a focus on regulatory requirements, evaluation methods, and the categorization of convertible bonds.

**Clarity:** The answer is structured and clear, presenting the information in a digestible format, which makes it easy for readers to grasp the key points.

**Score: 10/10** - Accurately reflects the document's guidelines, presented in a clear and structured manner.

Both answers effectively capture the guidelines from the FINMA Circular on the treatment of bonds and convertible bonds, with Answer 2 doing so in a manner that is particularly clear and accessible.



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Question: "What specific limits are placed on investments in foreign currencies?"

Answers:

Answer 1:

The limits placed on investments in foreign currencies are that the obligations arising from insurance contracts should be covered by investments in matching currencies, and investments in currencies other than the reference currency are limited to 20% of the target amount of the tied assets. The reference currency is the currency in which the insurance contracts concluded by the insurance company are denominated.

Answer 2:

According to the FINMA Circular 2016/5 for insurers, specific limits are placed on investments in foreign currencies to manage currency risk effectively. These limits are as follows:

Foreign Currency Exposure Limit:

Investments in foreign currencies must not exceed 20% of the target amount of the tied assets. This limitation helps ensure that the currency exposure remains manageable and does not disproportionately increase the risk to the financial stability of the insurance company.

Currency Matching:

Obligations arising from insurance contracts should be covered by investments in matching

currencies. This principle ensures that there is alignment between the currencies in which liabilities are denominated and the currencies of the assets held. This alignment helps mitigate the risk of currency fluctuations adversely affecting the insurer's ability to meet its obligations.

These limits are crucial in maintaining the solvency and financial health of insurance companies by minimizing the risks associated with foreign exchange rate fluctuations.



Based on the detailed content from the FINMA Circular 2016/5 regarding the specific limits on investments in foreign currencies for insurance companies, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** This answer directly addresses the specific limits placed on investments in foreign currencies, referencing the obligation to match the insurance liabilities in corresponding currencies and the specific quantitative limits.

**Accuracy:** The details provided, such as the 20% limit of the target amount for foreign currency investments, are accurate and aligned with the information in the document.

**Completeness:** It correctly mentions the main rules regarding currency matching and limits on foreign currency exposure, which are pivotal to managing currency risk.

**Clarity:** The explanation is straightforward and concise, making it easy to understand.

**Score: 10/10** - The answer is clear, accurate, and covers the essential information from the document regarding foreign currency investment limits.

### Answer 2 Evaluation:

**Relevance:** This answer also correctly addresses the specific limits on foreign currency investments, with added details on the purpose behind these limits.

**Accuracy:** It accurately describes the 20% limit for foreign currency exposure and the need for currency matching, consistent with the circular's stipulations.

**Completeness:** The answer provides comprehensive coverage of the limits and their rationale, adding context to the rules, which enhances understanding.

**Clarity:** The structuring of the answer adds clarity by breaking down the components of the regulation into bullet points, making the information more accessible.

**Score: 10/10** - This answer also fully captures the necessary details from the document, presenting them in a clear and structured manner.

Both answers provide a correct and comprehensive overview of the limitations on foreign currency investments as prescribed by the FINMA Circular 2016/5, tailored to the insurance sector's requirements.





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Question: "What are high-risk investments for insurance companies?"

Answers:

Answer 1:

High-risk investments for insurance companies are those that carry a higher level of uncertainty and potential for loss. These investments may only be made as a cautious addition to and appropriate diversification of the total tied assets. The risk capacity of the insurance company must always be taken into account. Investments in securities with a credit rating of 5 are only permitted if there is corresponding technical expertise in the area of credit risks. Additionally, investments must be chosen with the ability to be realized quickly, especially in the event of the insurance company's bankruptcy. The realizability of an investment depends on the term of an investment or the possibility of assigning it on the market or on a stock exchange.

Answer 2:

High-risk investments for insurance companies, as identified in the FINMA Circular 2016/5, typically include those that are susceptible to significant fluctuations in value, are subject to high default risk, or are complex and difficult to value. Here are some specific types of high-risk investments for insurers:

**Structured Products and Derivatives:** Investments that include complex instruments like derivatives (futures, options, swaps) or structured products (collateralized debt obligations, mortgage-backed securities). These can entail high risks due to their complexity and leverage factors.

**Lower-Rated Bonds:** Bonds that have lower credit ratings (typically, those rated below investment grade) represent higher risks due to increased likelihood of default.

**Foreign Investments:** Investments in foreign markets or in foreign currencies can be considered high risk due to exchange rate fluctuations and differences in market regulation and stability.

**Real Estate Investments:** While generally considered a stable asset, certain types of real estate investments, particularly those in volatile markets or involving high-maintenance properties, can pose higher risks.

**Alternative Investments:** This includes investments in hedge funds, private equity, and commodities, which are often subject to less regulation, have higher volatility, and involve higher fees and limited liquidity.

**Investments in High-Risk Tranches of Securitized Products:** Such as the equity or junior tranches of structured credit products, which are significantly more volatile and risky compared to senior secured tranches.

These investments are usually subject to strict regulatory limits regarding their proportion in the

insurer's portfolio to mitigate systemic risks and ensure that the company can meet its obligations to policyholders.



Based on the analysis of the FINMA Circular 2016/5 regarding high-risk investments for insurance companies, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** This answer discusses the general approach to managing high-risk investments and mentions investments with a credit rating of 5. This is relevant to the document's content on risk considerations.

**Accuracy:** The answer mentions the need for technical expertise in credit risks for investments in securities rated as credit rating 5, which aligns with the document. However, it does not cover other types of high-risk investments mentioned in the document.

**Completeness:** The answer addresses some aspects of high-risk investments like the need for quick realizability and risk capacity but lacks mention of specific high-risk categories like structured products or derivatives that are emphasized in the document.

**Clarity:** The answer is clear and understandable but could benefit from specific examples or a broader range of high-risk investment types for clarity.

**Score: 6/10** - While some relevant elements are covered, the answer lacks detail and breadth concerning the variety of high-risk investments defined in the document.

### Answer 2 Evaluation:

**Relevance:** Directly addresses the high-risk investments specified in the document, including structured products, derivatives, lower-rated bonds, and investments in volatile markets.

**Accuracy:** The details provided, such as the categorization of structured products and derivatives as high-risk, are accurate and reflect the document's guidance.

**Completeness:** This answer comprehensively describes various high-risk investments and contextualizes them within regulatory limits and the need for careful management as per the document.

**Clarity:** The structured format helps readability and understanding, effectively conveying the complexity and risks associated with each type of high-risk investment.

**Score: 10/10** - Accurately and comprehensively reflects the document's detailed descriptions of high-risk investments, presented in a clear and structured manner.

Answer 2 provides a comprehensive and detailed understanding of high-risk investments as per the FINMA guidelines, whereas Answer 1, while partially correct, does not encompass the breadth or specificity of the document's definitions.





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Question: "How are investments in high-risk assets regulated?"

Answers:

Answer 1:

Investments in high-risk assets are regulated through a comprehensive framework that includes the definition of investment principles and objectives, the description of the investment universe, investment techniques and their application, the investment process and monitoring, and staff requirements. The investment strategy must be approved by the Board of Directors, and the investment regulations are issued by the Executive Board or a member of the Executive Board or the general representative. The administration and control of the investment activity must be carried out by independent persons with adequate qualifications and knowledge of the asset classes invested in. The systems used should be appropriate to the size and complexity of the investment portfolio, and the staff must have specialist knowledge and experience. The insurance company regulates at least the internal investment principles and objectives, the description of the investment universe, the investment process, monitoring and controls, and staff requirements. The investment activity is comprehensively described in a document, and specific references to other internal directives are possible. The insurance company regulates at least the following topics in the investment regulations: internal investment principles and objectives, description of the investment universe, investment techniques and their area of application/purpose, description of the investment process, monitoring and controls, and staff requirements. The administration (investment management) must ensure and perform at least the following tasks: implementation of the investment strategy and the investment regulations, definition and documentation of strategic and tactical asset allocation, setting a limit system based on individual risk capacity, monitoring limits and defining measures in the event of limit breaches, provision of an investment process that is commensurate with the complexity of the investments, monitoring the value of the assets, monitoring and controlling compliance with regulatory requirements, monitoring and controlling the main risks in connection with investment activities, measurement and evaluation of investment results, and definition of internal reporting. If the insurance company commissions a third party with investment management, this does not relieve it of responsibility for compliance with the investment management regulations. Due diligence is conducted to ensure that both the selection and the ongoing monitoring of the investment are carried out in accordance with recognized and proven standards. The insurance company has quantitative analysis tools and a documented due diligence concept to ensure that the selection and ongoing monitoring of the investment are carried out in accordance with recognized and proven standards. The insurance company must ensure that the conditions specified in margin nos. 317-350 can actually be met. Due diligence can also be carried out by external specialists. The investment in high-risk assets is subject to specific limits, and the insurance company must ensure that commitments made in subsequent years do not lead to these limits being exceeded. The investments in high-risk assets are recognized at no more than market value, and the insurance company must receive net asset values for hedge funds on at least a monthly basis and for private equity and private debt on a quarterly basis. The general provisions on foreign assets do not have to be complied with for investments in alternative investments.

Answer 2:

Investments in high-risk assets by insurance companies are regulated under strict guidelines to manage and mitigate the risks associated with these types of investments. According to the FINMA Circular 2016/5, here are the key regulatory measures:

**Limit on High-Risk Investments:** Investments in high-risk assets must be made cautiously and should be an appropriate diversification of the total tied assets. This ensures that these investments do not disproportionately affect the overall investment portfolio's risk profile.

**Risk Capacity Consideration:** The insurance company's risk capacity must always be taken into account when investing in high-risk assets. This includes assessing the financial stability and risk tolerance of the company to ensure that it can handle potential losses from these investments.

**Credit Rating Requirement:** Investments in securities with the lowest credit rating (rating level 5) are only permissible if there is corresponding technical expertise in the area of credit risks. This implies that the company must have adequate knowledge and resources to manage the increased risk associated with such investments.

**Expertise and Risk Management:** Companies must have appropriate expertise and a robust risk management system in place when engaging in high-risk investments. This includes having knowledgeable staff and systems to continually monitor and manage the risks associated with these assets.

**Regular Analysis and Monitoring:** The risks of high-risk investments must be analyzed and monitored regularly to ensure they remain within the acceptable risk parameters set by the company. This ongoing scrutiny helps in early detection of potential issues that could affect the financial health of the company.

By regulating these aspects, the guidelines aim to balance the potential high returns from high-risk investments with the necessary safeguards to protect the company's financial stability and the interests of the policyholders.



Based on the detailed content from the FINMA Circular 2016/5 regarding how investments in high-risk assets are regulated, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** The answer mentions comprehensive regulatory measures, including staff requirements, investment principles, and monitoring, which are mentioned in the document.

**Accuracy:** The specifics about the organization, roles of different boards, and staff expertise are correctly aligned with the circular's regulatory framework.

**Completeness:** Provides a broad and detailed view of the regulatory landscape for managing high-risk assets, including internal guidelines and control measures.

**Clarity:** The explanation is complex and dense, which might make it difficult for some readers to follow without prior knowledge of regulatory compliance.

**Score: 8/10** - The answer is thorough and covers many aspects of regulation but could be clearer and more concise.

## Answer 2 Evaluation:

**Relevance:** Directly addresses the regulatory measures specifically for high-risk investments, highlighting key areas such as risk capacity and credit rating requirements.

**Accuracy:** Correctly reflects the circular's emphasis on risk capacity, credit ratings for high-risk securities, and the need for specialized expertise and risk management.

**Completeness:** Covers the essential regulatory aspects related to high-risk investments, emphasizing risk management and compliance.

**Clarity:** The structured format and focus on key regulatory aspects make the information accessible and easy to understand.

**Score: 9/10** - Provides a clear and focused summary of the regulations pertaining to high-risk assets, though it could include slightly more detail on specific limits and internal controls for perfect completeness.

Both answers capture essential aspects of the regulatory approach to managing high-risk investments in insurance companies. Answer 2, however, presents these aspects in a more structured and digestible manner, making it slightly superior in terms of clarity and direct relevance.



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Question: "What are the consequences for failing to comply with the guidelines?"

Answers:

Answer 1:

Failing to comply with the guidelines as outlined in the text can result in various consequences for an insurance company. These consequences may include breaching financial and organizational capacities, exposing the company to unnecessary risks, and violating regulatory requirements. The text emphasizes the importance of adhering to the investment strategy, setting appropriate risk limits, and issuing comprehensive investment regulations. Failure to do so can potentially jeopardize the value of the total assets and tied assets, the solvency of the insurance company, and may lead to reputational damage. Additionally, the insurance company may face regulatory penalties or legal consequences for non-compliance.

Answer 2:

The consequences for failing to comply with the investment guidelines set forth in the FINMA Circular 2016/5 for insurers can include several regulatory and operational impacts:

Regulatory Sanctions: Non-compliance with the guidelines can lead to regulatory sanctions from FINMA, which may include fines, restrictions on investment activities, or more severe penalties such



as withdrawal of operating license in extreme cases.

**Increased Scrutiny and Reporting Requirements:** Insurers found to be non-compliant may be subject to increased scrutiny and additional reporting requirements to ensure subsequent compliance. This could involve more frequent audits and mandatory submission of detailed compliance reports.

**Reputational Damage:** Failure to adhere to regulatory standards can lead to reputational damage, affecting the trust and confidence of policyholders, investors, and other stakeholders.

**Financial Impact:** Non-compliance can lead to financial instability due to mismanaged assets or overly risky investment strategies, which could impact the insurer's ability to meet its financial obligations to policyholders.

**Operational Restrictions:** In some cases, regulatory bodies might impose operational restrictions, limiting the insurer's ability to make certain types of investments or undertake new ventures until compliance is restored.

These consequences underline the importance of adherence to established investment guidelines to ensure operational stability, regulatory compliance, and the safeguarding of policyholder interests.



Based on the detailed content from the FINMA Circular 2016/5 regarding the consequences of failing to comply with the investment guidelines, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** The answer touches on potential consequences for failing to adhere to guidelines, such as jeopardizing assets, solvency, and facing reputational damage. These are relevant concerns.

**Accuracy:** This answer broadly matches the circular's implications, noting that non-compliance could lead to financial instability and regulatory issues. However, it doesn't specifically mention regulatory penalties or legal consequences, which are typically involved in such failures.

**Completeness:** The answer provides a general overview of the consequences but lacks specific details on regulatory actions or the exact legal repercussions that could be enforced according to the circular.

**Clarity:** The answer is clear and easy to understand, presenting the information in a way that is straightforward and concise.

**Score: 7/10** - Covers the general consequences but lacks specifics on enforcement and regulatory measures.

### Answer 2 Evaluation:

**Relevance:** Directly addresses the consequences of failing to comply with FINMA guidelines, including regulatory sanctions and operational impacts.

**Accuracy:** Accurately reflects the guidelines' requirements for risk management and the detailed regulatory repercussions for non-compliance, such as fines or increased scrutiny.

**Completeness:** Provides a comprehensive overview of the consequences, including financial impacts, regulatory sanctions, and operational restrictions.

**Clarity:** Well-structured and effectively communicates the potential consequences of non-compliance, making it easy to understand the seriousness and scope of these outcomes.

**Score: 10/10** - Accurately and comprehensively reflects the detailed descriptions of potential regulatory and operational consequences for failing to adhere to the guidelines.

Both answers recognize the importance of adhering to the investment guidelines set by FINMA and the serious implications of non-compliance. Answer 2, however, provides a more detailed and comprehensive view, directly reflecting the content of the FINMA Circular 2016/5 with greater specificity and clarity.



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Question: "How should claims of non-life insurers against reinsurers be handled?"

Answers:

Answer 1:

According to the provided context information from the FINMA circular, if reinsurance contracts are concluded with branches of reinsurers, the name and registered office of the company's head office must be stated on the application form. In justified cases, FINMA may limit the duration of approvals. Applications are deemed to have been approved unless FINMA initiates a review within four weeks. If the conditions change, in particular the assessment of the creditworthiness of an approved reinsurer, the crediting must be adjusted in accordance with the limits set out in margin nos. 162-166 and FINMA must be notified immediately. If a further reinsurer is to be approved in addition to those already approved, all reinsurers must be listed in the application, with those not yet approved marked.

Therefore, claims of non-life insurers against reinsurers should be handled by following the approval process outlined in the FINMA circular. This includes submitting an application with the required information, adhering to any duration limits set by FINMA, and notifying FINMA of any changes in conditions or creditworthiness.

Answer 2:

Claims of non-life insurers against reinsurers are handled carefully under the guidelines set by FINMA Circular 2016/5 to ensure that the reinsurance recoverables are secure and contribute appropriately to the solvency and liquidity needs of the non-life insurers. Here's how these claims should be managed:

**Crediting of Reinsured Portions:** The reinsured portions of the provisions are offset against the tied assets of non-life insurance companies. This means that the amounts recoverable from reinsurers can be included in the assets that secure policyholder claims.

**Crediting Limits Based on Credit Rating:**

Reinsurers with a credit rating of 2 or better can be credited up to 20% of the target amount of the tied assets.

For credit rating level 3, the limit is 10% of the target amount.

For credit rating level 4, the limit is 5% of the target amount.

Reinsurers with a credit rating of 5 are not allowed for offsetting against the tied assets.

**Special Provisions for Group Reinsurers:** If the reinsurer is part of the same group as the insurer, the limits for crediting are reduced by 50%.

**Total Limits for Group Reinsurers:** When offsetting claims relating to several reinsurers that belong to the same group, the total of the offsets is capped at 1.5 times the limits stated above based on the group's credit quality step.

**Special Cases:** Special reinsurance relationships, like those relating to the Swiss natural hazard pool, can be credited up to 10% of the target amount of the tied assets.

**Approval and Review Process:**

Applications for offsetting must be submitted using a form prescribed by FINMA.

If the conditions or the creditworthiness of the reinsurer change, the crediting must be adjusted according to the limits and FINMA must be notified immediately.

**Continued Compliance:** Insurance companies must ensure that they continually meet the requirements for crediting and must report any changes to FINMA that might affect their compliance with these provisions.

These regulations ensure that the claims of non-life insurers against their reinsurers are managed in a way that maintains financial stability and prioritizes the interests of policyholders.



Based on the specific guidance provided in the FINMA Circular 2016/5 concerning how claims of non-life insurers against reinsurers should be handled, here are the evaluations for the two answers provided:

## Answer 1 Evaluation:

**Relevance:** The answer discusses the general process of managing reinsurer relationships, including application and reporting requirements, which are covered in the circular.

**Accuracy:** It accurately reflects some procedural details, such as needing to list the head office on the application and the potential for FINMA to limit approval duration.

**Completeness:** The answer focuses more on the procedural aspects of reinsurer approval and less on the handling of claims, such as crediting and limits, which are critical in managing claims against reinsurers.

**Clarity:** The answer is somewhat clear but could be improved by more directly connecting the described procedures to the management of claims against reinsurers.

**Score: 6/10** - The response is somewhat relevant but does not fully address the handling of claims against reinsurers as outlined in the document.

## Answer 2 Evaluation:

**Relevance:** Directly addresses the handling of claims of non-life insurers against reinsurers by detailing the crediting of reinsured portions and specific crediting limits based on reinsurer credit ratings.

**Accuracy:** Accurately incorporates specific details from the circular, including the crediting rates and the limits based on the credit rating of the reinsurer.

**Completeness:** Provides a comprehensive overview of how claims against reinsurers are credited, the limits involved, and additional conditions under special circumstances like group reinsurers.

**Clarity:** The structured format helps readability and understanding, effectively conveying the complex regulatory requirements and processes involved in managing claims against reinsurers.

**Score: 10/10** - This answer thoroughly and accurately reflects the content of the FINMA Circular regarding the handling of claims against reinsurers.

Answer 2 provides a detailed and comprehensive explanation of how non-life insurers should handle claims against reinsurers according to FINMA guidelines, thus making it highly suitable in terms of relevance, accuracy, completeness, and clarity.



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Question: "What is the protocol for the inclusion of new types of investments?"

Answers:

Answer 1:

According to the provided context, new types of investments can be included in the investment portfolio of an insurance company under the category of alternative investments. However, the inclusion of new types of investments is subject to certain conditions and approvals. For instance, investments in other investment structures must be applied for and approved in advance by FINMA, and the insurance company must prove to FINMA that all the provisions listed in margin nos. 317-350 are fully complied with. The document also mentions that investments in fund solutions, indices, ETFs, baskets, and structured products linked to alternative investments are permitted, but they must meet specific conditions such as broad diversification, high liquidity, and transparency. Gold bars can also be allocated to tied assets under certain conditions. Therefore, the protocol for

the inclusion of new types of investments involves applying for approval from FINMA, ensuring compliance with the relevant regulations, and meeting the specific conditions for the type of investment.

Answer 2:

The protocol for the inclusion of new types of investments, as per the FINMA Circular 2016/5, involves a few essential steps to ensure that these investments comply with regulatory standards and align with the risk and investment strategy of the insurance company. Here are the key procedures:

**Compliance with Investment Guidelines:** Any new type of investment must adhere to the existing investment guidelines which are defined by the insurance company under the oversight of FINMA. These guidelines specify the types of permitted investments, the risk profiles, and the strategic alignment of asset categories.

**Approval Process:** For certain new types of investments, especially those that might not clearly fall under existing categories, an explicit approval from FINMA might be required. This process would involve demonstrating that the new investment type meets all regulatory requirements for security, liquidity, and profitability.

**Risk Assessment and Management:** New investments must be thoroughly assessed for their risk implications. This includes understanding the market, credit, liquidity, and operational risks associated with the investment. The insurance company must have the appropriate risk management processes in place to handle the specific risks associated with the new investment type.

**Expertise and Resources:** The insurance company must ensure that it has the necessary expertise and resources to manage the new investment type. This includes having knowledgeable staff and the right technological and operational infrastructure to support the investment.

**Integration into the Investment Strategy:** The new investment type should be integrated into the company's overall investment strategy. This integration involves adjusting the investment portfolio to maintain compliance with diversification requirements and alignment with the overall financial objectives of the company.

**Reporting and Monitoring:** Once included, the performance and compliance of the new investment type must be regularly reported to FINMA and monitored internally. This ensures ongoing compliance and allows for timely adjustments in strategy or risk management practices.

These steps ensure that new investment types are incorporated responsibly into an insurance company's portfolio, maintaining a balance between innovation in investment practices and regulatory compliance to protect the interests of policyholders and stakeholders.



Based on the detailed content from the FINMA Circular 2016/5 regarding protocols for the inclusion of new types of investments, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** The answer discusses the requirements for the inclusion of new types of investments under the category of alternative investments, focusing on the need for FINMA approval and compliance with specified provisions.

**Accuracy:** It accurately captures the procedural aspect of requiring FINMA approval and the need to comply with specific provisions, which reflects the document's directives.

**Completeness:** The answer is relatively comprehensive, discussing the requirement for broad diversification, high liquidity, and transparency, which are critical for alternative investments.

**Clarity:** The answer is structured clearly, explaining the steps and conditions involved in including new types of investments.

**Score: 9/10** - The answer is highly relevant, accurate, and clear but could be improved by specifying more detailed conditions and examples for a perfect score.

## Answer 2 Evaluation:

**Relevance:** Directly addresses the protocol for including new types of investments, with a clear explanation of compliance, approval processes, and risk assessment.

**Accuracy:** The answer accurately outlines the essential procedures, including adherence to investment guidelines, approval processes, and the need for expertise and resources to manage new investment types.

**Completeness:** Provides a comprehensive view of the entire process, from compliance with guidelines to integration into the investment strategy and ongoing monitoring.

**Clarity:** The answer is well-organized and effectively communicates the steps involved in incorporating new investments into an insurance company's portfolio.

**Score: 10/10** - Accurately reflects the document's guidelines for incorporating new types of investments with excellent clarity and comprehensiveness.

Both answers provide insightful explanations regarding the inclusion of new investment types as per the FINMA guidelines. Answer 2 provides a more detailed and systematic overview, making it slightly superior in terms of completeness and clarity.



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Question: "What is the principle of diversification within tied assets?"

Answers:

Answer 1:

he principle of diversification within tied assets refers to the practice of investing in a range of different assets, each with unique risk and return characteristics, to reduce overall risk. In the context of tied assets, this means investing in assets with varying credit ratings, industries, and geographical locations. The goal is to minimize the impact of potential losses in any one investment on the overall portfolio. The Swiss Financial Market Supervisory Authority (FINMA) regulates the use of tied assets in the insurance industry, and the principle of diversification is an important consideration in their allocation. The text provided in the context information discusses the use of credit ratings as a tool for diversification within tied assets, with different credit rating levels representing varying degrees of risk and return. Additionally, the text mentions exceptions for certain types of intra-group investments, such as loans to investment companies and real estate companies, which can be counted as tied assets under certain conditions. These exceptions may also contribute to diversification by introducing different types of assets into the portfolio.

Answer 2:

The principle of diversification within tied assets, as outlined in the FINMA Circular 2016/5 for insurers, is fundamentally about spreading investment risks to ensure that the insurance company can meet its obligations from insurance contracts at all times. Here are the key aspects of the diversification principle for tied assets:

**Asset Diversification:** The investment must be diversified appropriately across different asset categories, debtors, and geographical regions. This ensures that the tied assets are not overly concentrated in any particular investment, debtor, or location, which could expose the insurance company to higher risks if that specific investment, sector, or region faces a downturn.

**Risk Mitigation:** Diversification is also aimed at managing and reducing the various risks associated with the investments such as market risk, credit risk, and liquidity risk. By not overly concentrating assets in any specific area, the risk of significant financial loss from a single source is reduced.

**Investment Categories:** The principle calls for an appropriate mix in relation to the various investment categories. Investments must be assessed based on their specific risk profile, the default or impairment risk they carry, their investment horizon, and the correlation between different asset classes.

**Cluster Risks:** The principle specifically requires the exclusion of cluster risks. This means avoiding significant exposure to any single economic, industry, or sector risk that could potentially lead to large-scale defaults or impairments.

**Risk Capacity Consideration:** When making high-risk investments, the diversification must still be aligned with the insurance company's overall risk capacity. This ensures that even if high-risk investments are included, they are only a cautious addition to the overall portfolio and do not exceed the risk tolerance levels of the company.

The objective of these diversification requirements is to ensure the stability and security of the tied assets, which are crucial for meeting the claims of the insured in both normal and adverse situations.





Based on the information in the FINMA Circular 2016/5 regarding the principle of diversification within tied assets, here are the evaluations for the two answers provided:

## Answer 1 Evaluation:

**Relevance:** The answer addresses the principle of diversification in tied assets, including various risk levels and the geographic and sector diversification.

**Accuracy:** It correctly identifies that diversification involves different credit ratings, industries, and geographical locations, aligning with the circular's emphasis on minimizing risk through diversification.

**Completeness:** It includes specific details about exceptions and the role of intra-group investments, providing a comprehensive overview of the topic.

**Clarity:** The response is well-written and presents the diversification principles clearly, though it could integrate more specifics from the circular to strengthen its precision.

**Score: 8/10** - The answer is relevant and largely accurate but could use more detailed references to the circular to enhance accuracy and completeness.

## Answer 2 Evaluation:

**Relevance:** This answer directly addresses the diversification requirements as detailed in the circular, focusing on asset category, risk mitigation, and the avoidance of cluster risks.

**Accuracy:** It accurately reflects the circular's guidelines on how diversification should be managed within tied assets, particularly the need to spread investments across various asset categories and geographies.

**Completeness:** Provides a detailed explanation of diversification strategies, including the rationale behind them and how they protect the insurer's financial health.

**Clarity:** The answer is clearly articulated, structuring the diversification principles in a coherent and easy-to-understand manner.

**Score: 10/10** - This response excellently captures the diversification principles set forth in the FINMA Circular, with comprehensive details and clear explanations.

Answer 2 provides a more precise and thorough reflection of the FINMA Circular's guidelines on diversification within tied assets, offering a detailed understanding of how these principles safeguard the insurance company's interests.



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document.

Question: "What limits are set for investments in equities and equity securities?"

Answers:

Answer 1:

The text does not provide specific limits for investments in equities and equity securities. However, it does mention general limits for alternative investments, which include investments in equities and equity securities. The limits for alternative investments are that the value of all alternative investments included in the tied assets may not exceed 15% of the target amount, the imputed value per subcategory may not exceed 10% of the target amount, the imputed value per fund of funds may not exceed 5% of the target amount, and for all other investments, the imputed value per investment may not exceed 1% of the target amount. These limits do not apply to physical gold. It is important to note that these limits apply to alternative investments as a whole and not just to equities and equity securities.

Answer 2:

The limits set for investments in equities and equity securities by insurance companies, as outlined in the FINMA Circular 2016/5, include the following:

Equity Allocation Limit:

Investments in shares and other equity securities must not exceed 30% of the target amount of the tied assets.

Market Value Consideration:

Equity securities and convertible bonds with the character of shares are counted at market value at most. This is to ensure that the valuation reflects current market conditions, reducing the risk of overvaluation.

Liquidity Requirement:

All securities in this category must be traded on a liquid, regulated market and be available for sale at short notice. This ensures that the assets can be liquidated quickly if needed to meet claims or other financial obligations.

These limits help in managing the inherent volatility and risks associated with equity investments, ensuring that they remain a manageable portion of the insurers' overall investment portfolio.



Based on the detailed content from the FINMA Circular 2016/5 regarding limits set for investments in equities and equity securities, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** The answer discusses limits on alternative investments, which include equities and equity securities under specific conditions, but it primarily focuses on alternative investments as a category.

**Accuracy:** It correctly states the limits for alternative investments but does not directly answer the question about specific limits for equities and equity securities, as it conflates these with broader categories.

**Completeness:** While providing correct information regarding alternative investments, it lacks the specifics on equity investments that are directly addressed in the document.

**Clarity:** The explanation is clear regarding alternative investments but may confuse readers by not distinguishing between general equities and alternative investment vehicles.

**Score: 5/10** - The answer provides some relevant information but does not address the specific limits for equities and equity securities directly.

## Answer 2 Evaluation:

**Relevance:** Directly addresses the question, focusing on the specific limits for equities and equity securities as outlined in the circular.

**Accuracy:** Accurately details the limits for equity investments, including the maximum percentage allowed and the conditions under which equities must be traded.

**Completeness:** Provides a comprehensive overview of the regulatory limits on equity investments, including considerations for market value and liquidity requirements.

**Clarity:** The answer is structured clearly, making it easy to understand the regulatory requirements for equity investments.

**Score: 10/10** - This answer precisely matches the information in the document, providing a detailed and accurate response to the question.

Answer 2 provides a detailed and correct explanation of the limits set for investments in equities and equity securities as specified in the FINMA Circular, aligning closely with the document's content and thus earning a higher score.



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Question: "What are the specific limitations for investing in real estate within tied assets?"

Answers:

Answer 1:

According to the provided text, an insurance company may invest in real estate as part of its tied assets, but each individual element of the structured product and the underlyings of derivative transactions must be individually eligible. The real estate investment must meet the criteria for collective investment schemes, which include saleability at any time in a liquid market and subordination to an effective fund supervisory authority. If an investment has a non-eligible component, the entire investment is not permitted in the tied assets unless it contains additional security that compensates for the deficiency. Additionally, limits are set for individual investment categories, including real estate, and an insurance company may not hold more than a specified percentage of the target amount of each individual tied asset in real estate. Exceeding the specified

limits is permitted within the scope of the excess cover of the target amount. The insurance company must take appropriate measures to ensure that the limits are complied with at all times, and securities that have been transferred to securities lending or repurchase agreements must be included in the calculation of the limits. The exposure to a counterparty may not exceed 5% of the target amount of the tied assets, but claims against the Swiss Confederation, cantons, cantonal banks with a state guarantee, and Swiss mortgage bond institutions are exempt from this limit. Receivables from debtors whose obligations are due at any time and are fully guaranteed by a state with a credit rating of 1 are also excluded from this limit. To determine the net exposure, all receivables and investment instruments in the tied assets vis-à-vis this party must be accumulated, and guarantees issued to the insurance company are also included in the calculation of net exposure. Investments in currencies other than the reference currency are limited to 20% of the target amount of the tied assets. Upon request, an insurance undertaking may deviate from these limits for the real estate investment category and apply for its own limits.

Answer 2:

The specific limitations for investing in real estate within tied assets, according to the FINMA Circular 2016/5, are designed to ensure that these investments are secure, liquid, and capable of being realized in case of the insurer's insolvency. Here are the key limitations:

**Maximum Allocation Limits:** Investments in real estate are limited to 25% of the total tied assets. This is to prevent over-concentration in real estate, which could be less liquid compared to other asset classes.

**Individual Property Limit:** The investment in any single property should not exceed 5% of the tied assets to avoid significant exposure to any single asset.

**Liquidity and Marketability:** Real estate investments must be easily realizable and their valuation subject to little uncertainty. This typically excludes specialized properties like hotels, leisure facilities, or buildings in progress, which may be harder to sell or value.

**Location and Use Restrictions:** The properties should be suitable for insurance purposes, meaning they should not be subject to restrictions or characteristics that could impair their value or saleability. Properties must be located in Switzerland to be included in tied assets.

**Valuation Requirements:** Real estate must be valued at market value, and valuations must be updated regularly to reflect current market conditions. This is to ensure that the real estate's book value aligns closely with what it could realistically fetch on the market.

These limitations ensure that real estate investments are secure, not overly concentrated, and liquid enough to meet the insurance company's obligations, especially in scenarios of financial distress or claims payouts.



Based on the information detailed in the FINMA Circular 2016/5 regarding limitations on real estate investments within tied assets, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** This answer focuses on general regulations related to different investment types, including structured products, but it strays from directly addressing real estate limitations within tied assets.

**Accuracy:** The specifics mentioned, such as collective investment schemes and liquidity conditions, are relevant to the broader investment guidelines but not specifically accurate to real estate investments within tied assets as outlined in the circular.

**Completeness:** The answer attempts to cover various compliance aspects but lacks direct focus on real estate limitations which are explicitly provided in the circular.

**Clarity:** The answer could mislead by discussing aspects more relevant to alternative investments and structured products rather than direct limitations on real estate.

**Score: 4/10** - The response mixes up the guidelines with general investment information and does not accurately reflect the circular's specific limitations on real estate.

## Answer 2 Evaluation:

**Relevance:** Directly addresses the question with a clear focus on real estate investment limitations within tied assets as specified in the circular.

**Accuracy:** Correctly outlines the key limitations including maximum allocation limits, liquidity and marketability requirements, and valuation criteria, which are essential elements described in the circular.

**Completeness:** Provides a comprehensive understanding of how real estate investments are managed within the regulatory framework, highlighting limits on individual properties and overall allocation in tied assets.

**Clarity:** The response is well-structured and effectively communicates the regulatory requirements and limitations on real estate investments, making it easy for readers to understand the imposed conditions.

**Score: 10/10** - Accurately and thoroughly reflects the detailed descriptions of real estate investment limitations from the circular.

Answer 2 is far superior in addressing the specific question concerning limitations on real estate investments within tied assets, presenting a clear and detailed understanding according to the FINMA Circular 2016/5, whereas Answer 1 is less focused and inaccurate in the context of the question asked.



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Question: "What are synthetic bonds and how are they used?"

Answers:

Answer 1:

Synthetic bonds are investments that mimic the characteristics of fixed-interest securities. They are made up of a combination of financial instruments, such as a fixed-term deposit with a variable interest rate and a receiver swap. Insurance companies use synthetic bonds to make investments with maturities that are not available on the market in the form of fixed-interest securities. The same provisions that apply to derivatives with a replicating strategy also apply to synthetic bonds. They are recognized at no more than their nominal value, separately in a sub-category of fixed-income securities, and the receiver swap is measured using the cost amortization method. If the receiver swap has a value of zero on conclusion, it must be recognized at zero for the entire term. The use of synthetic bonds is permitted with prior notification to FINMA and submission of a concept. The derivatives used to hedge cash flows from underwriting obligations are recognized at no more than the value of the cost amortization method. The replicating strategies are valued in accordance with the categories to which they are assigned. The limitations include the premiums for open derivative financial instruments to hedge cash flows from technical obligations being limited to 5% of the target amount of the tied assets. The assessment involves recognizing swaptions and similar derivatives used to hedge technical obligations at no more than the value of the cost amortization method. The replicating strategies pursuant to margin nos. 406-407 and 422-431 are valued in accordance with the categories to which they are assigned. In the case of synthetic bonds, the fixed-term deposit may be valued and recognized at no more than its nominal value. They are recognized separately in a sub-category of fixed-income securities. The receiver swap is measured using the cost amortization method. If the receiver swap has a value of zero on conclusion, it must be recognized at zero for the entire term.

Answer 2:

Synthetic bonds are a type of financial instrument used in investment strategies, which essentially combine various elements of debt and derivatives to create a bond that mimics the performance of other assets. Here's how they are used:

**Creation and Structure:** Synthetic bonds are created by combining traditional debt securities, like bonds, with derivatives such as options, swaps, or futures. The goal is to replicate the cash flows and risk profiles of a particular asset or set of assets. For example, an investor might combine a zero-coupon bond (a bond that pays no interest until maturity) with a derivative that provides income based on the performance of a stock index.

**Purpose:** These bonds are typically used to gain exposure to a certain asset class or market without actually owning the physical assets. This can be beneficial for managing risk, diversifying portfolios, or accessing markets that might be otherwise out of reach due to cost, regulatory, or other constraints.

**Risk Management:** Synthetic bonds allow investors to tailor the risk and return profiles of their investments more finely than traditional bonds. By adjusting the mix of the underlying debt and derivative components, investors can control factors such as credit risk, interest rate risk, and market volatility.

**Use in Portfolios:** Investors, particularly institutional ones like pension funds or insurance companies, might use synthetic bonds to hedge against certain risks or to improve the yield of their portfolios under specific financial conditions.

In essence, synthetic bonds provide a versatile tool in modern finance, allowing for complex strategies that can be customized to suit specific investment goals and risk management requirements.



Based on the detailed content from the FINMA Circular 2016/5 regarding synthetic bonds, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** The answer is directly related to synthetic bonds, explaining their structure and use in investment strategies, especially within the context of insurance companies.

**Accuracy:** It accurately describes synthetic bonds as being comprised of multiple financial instruments, including swaps and fixed-term deposits, aligning well with their description in the document.

**Completeness:** Provides a comprehensive overview of how synthetic bonds function, including their valuation, regulatory compliance, and the specific conditions under which they can be used.

**Clarity:** The response is detailed and informative, though it could be slightly clearer by simplifying the explanation of the technical aspects of synthetic bonds and their regulatory requirements.

**Score: 8/10** - The answer is detailed and accurate but could benefit from clearer articulation of the concepts to enhance understanding.

### Answer 2 Evaluation:

**Relevance:** Addresses the concept and utility of synthetic bonds in a broad investment context, touching on their construction and usage by insurance companies.

**Accuracy:** Accurately describes the creation and purpose of synthetic bonds, including their risk management and investment strategy applications.

**Completeness:** While it covers the broader aspects of synthetic bonds, it does not delve into the specific regulatory or operational details provided in the circular.

**Clarity:** This response is structured well and presents a clear, high-level overview of synthetic bonds and their strategic uses in modern finance.

**Score: 7/10** - Provides a general understanding of synthetic bonds but lacks the detailed regulatory context and specific examples as seen in the circular.

Both answers provide insightful explanations about synthetic bonds, with Answer 1 providing a more detailed look at the specifics as per the FINMA guidelines, which makes it slightly more suitable for someone looking for a detailed regulatory context. Answer 2, while informative and clear, lacks the depth required to fully align with the details found in the circular.



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Question: "How should insurance companies manage and report structured product investments?"

Answers:

Answer 1:

Insurance companies that invest in structured products must have qualified and knowledgeable staff, an appropriately designed investment strategy, an investment management system tailored to their specific needs, a fully implemented and documented investment process, an appropriate risk management system, and an adequate system infrastructure. They must also use scenario analyses to ensure that the use of complex investments does not jeopardize the value of the total assets and tied assets or the solvency of the insurance company. The insurance company is responsible for monitoring and controlling compliance with the investment principles and objectives, regulatory requirements, and the main risks associated with investment activities. If the insurance company commissions a third party with investment management, it remains responsible for compliance with the investment management regulations. The transfer of investment management to third parties is subject to FINMA approval. Control (risk management) must ensure and perform at least the following tasks: monitoring and controlling compliance with the investment principles and objectives, regulatory requirements, and the main risks associated with investment activities. For structured products or individual elements of structured products, the limitations of the categories to which they are assigned apply. The provisions relating to foreign counterparties must be taken into account, and investments in insurance-linked securities are permitted only if the resulting risks are not positively correlated with the company's own insurance risk. The insurance company must understand the investment process, monitor the specified strategy and investment principles, and be able to track all transactions in a timely manner for accounting purposes. The Circular must be observed for each separate tied asset, whereby in particular the defined limits, coverage obligations, and qualitative requirements for each tied asset must be taken into account. For the separate tied assets of unit-linked life insurance and capitalization transactions, exceptions apply with regard to the limits. The insurance undertaking is not obliged to secure its foreign insurance portfolios with tied assets if equivalent security must be provided abroad. If no equivalent security has to be provided abroad, the security is provided in Switzerland, whereby the provision can be made in separate tied assets. If there is no equivalent guarantee abroad, a supplementary guarantee must be provided in Switzerland. The following criteria are relevant for the equivalence check: special assets.

Answer 2:

Insurance companies are required to manage and report structured product investments with stringent oversight and precision as outlined in the FINMA Circular 2016/5. Here are the main points concerning the management and reporting of these investments:

**Compliance with Investment Categories:** Structured products must comply with the existing investment categories specified by FINMA. Each component of the structured product (like derivatives within the product) must meet the requirements of the corresponding investment category.

**Risk Management:** Insurance companies must have a robust system to manage the risks associated with structured products. This includes having qualified personnel and a sound investment strategy that incorporates these products appropriately within the overall portfolio.

**Documentation and Process:** The investment process, including the decision-making criteria and risk assessment for structured products, must be well-documented. This documentation helps in providing clarity during audits and regulatory reviews.

**Valuation and Reporting:** Structured products need to be valued accurately and reported on. The valuation should reflect the fair market value, and any changes in valuation must be reported to FINMA as part of regular disclosures.

**Limitations on Investment:** There may be specific limits on the proportion of structured products within the overall investment portfolio, depending on their risk profile and the insurance company's capacity to absorb potential losses.

**Regular Updates to FINMA:** Insurance companies must regularly update FINMA about their investments in structured products. This includes detailed reports on the valuation methods, risk exposure, and performance of these investments.

**Special Approval for Certain Investments:** If structured products include components that do not fit neatly into established categories, special approval from FINMA might be required. This ensures that all investments are made transparently and within the regulatory framework.

By adhering to these protocols, insurance companies ensure that their investments in structured products are secure, comply with regulatory requirements, and are aligned with the company's risk management strategy and financial objectives.



Based on the content from the FINMA Circular 2016/5 regarding the management and reporting of structured product investments, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** This answer is relevant as it addresses the management of structured product investments through various aspects like qualified staff, investment strategy, and a documented investment process.

**Accuracy:** It accurately describes the needs for a robust investment management system and scenario analysis, though it mixes elements that apply to broader investment management not strictly limited to structured products.

**Completeness:** The answer provides an extensive overview of the management requirements including monitoring and compliance, yet it could detail more about reporting requirements specifically related to structured products.

**Clarity:** The response is detailed, though somewhat complex and could benefit from more concise structuring to enhance clarity, particularly in linking practices directly to structured products.

**Score: 7/10** - The answer covers most aspects relevant to the management of structured product investments but lacks specific examples and could improve in clarity.

### Answer 2 Evaluation:

**Relevance:** Directly addresses management and reporting of structured products, clearly focusing on compliance and risk management.

**Accuracy:** Correctly identifies compliance with investment categories, risk management requirements, and the need for detailed documentation and reporting to FINMA.

**Completeness:** Provides a thorough description of the structured products management including the necessity for documentation, valuation, and regular updates to FINMA, aligned with the circular's requirements.

**Clarity:** Well-structured and clearly communicates the obligations and processes for managing and reporting structured products, making it easy for the reader to understand regulatory expectations.

**Score: 9/10** - Excellently outlines the structured products management and reporting process with a slight deduction for not deeply explaining the valuation and categorization specifics mentioned in the circular.

Both answers are good; however, Answer 2 is slightly more aligned with the circular's specifics, particularly in its focus on regulatory compliance and structured risk management processes. Answer 1, while comprehensive, blends general investment management practices with those specific to structured products, leading to a slightly broader approach.



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Question: "What derivatives can be used to hedge credit risk of asset portfolio?"

Answers:

Answer 1:

The derivatives that can be used to hedge credit risk of asset portfolios are CDSs on individual securities if the insurance company is the protection buyer (buy protection) and CDSs on indices if the insurance company is the protection buyer (buy protection). These derivatives must be structured in such a way that a high hedging effect is achieved, ensuring that the portfolio to be hedged and the index portfolio are largely identical in terms of composition and portfolio weightings. If there is no stable correlation between the portfolio to be hedged and the index portfolio, the hedging effect is not ensured but can only be approximated, and this hedging instrument cannot be assigned to this strategy. CDSs on individual securities are only recognized at market value if the bond (underlying security) is permanently impaired, and the CDS therefore has a hedging effect. CDSs on indices used for hedging purposes are always included in the tied assets with a value of zero.

Answer 2:

To effectively manage and report on structured product investments, insurance companies must adhere to stringent regulatory standards and internal guidelines. Here's a detailed breakdown of

the approach:  
Management

#### Risk Assessment and Due Diligence:

Insurance companies must thoroughly assess the risks associated with structured products, including market, credit, and liquidity risks.

A comprehensive due diligence process is necessary to understand all the components of the structured product, such as underlying assets and derivative components.

#### Qualified Personnel:

Companies must ensure that personnel managing structured products are well-qualified and have the requisite knowledge and experience.

Staff should be familiar with the specific complexities of structured products to manage them effectively.

#### Investment Strategy:

Structured products should be integrated into the overall investment strategy of the company.

The strategy must account for the risk profile and investment objectives of the company, ensuring that these products are suitable for their portfolio.

#### Risk Management Systems:

Robust risk management systems need to be in place to monitor and control the risks associated with structured products continually.

This includes setting limits on exposure to structured products and ensuring these limits are adhered to.

### Reporting

#### Transparency and Disclosure:

Regular reporting on the performance and risks associated with structured products is required.

These reports should be made available to the management and, as necessary, to regulators and stakeholders.

#### Compliance and Regulatory Reporting:

Insurance companies must comply with local and international regulations regarding their investments in structured products.

This includes detailed reporting to regulatory bodies like FINMA, outlining the valuation methods, risk exposure, and compliance with investment guidelines.

#### Valuation and Accounting:

Structured products must be accurately valued and reported in the company's financial statements.

The valuation methods should reflect fair value, taking into account the market conditions and the specific features of the structured products.

#### Documentation:

Detailed documentation of all transactions and management processes related to structured products is crucial.

This ensures that there is an audit trail that can be reviewed by internal auditors or regulatory authorities.

By adhering to these guidelines, insurance companies can manage structured products effectively, minimizing risks and ensuring compliance with regulatory standards.



Based on the content from the FINMA Circular 2016/5 regarding the use of derivatives to hedge credit risks in asset portfolios, here are the evaluations for the two answers provided:

### Answer 1 Evaluation:

**Relevance:** Directly addresses the use of derivatives for credit risk hedging, specifically mentioning credit default swaps (CDS) for both individual securities and indices, which is relevant to the use of derivatives in financial risk management.

**Accuracy:** Accurately discusses the use of CDSs to hedge credit risks, highlighting the need for a high hedging effect and the alignment of the hedged portfolio with the index portfolio.

**Completeness:** Provides detailed information on the conditions under which CDSs can be effectively used and recognized, including the impact of the correlation between the portfolios and the hedging effect.

**Clarity:** Clearly explains the scenarios in which CDSs are effective and their valuation, especially in the context of hedging strategies.

**Score: 9/10** - The answer is highly relevant, accurate, and complete with a clear explanation of how CDSs function as a hedging tool against credit risk.

### Answer 2 Evaluation:

**Relevance:** This answer does not address the question regarding derivatives for hedging credit risks directly; instead, it details the management and reporting of structured products broadly.

**Accuracy:** While detailed, the response is not accurate in the context of the question asked, as it does not focus on derivatives used specifically for credit risk hedging.

**Completeness:** The answer provides a comprehensive view on managing structured products but is not relevant to managing credit risk with derivatives.

**Clarity:** Well-structured and clear, but off-topic regarding the specific use of derivatives for credit risk.

**Score: 2/10** - This answer fails to address the specific question about derivatives for hedging credit risk, focusing instead on a different aspect of financial management.

Overall, Answer 1 provides a specific and detailed response to the use of derivatives for hedging credit risks in asset portfolios, aligning well with the regulatory insights from FINMA. Answer 2, while detailed and informative on a related subject, does not address the question directly.





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Question: "How should liquidity be maintained when using derivatives in investment strategies?"

Answers:

Answer 1:

Liquidity must be maintained in full at all times in the event of an obligation to sell derivatives, especially when cash settlement is mandatory for underlyings that cannot be physically delivered. This is crucial for ensuring that the necessary liquidity is available to fulfill the obligations associated with derivative transactions.

Answer 2:

To manage and report on investments in derivatives effectively, insurance companies must adhere to several critical practices according to the FINMA Circular 2016/5:

Management of Derivative Investments

**Risk Mitigation:** Derivatives should be used primarily for hedging risks associated with the assets or obligations of the insurance company or for efficient management of investments.

**Limitation on Risk Exposure:** The usage of derivatives must not expose the company to risks that exceed its capacity or the scope of its business operations.

**Coverage Requirements:** All potential obligations arising from derivative transactions must be fully covered at all times. This coverage can be either through the underlying assets or liquidity to ensure that the company can meet its derivative obligations without fail.

## Reporting Requirements

**Regular Risk Analysis:** The risks associated with derivative usage, such as market and credit risks, must be regularly analyzed — weekly for market risks and monthly for credit risks.

**Executive Reporting:** The outcomes of these analyses must be reported to the company's executive board regularly — monthly for market risks and quarterly for credit risks.

**Annual Reporting to FINMA:** Companies must report their derivative activities annually to FINMA, detailing the usage, risk exposure, and compliance with the set regulatory requirements.

## Liquidity Management

When using derivatives as part of their investment strategies, maintaining sufficient liquidity is crucial:

**Liquidity Reserves:** Insurance companies must ensure they have enough liquid assets or cash equivalents to meet obligations from derivatives at all times. This is especially critical for derivatives with potential future financial obligations like margin calls.

**Cash and Cash Equivalents:** These can include readily available funds such as cash deposits and highly liquid government bonds, which are counted towards covering potential derivative payouts.

**Prohibitions on Double Usage:** The same assets or liquidity must not be used to cover multiple derivative positions unless they cover different aspects of the same underlying asset, ensuring clear



and unambiguous coverage for each position.

### Organizational and Infrastructure Requirements

**Qualified Personnel:** Companies must employ staff with specific qualifications and knowledge suitable for managing derivatives.

**Adequate Systems:** Adequate systems and infrastructure must be in place to support the complex nature of derivative transactions, including robust risk management and investment monitoring systems.

### Compliance with Internal and Regulatory Guidelines

**Adherence to Investment Strategies:** All derivatives used must align with the company's broader investment strategies and risk management frameworks.

**Compliance Monitoring:** Continuous monitoring and control of compliance with both internal directives and external regulatory requirements are mandatory.

Through these stringent management, reporting, and liquidity maintenance requirements, insurance companies can ensure that their use of derivatives aligns with regulatory expectations and their risk management objectives, thereby safeguarding the company's financial stability and compliance.



Evaluating the answers provided to the question "How should liquidity be maintained when using derivatives in investment strategies?" against the content of the provided PDF document (FINMA Circular 2016/5):

#### Answer 1:

This answer correctly identifies the need for maintaining liquidity for obligations arising from derivatives, specifically when cash settlement is mandatory for underlyings that cannot be physically delivered. It emphasizes the importance of ensuring sufficient liquidity to fulfill obligations related to derivative transactions, which aligns with the requirements detailed in the PDF, particularly the stipulations about liquidity in margin nos. 15 and the need for full coverage by cash or cash equivalents. Therefore, the answer is accurate and relevant.

**Score: 9/10** - It captures the essential requirement of liquidity management in derivatives trading but could have provided more detail about the mechanisms or strategies to maintain liquidity as described in the document.

#### Answer 2:

This answer offers a detailed explanation of how insurance companies should manage and report investments in derivatives, focusing on risk management, compliance, and liquidity maintenance. It outlines specific requirements for managing derivative investments, such as covering potential obligations, having qualified personnel, and ensuring liquidity reserves. The answer is thorough and provides a broad and accurate explanation of the regulations and practices for managing liquidity risks in derivative use, specifically aligning with the sections about risk management systems and the comprehensive need for liquidity coverage for derivatives as discussed in the PDF.



**Score: 10/10** - The answer provides a comprehensive explanation that aligns closely with the regulatory requirements specified in the document, emphasizing the critical aspects of liquidity management, risk analysis, and regulatory compliance in the context of using derivatives.

Both answers are consistent with the guidelines from the FINMA Circular 2016/5, providing correct interpretations and highlighting the importance of liquidity in derivatives trading from a regulatory perspective. Answer 2, however, stands out by offering a more comprehensive and detailed explanation that aligns perfectly with the document's content on managing derivatives and liquidity requirements.



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Question: "What specific provisions must be followed when dealing with tied assets in relation to unit-linked life insurance policies?"

Answers:

Answer 1:

When dealing with tied assets in relation to unit-linked life insurance policies, the specific provisions that must be followed include:

1. The investments used as collateral must correspond to those on which the contracts are based (matching cover), ensuring that the insurance company does not bear an additional investment risk.
2. Any guarantees must be secured with investments that replicate the fluctuations in value of these guarantees as well as possible.
3. Other contractual components, non-unit-linked provisions, and any supplement to the target amount must be secured with values in accordance with Art. 79 AVO.
4. The investments underlying the contracts must be used to determine the tied assets, and the quantitative limits of the Circular do not apply to the separate tied assets of unit-linked life insurance.
5. The exposure to a counterparty and securities lending and repurchase agreements must be observed, but these limits may be exceeded if the policyholder has been expressly informed of the possible deviation from these limits before the contract is concluded.
6. The investment principles of security, ALM, profitability, diversification, and liquidity must be observed.
7. Small insurance undertakings with only a small debit amount of tied assets may apply for an exception to the 5% counterparty limit in justified cases, providing reasons for the intended deviation from the counterparty limit and information on the debtor of the claims that account for more than 5% of the target amount of tied assets.
8. The insurance company must review the value of the individual investment on an ongoing basis and take into account any impairment as a result of a deterioration in creditworthiness in the valuation of the investment.
9. The value of an investment is at risk if it requires impairment, and the ordinary valuation method

must be deviated from for inclusion in tied assets and the inclusion must be at most at market value.

10. This may affect the following investment categories in particular: cash contributions, bonds, convertible bonds, structured products, other acknowledgements of debt, and mortgages.

These provisions ensure that the tied assets are managed in a way that aligns with the insurance company's obligations to policyholders, maintains the security and value of the investment fund, and adheres to regulatory requirements.

Answer 2:

Specific provisions that must be followed when dealing with tied assets in relation to unit-linked life insurance policies, according to the FINMA Circular 2016/5, include the following:

**Separate Tied Assets Requirement:** Separate tied assets must be established for unit-linked life insurance and capitalization transactions. This ensures that the policyholder claims are secured by designated assets, directly correlating to the liabilities arising from these policies.

**Matching Cover:** The assets used to cover unit-linked contracts must correspond to the investments upon which the contracts are based. This principle ensures that the fluctuations in the value of the assets match those of the liabilities, minimizing the insurer's exposure to additional investment risks.

**Valuation at Market Value:** Investments used to secure claims from unit-linked life insurance policies must be valued at no more than their market value. This valuation must be consistent with the underlying asset fluctuations and maintain transparency in asset reporting.

**Admissible Assets:** In the case of unit-linked contracts, permissible assets include open-ended collective investment schemes under the Collective Investment Schemes Act. For contracts linked to internal investment portfolios or other reference values, permissible values must comply with specific articles outlined in the FINMA Circular.

**Compliance with Investment Limits:** The general investment limits of the Circular do not apply to separate tied assets for unit-linked life insurance. This flexibility allows for tailored investment strategies that align closely with the nature of the liabilities provided these are sufficiently covered and reported.

**Reporting and Compliance:** Insurance companies must regularly report on these assets to FINMA and ensure continuous compliance with the regulatory frameworks. This includes documenting and justifying the alignment of assets with the corresponding insurance liabilities.

These provisions ensure that the assets backing unit-linked life insurance policies are managed in a way that protects the interests of policyholders, aligning investment risks with policy liabilities and ensuring sufficient liquidity and asset coverage.



Based on the document details and evaluating the responses:

**Answer 1**

- **Relevance:** The response broadly outlines the key aspects of managing structured product investments, covering risk management, staff requirements, and compliance with investment regulations.
- **Accuracy:** The details about risk management and staff expertise are consistent with the document's requirements for managing complex investments.
- **Completeness:** This answer covers a wide range of aspects, including management responsibilities and the need for FINMA approval for outsourcing.
- **Clarity:** The response is structured and clear, laying out the steps and requirements systematically.

**Score for Answer 1:** 8/10. The answer is comprehensive and aligns well with the document's guidelines, although it could emphasize more on specific reporting to FINMA and the use of these investments within the constraints of tied assets.

## Answer 2

- **Relevance:** This answer focuses on the broader aspects of managing and reporting on structured product investments, aligning with the document's requirements.
- **Accuracy:** It accurately reflects the document's directives about investment compliance, risk assessment, and the need for skilled management.
- **Completeness:** Provides a detailed breakdown of management and reporting processes, including compliance with investment categories and risk management.
- **Clarity:** Clearly articulates the management and reporting requirements for structured product investments with detailed steps and protocols.

**Score for Answer 2:** 9/10. This answer provides a detailed and accurate description of the structured product investment management and reporting, closely adhering to the document's guidelines. It slightly edges out Answer 1 by providing more detailed steps and considerations in risk management and reporting.

Both answers provide a thorough overview of the subject matter, with Answer 2 slightly more detailed in terms of compliance and reporting specifics as required by the document.



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Question: "Explain the criteria and process for allocating an investment to tied assets."

Answers:

Answer 1:

The criteria and process for allocating an investment to tied assets, as outlined in the provided text, are as follows:

1. **Inventory and Allocation**: The investments per single investor fund are not limited. The fund's direct investments are inventoried in the tied assets and allocated to the corresponding categories. They are subject to the limits for direct investments.
2. **Look-through Approach**: The direct investments contained in the fund are used as the basis for the inclusion and valuation of the single investor fund. The individual investments contained in the fund must be listed in the inventory of tied assets and allocated to the categories in accordance with Art. 79 SO.
3. **Valuation**: The valuation is carried out in accordance with the principles set out in Art. 88-95 SO.

This process ensures that the investments made by the fund are accurately reflected in the tied assets, allowing for a clear and transparent representation of the fund's financial position. It also ensures that the investments are allocated to the appropriate categories and are subject to the necessary limits, ensuring compliance with regulatory requirements. The valuation process is crucial for accurately reflecting the value of the tied assets, which is essential for financial reporting and regulatory compliance.

Additionally, the text specifies that the securities lending transactions must be processed promptly, all open positions must be valued at least once a day, net exposures must be balanced with margin calls at least once a day, and the collateral must be fully segregated per tied asset. This ensures that the securities lending activities are conducted in a manner that is transparent, secure, and in compliance with regulatory requirements.

The text also highlights that securities accepted as collateral in the context of repurchase agreements, securities lending, and similar transactions may not be used for securities lending. This is likely to prevent conflicts of interest or potential risks associated with using the same securities for multiple transactions.

Overall, the process for allocating an investment to tied assets involves a clear and transparent inventory and allocation of the investments, a valuation process that adheres to regulatory principles, and a securities lending process that is conducted in a manner that ensures transparency, security, and compliance with regulatory requirements.

Answer 2:

The criteria and process for allocating an investment to tied assets are comprehensively outlined in the FINMA Circular 2016/5. Here's a detailed explanation based on the guidelines:

**Criteria for Allocating Investments to Tied Assets**

**Permissibility and Eligibility:** The investment must be a permissible value under the applicable regulations (Art. 79 or Art. 68 para. 2 SO) and must comply with the specific requirements set out in the Circular.

**Valuation:** The investment should be easily valued without significant problems.

**Liquidity:** Investments must exhibit a high level of liquidity relative to their investment category.

**Expertise and System Requirements:** There must be the necessary expertise and appropriate systems and processes in place for selecting, managing, and controlling the investment.

**Risk Understanding:** The financial, legal, and operational risks associated with the investment should be fully understood.

Creditworthiness of Debtor: The debtor's creditworthiness must be verifiable.

Encumbrances: The asset must be unencumbered and not subject to any rights of set-off or similar claims.

#### Process for Allocating Investments to Tied Assets

Allocation Decision: The insurance company decides which assets are to be allocated to tied assets based on their ability to cover the target amount of the tied assets. This decision is based on the valuation of the assets, their liquidity, and the overall investment strategy of the company.

Documentation and Record-Keeping: Assets allocated to tied assets must be recorded and identified in such a way that the company can demonstrate at any time which assets belong to tied assets. This includes maintaining up-to-date records and being able to quickly verify the coverage of the target amount by the tied assets.

Compliance with Investment Limits: The allocation must comply with any specific investment limits or restrictions outlined in the Circular, ensuring that the portfolio remains diversified and aligned with the insurer's risk capacity.

Ongoing Review and Adjustment: Allocated assets should be regularly reviewed to ensure they continue to meet the necessary criteria and are performing as expected. Adjustments should be made as needed to respond to changes in market conditions or the financial health of the insurance company.

Reporting to FINMA: Insurers must report their tied assets and any changes to their allocation to FINMA as required by the regulations. This includes an annual report detailing the composition and valuation of tied assets.

By adhering to these criteria and processes, insurance companies ensure that their tied assets are capable of covering the obligations associated with insurance contracts, thereby protecting the interests of policyholders.



Evaluating the responses based on the PDF document:

#### **Answer 1: Score 7/10**

This answer details a robust, structured process for allocating an investment to tied assets, including inventory and allocation, valuation principles, and special requirements for securities lending. It touches upon several key areas of asset allocation, like the need for a comprehensive inventory and look-through approach, which aligns with the document's emphasis on thoroughness in asset management. However, it lacks specific references to regulatory and compliance considerations explicitly mentioned in the document, like the need for consistent coverage and evaluation of risks, which are crucial in understanding the complete regulatory framework.

#### **Answer 2: Score 9/10**

This answer is quite comprehensive and aligns closely with the content and principles outlined in the document. It includes criteria like permissibility and eligibility of investments, the importance of valuation and liquidity, and adhering to risk and creditworthiness assessments. It also correctly addresses the process of maintaining documentation and continuous review, as specified by the regulations. This response directly reflects the emphasis on regulatory compliance, risk management, and the strategic approach required for managing tied assets, as outlined in the document. It includes almost all elements from the official guidelines, making it highly relevant and accurate.

These scores reflect the answers' alignment with the regulatory requirements, clarity in describing the asset allocation process, and the completeness of addressing the critical aspects of managing tied assets in compliance with regulatory standards.



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Question: "How are claims of non-life insurers against reinsurers treated in the context of tied assets?"

Answers:

Answer 1:

The context information indicates that for non-life insurers, if an analogous system for offsetting the reinsured portions of the provisions exists, the gross principle is deemed to be fulfilled. This means that the reinsured portions of the provisions are included in the special fund, which is the tied asset, and the gross principle is considered to be met. This system allows for the offsetting of the reinsured portions of the provisions against the special fund, which is a form of tied asset, ensuring that the entire technical provisions are covered. However, it is important to ensure that only contracts that are fully included in the target amount participate in the special fund. This approach is different from the treatment of life insurance, where the special assets are primarily available to satisfy claims arising from insurance contracts in the event of bankruptcy.

In summary, for non-life insurers, the reinsured portions of the provisions can be included in the special fund, which is a form of tied asset, through an analogous system for offsetting the reinsured portions of the provisions. This system ensures that the entire technical provisions are covered, and the gross principle is considered to be met. This approach allows for the reinsured portions of the provisions to be included in the tied assets, which is a form of security for insurance claims, even though the reinsured portions are not technically part of the insurance contracts. This system is designed to maintain the security and value of the investment fund, as required by the investment guidelines of the local supervisory authority.

This information is derived from the context information provided, specifically from Art. 77 para. 1

let. b and c AVO, which indicates that for non-life insurers, the gross principle is deemed to be fulfilled if an analogous system for offsetting the reinsured portions of the provisions exists. This system allows for the reinsured portions of the provisions to be included in the special fund, which is a form of tied asset, ensuring that the entire technical provisions are covered. The context also indicates that the investments used as collateral must correspond to those on which the contracts are based, as well as any guarantees must be secured with investments that replicate the fluctuations in value of these guarantees. This ensures that the insurance company bears only the intended investment risk and that the contractual components, non-unit-linked provisions, and any supplement to the target amount are also secured with values in accordance with Art. 79 AVO.

Therefore, the claims of non-life insurers against reinsurers are treated by including the reinsured portions of the provisions in the special fund, which is a form of tied asset, through an analogous system for offsetting the reinsured portions of the provisions. This system ensures that the entire technical provisions are covered, and the gross principle is considered to be met, while also maintaining the security and value of the investment fund as required by the investment guidelines of the local supervisory authority.

Answer 2:

The treatment of claims of non-life insurers against reinsurers in the context of tied assets, according to the FINMA Circular 2016/5, involves specific guidelines to ensure these claims contribute effectively and securely to the insurer's solvency requirements. Here's how these claims are treated:

#### Principles for Claims of Non-Life Insurers Against Reinsurers

**Offsetting Against Tied Assets:** The reinsured portions of the provisions are offset against the tied assets of non-life insurance companies. This means that recoveries expected from reinsurers are considered part of the assets backing the insurer's obligations.

**Application for Offsetting:** The process requires an application to FINMA whenever an insurer wishes to offset the reinsured portions of its provisions against the tied assets. This involves specifying the reinsurer and the amount covered by reinsurance.

#### Crediting and Limits

**General Crediting:** Generally, the reinsured portions are credited at 100% of the current portion's amount. However, for reinsurers in run-off, the crediting is reduced to 75%.

##### Limits Based on Credit Rating:

Credit Rating 2 or Better: Up to 20% of the target amount of the tied assets.

Credit Rating Level 3: Up to 10% of the target amount.

Credit Rating Level 4: Up to 5% of the target amount.

Credit Rating Level 5: Reinsured portions cannot be offset against the tied assets.

**Group Reductions:** If the reinsurer is part of the same insurance group as the insurer, these limits are halved.

#### Special Provisions

**Swiss Natural Hazard Pool:** Claims related to this pool can be credited up to 10% of the tied assets' target amount.

#### Application and Approval Process



Application Form: Insurers must use a prescribed FINMA form for their applications. The form should include the name and office location of the reinsurer.

Approval Process: The approval is assumed unless FINMA raises an objection or requires a review within four weeks.

### Adjustment and Notification

Adjustment of Crediting: If there's a change in the reinsurer's credit rating or other relevant conditions, the insurer must adjust the credited amount accordingly and notify FINMA immediately.

These guidelines ensure that claims against reinsurers are treated in a way that maintains the financial integrity and regulatory compliance of non-life insurers, by adequately reflecting the risk and recovery potential associated with reinsurance agreements.



For the question "How are claims of non-life insurers against reinsurers treated in the context of tied assets?" let's analyze the two responses in relation to the content of the FINMA Circular 2016/5.

## Answer 1

This answer discusses how the reinsured portions of provisions are included in the special fund, referencing the gross principle and specific articles and margin numbers related to non-life insurers. The explanation highlights the offsetting mechanism, the use of the special fund as a form of tied asset, and conditions under which the special fund can include these reinsured portions. The answer also delves into operational specifics like notification requirements to FINMA when conditions change, which are directly relevant as outlined in the document sections on crediting and limits.

## Evaluation of Answer 1

**Relevance:** The answer directly addresses the specifics of how claims of non-life insurers against reinsurers are managed with tied assets.

**Accuracy:** Accurate depiction of the processes and regulatory considerations for non-life insurers dealing with reinsured portions.

**Completeness:** Detailed, citing specific margin numbers and articles, giving a full view of the process.

**Clarity:** While detailed, the answer maintains clarity by breaking down the process into structured segments.

**Score:** 10/10

## Answer 2

This response gives a broader overview of the process for treating claims of non-life insurers against reinsurers. It mentions the principles of offsetting against tied assets, specific crediting limits based on credit ratings, and processes like the application for offsetting and notification requirements in case of changes. The answer integrates details on crediting limits based on the reinsurer's credit rating and the

impact of group affiliation, which are crucial for understanding how tied assets are managed in relation to reinsurer claims.

## Evaluation of Answer 2

**Relevance:** Directly relevant to the treatment of reinsured portions as tied assets.

**Accuracy:** Accurately reflects the content of the circular regarding credit limits and regulatory oversight.

**Completeness:** Covers all key aspects of managing reinsurer claims within the framework of tied assets, including crediting, limits, and procedural requirements.

**Clarity:** Clearly communicates the step-by-step process, making it comprehensible even for those unfamiliar with insurance regulations.

**Score:** 10/10

Both answers provide comprehensive and accurate representations of the provisions laid out in the FINMA Circular 2016/5 regarding the treatment of claims of non-life insurers against reinsurers in the context of tied assets.



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Question: "What are the limitations and conditions for credit exposure to counterparties within tied assets?"

Answers:

Answer 1:

The limitations and conditions for credit exposure to counterparties within tied assets are as follows:

1. The exposure to a counterparty may not exceed 5% of the target amount of the tied assets.
2. If there is a higher exposure per counterparty, it must be submitted to FINMA for approval without delay.
3. Claims against the Swiss Confederation, cantons, cantonal banks with a state guarantee, and Swiss mortgage bond institutions are exempt from the 5% limit.
4. Receivables from debtors whose obligations are due at any time and are not subject to a counterparty agreement are excluded from the calculation of the counterparty limits.
5. Securities that have been transferred to securities lending or repurchase agreements must be included in the calculation of the limits.

These limitations and conditions are intended to manage risk and ensure the stability of the tied assets, preventing excessive exposure to any single counterparty and maintaining diversification.

Answer 2:

The limitations and conditions for credit exposure to counterparties within tied assets, as outlined in

the FINMA Circular 2016/5, include specific caps on exposure and requirements to ensure that credit risk is managed appropriately. Here are the key points:

#### Limitations on Counterparty Exposure

**Counterparty Limits:** The exposure to a single counterparty may not exceed 5% of the target amount of the tied assets. This limitation helps to mitigate the risk of significant loss from the potential default of any single counterparty.

**Exemptions from the Limit:** Claims against the Swiss Confederation, cantons, cantonal banks with a state guarantee, and Swiss mortgage bond institutions are exempt from the 5% limit. Additionally, receivables from debtors fully guaranteed by a state with a credit rating of 1 are also excluded from this limitation.

**Accumulation of Exposure:** To determine the net exposure, all receivables and investment instruments in the tied assets vis-à-vis a party must be accumulated. If the insurance company invests in several companies within a group, the total exposure to this group is considered.

**Calculation of Net Exposure:** Guarantees issued to the insurance company are included in the calculation of net exposure, while collateral received can be deducted from the exposure.

#### Conditions for Managing Credit Exposure

**Foreign Currency Exposure:** Obligations arising from insurance contracts should be covered by investments in matching currencies. Investments in currencies other than the reference currency (the currency in which the insurance contracts are denominated) are limited to 20% of the target amount of the tied assets.

**Matching Cover:** The principle of matching cover requires that the investments correlate with the currency and duration characteristics of the liabilities they are meant to cover, ensuring effective risk mitigation related to currency and duration mismatches.

**Request for Exceptions:** Insurance companies may request deviations from these limits if they can demonstrate that the deviations will not negatively impact the solvency of the company. Such requests must show that the insurance company maintains an appropriate risk management system for the relevant asset classes.

These limitations and conditions are crucial for ensuring that the credit exposure of tied assets is managed in a way that prioritizes the solvency and liquidity needs of the insurance company, protecting against potential losses from counterparty defaults.



Here's the evaluation of the two answers provided for the question on the limitations and conditions for credit exposure to counterparties within tied assets:

#### Answer 1:

- **Relevance:** The answer directly addresses the limitations and conditions for credit exposure to counterparties within tied assets, mentioning specific limits and exceptions. This aligns well with

the content of the document.

- **Accuracy:** The answer accurately mentions the 5% exposure limit, the exemptions for certain entities, and includes details on how securities lending and repurchase agreements are treated. These details are consistent with the document.
- **Completeness:** This answer is somewhat complete but does not discuss exceptions or the conditions under which these limits might be modified, which are important aspects covered extensively in the document.
- **Clarity:** The answer is clear and straightforward, presenting the limitations in a structured format that is easy to understand.

**Score:** 8/10 - The answer is relevant, accurate, and clear but could improve in completeness by addressing exceptions and the process for exceeding these limits.

## Answer 2:

- **Relevance:** The answer covers the essential aspects of the limitations on credit exposure to counterparties within tied assets, providing a detailed breakdown of limits based on credit ratings, which aligns with the document.
- **Accuracy:** The specifics about credit rating limits, general crediting, and group reductions are accurate and reflect the document's content.
- **Completeness:** This response is more comprehensive, discussing the general approach, specific limits, conditions under which limits can be adjusted, and additional regulatory requirements. It addresses broader regulatory frameworks that govern these limits.
- **Clarity:** Although detailed, the answer maintains clarity by systematically addressing each point related to the credit exposure limits, making it accessible and understandable.

**Score:** 9/10 - This answer provides a thorough and accurate explanation of the topic, covering more nuances and details than Answer 1.

These evaluations are based on the content provided in the document, specifically the detailed guidelines on counterparty limits and the management of credit exposure within tied assets as outlined in the FINMA Circular 2016/5.



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Question: "How are mortgage receivables treated under the tied assets regulations?"

Answers:

Answer 1:

Mortgage receivables are treated under the tied assets regulations as follows:

- Mortgage claims (mortgages) can be allocated to tied assets if the mortgage relates to a property in accordance with margin nos. 247-253 or a permitted building under building rights (see margin nos. 254 and 255).
- Mortgages whose mortgage relates to non-assignable real estate are not assignable, with exceptions governed by the provisions on real estate (margin nos. 257-258, 260).
- Mortgages cannot be assigned to tied assets if they are subordinate to other claims secured by mortgage. An exception exists in the case of subsequently registered statutory mortgages and mortgages that are included in the same tied assets.
- The offsetting of mortgages is limited to 25% of the debit amount.
- The offsetting of an individual mortgage is limited to 5% of the debit amount.
- The deduction of real estate and mortgages is limited to a total of 35% of the debit amount.
- Before granting a loan, the insurance company is obliged to carry out a credit check, including checking the creditworthiness of the debtor and assessing the collateral. These must be clearly and conclusively defined by the insurance company in internal regulations.
- The basis for calculating affordability is the borrower's sustainable income and expenditure in the case of owner-occupied residential property or income and cost components in the case of investment properties. The assessments must be documented and kept for the term of the mortgage.
- The insurance company must ensure that the assessment of creditworthiness and affordability is carried out systematically.

The regulations also specify that the tied assets may be held in custody or booked by the custodian bank on its own premises, at a domestic correspondent bank, at a domestic or foreign clearing house, or at a foreign custodian, either individually or collectively. The custodian bank is liable for its custodian duties in accordance with the principles of Art. 399 para. 2 CO. The custodian bank identifies the securities accounts or accounts with values of tied assets held with it under the heading "tied assets" and ensures that only tied assets are held in such custody accounts or accounts. The custodian bank declares that it will not assert any rights of lien, retention, set-off, or similar rights in respect of the tied assets, even if the depositor becomes insolvent after the assets have been transferred or allocated to tied assets. If claims are asserted by third parties regarding the value of the tied assets, the custodian bank must notify the custodian immediately. If the custodian wishes to book assets into custody accounts or "tied assets" accounts for which the custodian bank already has a security interest, the custodian bank may refuse the transfer, demand that the custodian provide substitute collateral, or demand that the collateral be redeemed. The depositor is solely and exclusively responsible for compliance with regulatory provisions, particularly with regard to the minimum size of the tied assets, the permissible values and their composition.

These regulations ensure that mortgage receivables are allocated to tied assets in a manner that is compliant with regulatory requirements, ensuring that the mortgage claims are related to properties that can be assigned to tied assets, and that the mortgage claims are not subordinate to other claims secured by mortgage. They also set limits on the offsetting and deduction of mortgages, and require a credit check and assessment of affordability before granting a loan. The regulations also specify how the tied assets are to be held and managed by the custodian bank, ensuring that the assets are securely held and that the custodian bank does not assert any rights that would conflict with the claims of the policyholders of the depositor.

Answer 2:

Mortgage receivables are treated under tied assets regulations according to specific criteria to ensure they are secure and adequate to cover the claims of insured persons. Here's how they are managed:

Criteria for Including Mortgage Receivables in Tied Assets:

**Permissible Property Types:** The mortgaged property must qualify under the specified categories (residential buildings, commercial buildings, and permitted buildings under building law).

**Valuation:** Mortgages must be tied to properties that are easily realizable and whose valuation is subject to minimal uncertainty. The mortgage receivables are evaluated at nominal value but must be secure, implying that the underlying properties have reliable, sustainable value.

**Loan-to-Value Ratio:** The lending value of the property should not exceed the maximum allowed loan-to-value ratio, ensuring that the mortgage does not exceed the realizable value of the property.

**Location:** The property associated with the mortgage must be located within jurisdictions that allow for the swift and uncomplicated realization of the asset, typically within the same country as the insurer.

#### Limitations and Additional Conditions:

**Maximum Allocation Limits:** The allocation of mortgage receivables to tied assets is limited to ensure diversification and manage concentration risk. Specific limits are placed on the proportion of the total tied assets that can be allocated to mortgages.

**Creditworthiness Assessment:** Before a mortgage is granted, insurers must perform a thorough assessment of the borrower's creditworthiness. This includes a detailed evaluation of the borrower's ability to meet payment obligations under stressed financial conditions.

**Regular Revaluation:** Mortgage properties must be regularly revalued to confirm that the mortgage does not exceed the value of the property, protecting the insurer from potential declines in property values.

**Documentation and Reporting Requirements:** Insurers must maintain detailed records of all mortgage receivables, including documentation on the valuation of properties, the terms of mortgage agreements, and the ongoing creditworthiness of borrowers.

#### Regulatory Compliance:

Insurance companies must comply with regulatory guidelines that ensure the safety and liquidity of mortgage receivables as tied assets. These regulations are designed to protect the financial stability of the insurer and ensure that it can meet its obligations to policyholders.

By adhering to these rigorous standards, insurers manage their risk exposure and maintain the overall health of their financial portfolios.



### Evaluation of Answers for the Question on Mortgage Receivables Treatment under Tied Assets Regulations:

#### Answer 1 Evaluation:

Answer 1 presents a detailed discussion of how mortgage receivables are treated under tied assets regulations, highlighting various aspects such as eligibility of mortgages, conditions for assignability,

valuation, and credit assessment. The response also touches upon the role of the custodian bank in handling tied assets. The information provided largely aligns with the guidelines found in the FINMA Circular 2016/5. However, some details, especially those around the custodian bank's responsibilities, go beyond the typical treatment of mortgage receivables directly related to tied assets and might confuse the focus on mortgage specifics. Nonetheless, the core aspects of how mortgage receivables are handled under tied assets, such as the conditions for mortgages on assignable real estate and limitations on offsetting, are accurately covered.

**Score: 9/10** — The answer provides an in-depth and mostly accurate explanation of the treatment of mortgage receivables within tied assets, including several specific regulations and limitations. A point is deducted for slightly straying into broader custodial roles not specific to mortgage receivables.

### Answer 2 Evaluation:

Answer 2 succinctly outlines the criteria for including mortgage receivables in tied assets, detailing the permissible property types, valuation approaches, and the importance of regular revaluation and creditworthiness assessment. The answer addresses the general regulatory framework and specific conditions like loan-to-value ratios and the properties' location. It accurately reflects the regulations found in the FINMA Circular 2016/5, especially regarding the valuation and the types of properties eligible for inclusion as mortgage receivables. The answer also emphasizes the need for a creditworthiness assessment and documentation, directly correlating with the Circular's requirements.

**Score: 9.5/10** — This answer provides a clear, concise, and highly relevant explanation of the management and regulatory considerations for mortgage receivables in tied assets. The deduction is minimal, primarily for slightly less detail compared to the comprehensive legal references in Answer 1.

Both answers are well-informed and adhere closely to the FINMA regulations. Answer 2, while slightly more concise, gives a thorough overview with slightly better clarity, hence scoring slightly higher.



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Question: "How do regulations ensure that the claims of the insured are prioritized in the event of an insurer's insolvency?"

Answers:

Answer 1:

The regulations ensure that the claims of the insured are prioritized in the event of an insurer's insolvency through the concept of tied assets. Tied assets are assets that are specifically allocated to secure the claims of policyholders in the event of the insurer's bankruptcy. These assets are held in



trust by the insurance company on behalf of the policyholders and are intended to be used to pay out claims in the event of the insurer's insolvency. The regulations specify that the tied assets must be managed in a way that prioritizes the claims of the insured, ensuring that they are paid out before the claims of other creditors. This is achieved through the requirement that the tied assets be held in trust, which means that they are legally and financially separate from the assets of the insurance company. This ensures that in the event of the insurance company's insolvency, the tied assets are not subject to claims by other creditors and are available solely to pay out the claims of the insured. Additionally, the regulations specify that the tied assets must be diversified and liquid, ensuring that they can be readily realized to pay out claims in the event of the insurer's insolvency. This prioritization of the claims of the insured over those of other creditors is a key aspect of the regulatory framework for insurance companies, ensuring that policyholders are protected in the event of the insurer's insolvency.

Answer 2:

Regulations ensure that the claims of the insured are prioritized in the event of an insurer's insolvency through several key measures:

**Tied Assets Designation:** Tied assets are specifically designated and segregated to cover the claims of policyholders. This separation from the insurer's other assets ensures that they are preserved to satisfy the obligations towards the insured, particularly in insolvency scenarios.

**Priority in Bankruptcy:** In the event of insolvency and subsequent liquidation, tied assets provide a priority claim for policyholders over other creditors. This means that claims arising from insurance contracts are settled first from these tied assets before any other corporate debts or obligations.

**Asset Quality and Security:** The assets included in tied assets must be secure, high-quality, and easily realizable. This is to ensure that they can be quickly converted into cash to meet claims without significant loss of value.

**Regulatory Oversight:** Insurance companies must comply with stringent regulatory guidelines regarding the quality, diversification, and management of tied assets. These guidelines help ensure that the assets are sufficient to cover all potential claims and are not unduly exposed to high risks.

**Regular Reporting and Valuation:** Insurers are required to regularly report the status and value of tied assets to the regulatory authority (FINMA). This allows for ongoing oversight and ensures that the insurer maintains adequate coverage for the insured's claims at all times.

**Legal and Operational Measures:** The legal framework mandates that these assets must be unencumbered and exclusively available to meet policyholder claims, particularly in bankruptcy proceedings. The insurer is also obliged to maintain operational capabilities to manage these assets effectively under all circumstances.

These provisions ensure that the interests of policyholders are safeguarded even in adverse situations, such as the insurer's financial distress or insolvency, reinforcing the overall stability and trust in the insurance sector.



### Answer 1 Analysis:

This answer accurately describes the prioritization of insured claims through tied assets in the event of

an insurer's insolvency. It correctly identifies that tied assets are segregated to secure policyholder claims, ensuring they are prioritized over other creditors' claims during insolvency. The explanation of the regulatory framework for managing tied assets reflects the information in the document, including the legal and financial separation of these assets from the company's own assets to shield them from other creditors. The answer also touches on diversification and liquidity requirements, aligning well with the regulations stipulated for tied assets, which aim to ensure their availability and adequacy to cover claims in all scenarios, including insolvency.

**Score: 10** — The answer is entirely consistent with the regulatory expectations for tied assets as detailed in the document, ensuring prioritization of insured claims during insolvency.

### Answer 2 Analysis:

This answer elaborates on the concept of tied assets similarly to the first answer but with more detailed regulatory mechanisms. It accurately discusses the designation of tied assets, their prioritization in bankruptcy, asset quality and security standards, regulatory oversight, and the specific legal and operational measures ensuring that tied assets can only be used to settle policyholder claims. The answer integrates details about continuous regulatory reporting and valuation, adding depth to the understanding of how compliance and sufficiency of tied assets are ensured. It directly correlates with the document's sections on the necessity for tied assets to be secure, unencumbered, and prioritized in insolvency proceedings.

**Score: 10** — The answer is comprehensive, echoing the detailed regulatory framework described in the document to ensure that tied assets effectively prioritize the claims of insured in the event of the insurer's insolvency.

Both answers provide an exhaustive and accurate portrayal of the regulatory treatment of tied assets in insurance, effectively ensuring the protection of policyholder claims above other creditors during insolvency, which is highly consistent with the regulatory details outlined in the document.



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Question: "What are the penalties for violating the tied asset regulations?"

Answers:

Answer 1:

The text does not provide information on the penalties for violating the tied asset regulations. It

does, however, specify that the insurance company is solely and exclusively responsible for compliance with regulatory provisions, including those related to the minimum size of the tied assets, the permissible values, and their composition. If the Custodian Bank identifies that the assets held in safekeeping or booked in accordance with clause 2 are not intended to secure the claims of the policyholders of the Depositor, it may refuse the transfer, demand that the Custodian provide substitute collateral, or demand that the collateral be redeemed. If claims are asserted by third parties regarding the value of the tied assets, the Custodian Bank shall notify the Custodian immediately. If the Custodian wishes to book assets into custody accounts or "tied assets" accounts for which the Custodian Bank already has a security interest, the Custodian Bank may refuse the transfer, demand that the Custodian provide substitute collateral, or demand that the collateral be redeemed. The text does not mention any specific penalties for violating the tied asset regulations.

Answer 2:

The penalties for violating the tied asset regulations, as detailed in the FINMA Circular 2016/5, are primarily aimed at ensuring compliance and maintaining the integrity and solvency of insurance companies. Here are some key aspects of the penalties and consequences for non-compliance:

**Regulatory Sanctions:** Non-compliance with tied asset regulations can lead to regulatory sanctions from FINMA. These can include fines, orders for corrective actions, and in severe cases, restrictions on business activities or revocation of the insurance license.

**Corrective Measures:** If an insurer fails to comply with the requirements for tied assets, FINMA may require the insurer to take specific corrective measures to rectify the situation. This might involve restructuring the investment portfolio to meet the regulatory requirements.

**Increased Supervision:** An insurer that violates tied asset regulations may be subject to increased supervision by FINMA. This can include more frequent inspections and reporting requirements, and more stringent scrutiny of investment and risk management practices.

**Reputational Damage:** Violations of regulatory requirements can also lead to reputational damage, potentially affecting the insurer's relationships with policyholders, investors, and other stakeholders.

**Financial Implications:** Non-compliance may lead to financial instability for the insurer, as failing to maintain adequate tied assets can jeopardize the insurer's ability to meet its obligations to policyholders, especially in adverse scenarios.

The regulatory framework, including penalties for non-compliance, is designed to protect policyholders by ensuring that insurers maintain sufficient and appropriate assets to cover their insurance liabilities, thereby upholding the stability of the insurance market.



## Analysis and Scoring for Answers on Tied Asset Regulation Violation Penalties

**Question:** "What are the penalties for violating the tied asset regulations?"

**Answer 1:**

- **Relevance:** The answer discusses the responsibility of the insurance company in ensuring compliance with tied asset regulations and the actions the custodian bank may take if assets are mismanaged. It does not directly address penalties but focuses on compliance and consequences within operational management.
- **Accuracy:** Accurate in terms of operational actions related to asset management but does not directly address penalties for regulatory violations.
- **Completeness:** Incomplete with respect to the question about penalties. It discusses the broader context of asset management compliance but does not provide information on specific penalties.
- **Clarity:** Clearly articulated in terms of asset management responsibilities but lacks clarity on the penal consequences of violations.
- **Score:** 3/10 - While the answer provides some context about the management and security of tied assets, it does not specifically address penalties for violations, which is the focus of the question.

## Answer 2:

- **Relevance:** Directly addresses the potential consequences of violating tied asset regulations, focusing on regulatory sanctions and corrective measures.
- **Accuracy:** Correct in outlining that non-compliance can lead to various regulatory and operational consequences, including fines and increased oversight. However, specifics about these penalties are not found in the document.
- **Completeness:** Provides a comprehensive view of potential regulatory and reputational consequences, though it does not specify exact penalties such as fine amounts or direct citations from the regulations.
- **Clarity:** Clearly explains the potential outcomes of non-compliance with tied asset regulations, including sanctions and supervisory actions.
- **Score:** 6/10 - Provides a well-rounded view of the consequences of non-compliance, but lacks specific examples or detailed descriptions of penalties as described in regulatory texts.

## Summary

Both answers attempt to address the consequences of violating tied asset regulations. However, neither provides specific details from the provided document regarding explicit penalties like fines or legal repercussions. Answer 2 offers a broader and more relevant perspective on the implications of non-compliance, making it the more effective response despite lacking detailed specifics.



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Question: "Describe the process for the annual evaluation of the insurance company's overall investment portfolio including tied assets."

Answers:

Answer 1:

The process for the annual evaluation of the insurance company's overall investment portfolio including tied assets is not explicitly detailed in the provided text. However, it can be inferred that the insurance company is required to monitor the value of its assets, including tied assets, on an ongoing basis. This monitoring is likely part of the investment management process, which includes setting limits, monitoring compliance with regulatory requirements, and managing risks. The text also mentions that the insurance company must understand the investment process, monitor the specified strategy and investment principles, and be able to track all transactions in a timely manner for accounting purposes if it commissions a third party with investment management. This suggests that the insurance company is responsible for ensuring that the investment management process, including the annual evaluation of the investment portfolio, is carried out effectively and in accordance with regulatory requirements. The transfer of investment management to third parties is subject to FINMA approval, indicating that there is regulatory oversight of the investment management process, including the annual evaluation of the investment portfolio.

The text also mentions that the insurance company must have adequate qualifications and knowledge of the asset classes invested in, and in the case of investments in riskier investments, appropriate expertise. This implies that the insurance company should have the necessary expertise and knowledge to evaluate its investment portfolio, including tied assets, effectively.

In summary, while the text does not provide a detailed process for the annual evaluation of the insurance company's overall investment portfolio including tied assets, it implies that the insurance company is responsible for monitoring the value of its assets on an ongoing basis, understanding the investment process, and ensuring compliance with regulatory requirements. The text also suggests that the insurance company should have the necessary expertise and knowledge to evaluate its investment portfolio effectively. The transfer of investment management to third parties is subject to regulatory oversight, indicating that there are regulatory requirements for the annual evaluation of the investment portfolio.

Answer 2:

The annual evaluation of an insurance company's overall investment portfolio, including tied assets, follows a structured process to ensure compliance with regulatory requirements and effective risk management. Here's how this evaluation typically unfolds:

**Review of Investment Strategy and Policy Compliance:** The process begins with a review of the investment strategy to ensure it aligns with the insurer's liabilities, market conditions, and regulatory requirements. This includes verifying adherence to the strategic asset allocation and investment limits set for various asset categories, including tied assets.

**Asset Valuation:** All assets, including tied assets, are valued at market value or other appropriate valuation standards to assess their current worth accurately. This valuation is crucial for ensuring that the assets adequately cover the insurer's liabilities and for regulatory reporting purposes.

**Risk Assessment:** The portfolio undergoes a thorough risk assessment, which includes analyzing market risk, credit risk, liquidity risk, and other relevant risks. This step helps in identifying potential vulnerabilities within the portfolio and assessing the adequacy of the risk mitigation measures in place.

**Performance Evaluation:** The performance of the investment portfolio is evaluated against benchmarks and objectives. This involves analyzing returns, comparing them with expectations, and understanding the drivers of performance variations.

**Regulatory Compliance Check:** Compliance with all relevant regulations, including those specifically governing tied assets, is checked. This includes ensuring that tied assets are adequately diversified, secured, and aligned with the obligations they are meant to cover.

**Documentation and Reporting:** Detailed documentation of the evaluation process and outcomes is prepared. This includes financial statements, risk management reports, and compliance reports. These documents are essential for internal audits, regulatory reviews, and informing stakeholders.

**Adjustments and Rebalancing:** Based on the evaluation, adjustments may be necessary to align the portfolio with the investment strategy, risk appetite, and regulatory requirements. This could involve rebalancing asset allocations, modifying risk controls, or changing investment tactics.

**Submission to Regulatory Bodies:** The final step involves submitting the evaluation report and other relevant documentation to regulatory bodies, such as FINMA. This submission typically includes detailed descriptions of the assets, their valuations, and compliance with the tied assets regulations.

These steps ensure that the investment portfolio is not only compliant with regulations but also optimally positioned to meet the insurer's financial obligations and strategic objectives.



**Question: Describe the process for the annual evaluation of the insurance company's overall investment portfolio including tied assets.**

**Answer 1:**

The response attempts to deduce the evaluation process from general investment management practices mentioned in the document. It speaks to the responsibilities of the insurance company in monitoring investments, maintaining expertise, and complying with regulatory requirements. This answer provides a high-level inference based on regulatory oversight and the requirement for FINMA approval in managing third-party investment activities but lacks specifics about the annual evaluation process itself.

**Score: 4/10**

- The answer partially captures the responsibilities related to investment management but fails to directly address the specific processes involved in the annual evaluation of the entire investment portfolio, including tied assets.

**Answer 2:**

This answer lays out a structured approach to the annual evaluation, detailing steps such as strategy review, asset valuation, risk assessment, performance evaluation, and compliance checks. It also discusses the importance of documentation and adjustments based on the evaluation findings. The response aligns with general investment management practices and regulatory expectations, indicating a comprehensive understanding of what such an evaluation would entail.

**Score: 7/10**

- The response effectively outlines a plausible and structured evaluation process that would be expected in an insurance company's management of its investment portfolio, including tied assets. However, it might slightly overreach in details not specifically provided in the document but inferred from typical regulatory and management practices.

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