

# Asset Credit Ratings Explained

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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What are the five credit rating levels that can be assigned for tied assets? Explain each level.



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

1. **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.
2. **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.
3. **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.
4. **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.
5. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What are the primary investment principles for total assets?



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

1. **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.
2. **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.
3. **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.
4. **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.
5. **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.





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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What are the rules for investment in cash deposits?



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

1. **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.
2. **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.
3. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: How are bonds and convertible bonds treated?



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:

## 1. 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.

## 2. 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.

## 3. 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.

## 4. 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."

## 5. 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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What specific limits are placed on investments in foreign currencies?



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:

### 1. 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.

### 2. 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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What are high-risk investments for insurance companies?



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.

3. **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.
4. **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.
5. **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.
6. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: How are investments in high-risk assets regulated?



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:

1. **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.
2. **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.
3. **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.

4. **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.
5. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What are the consequences for failing to comply with the guidelines?



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:

1. **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.
2. **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.
3. **Reputational Damage:** Failure to adhere to regulatory standards can lead to reputational damage, affecting the trust and confidence of policyholders, investors, and other stakeholders.
4. **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.

5. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: How should claims of non-life insurers against reinsurers be handled?



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:

1. **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.
2. **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.
3. **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%.
4. **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.
5. **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.



## 6. 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.

7. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What is the protocol for the inclusion of new types of investments?



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:

1. **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.
2. **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.
3. **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.

4. **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.
5. **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.
6. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What is the principle of diversification within tied assets?



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:

1. **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.
2. **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.
3. **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.

4. **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.
5. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What limits are set for investments in equities and equity securities?



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

### 1. Equity Allocation Limit:

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

### 2. 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.

### 3. 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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What are the specific limitations for investing in real estate within tied assets?



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:

1. **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.
2. **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.
3. **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.
4. **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.
5. **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.





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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What are synthetic bonds and how are they used?



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:

1. **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.
2. **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.
3. **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.
4. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: How should insurance companies manage and report structured product investments?



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:

1. **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.
2. **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.
3. **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.
4. **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.
5. **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.
6. **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.
7. **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.





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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What derivatives can be used to hedge credit risk of asset portfolio?



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

### 1. 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.

### 2. 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.

### 3. 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.

### 4. 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

### 1. 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.

## 2. 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.

## 3. 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.

## 4. 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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: How should liquidity be maintained when using derivatives in investment strategies?



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

1. **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.
2. **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.
3. **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

1. **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.
2. **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.
3. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What specific provisions must be

followed when dealing with tied assets in relation to unit-linked life insurance policies?



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:

1. **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.
2. **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.
3. **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.
4. **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.
5. **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.
6. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: Explain the criteria and process for allocating an investment to tied assets.



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

1. **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.
2. **Valuation:** The investment should be easily valued without significant problems.
3. **Liquidity:** Investments must exhibit a high level of liquidity relative to their investment category.
4. **Expertise and System Requirements:** There must be the necessary expertise and appropriate systems and processes in place for selecting, managing, and controlling the investment.
5. **Risk Understanding:** The financial, legal, and operational risks associated with the investment should be fully understood.
6. **Creditworthiness of Debtor:** The debtor's creditworthiness must be verifiable.
7. **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

1. **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.
2. **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.
3. **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.
4. **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.

5. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: How are claims of non-life insurers against reinsurers treated in the context of tied assets?



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

1. **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.
2. **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

1. **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%.
2. **Limits Based on Credit Rating:**
  - o **Credit Rating 2 or Better:** Up to 20% of the target amount of the tied assets.
  - o **Credit Rating Level 3:** Up to 10% of the target amount.
  - o **Credit Rating Level 4:** Up to 5% of the target amount.

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

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

## Special Provisions

1. **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

1. **Application Form:** Insurers must use a prescribed FINMA form for their applications. The form should include the name and office location of the reinsurer.
2. **Approval Process:** The approval is assumed unless FINMA raises an objection or requires a review within four weeks.

## Adjustment and Notification

1. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What are the limitations and conditions for credit exposure to counterparties within tied assets?



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

1. **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.
2. **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.
3. **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.
4. **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

1. **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.
2. **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.
3. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: How are mortgage receivables treated under the tied assets regulations?



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:

1. **Permissible Property Types:** The mortgaged property must qualify under the specified categories (residential buildings, commercial buildings, and permitted buildings under building law).
2. **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.
3. **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.
4. **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:

1. **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.
2. **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.
3. **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.
4. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: How do regulations ensure that the claims of the insured are prioritized in the event of an insurer's insolvency?



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

1. **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.
2. **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.
3. **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.
4. **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.
5. **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.
6. **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.



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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: What are the penalties for violating the tied asset regulations?



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:

1. **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.
2. **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.
3. **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.
4. **Reputational Damage:** Violations of regulatory requirements can also lead to reputational damage, potentially affecting the insurer's relationships with policyholders, investors, and other stakeholders.
5. **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.





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You are a helpful assistant. Make direct answers with good explanations. Do not lie and if you do not know the answer, say you do not know. Answer this question: Describe the process for the annual evaluation of the insurance company's overall investment portfolio including tied assets.



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:

1. **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.
2. **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.
3. **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.
4. **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.
5. **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.
6. **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.
7. **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.
8. **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.

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