Switzerland

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Definition of an Insurance Contract

1. **Is there a definition in your jurisdiction with regard to an insurance contract, based on either statutory or case law? Please summarize the legal requirements for an insurance contract by identifying the main criteria.**

There is no definition of an insurance contract in statutory law, neither in the Swiss Federal Act on Insurance Contracts ("ICA") nor in the Swiss Federal Act on Insurance Supervision ("ISA"). The Swiss Federal Supreme Court ("SFSC") has defined a contract of insurance as a contract under which an insurer promises an economic performance to an insured (or a third person) in case of the realization of a risk in exchange for payment of a premium. (e.g., Swiss Federal Supreme Court Decision ("SCD") 124 III 382, no. 6f). The basic defining elements of an insurance contract are thus the transfer of risk against payment. Furthermore, the SFSC has established two additional requirements, which are particularly relevant from an insurance supervisory law perspective, but might also have to be considered in the context of an insurance contract law analysis: (i) the requirement that the insurance contract must be an autonomous or independent agreement and (ii) the requirement that the insurer compensate the risks according to the laws of statistics. Consequently, according to the practical definition elaborated and constantly used in case law for decades (e.g. in SCD 58 I 259, no. 2; 107 Ib 56, no. 1b; 114 Ib 247, no. 4a; SFSC decision 4P.52/2000, no. 3a/bb) the concept of insurance in Swiss law rests upon the following five elements:

i) Risk or danger: Risk may be defined as a future event whose occurrence is both uncertain and in fact possible. There must be either uncertainty as to whether the future event will occur at all or uncertainty as to when the future event will occur (incertus an or incertus quando, see SCD 92 I 133, no. 4).

ii) Performance by the insured (i.e. premium payment): The premium is, in principle, the price the insured pays in exchange for the performance by the insurer in the event that the insured risk materializes. Although the Swiss Federal Supreme Court often uses the term "performance by the insured", it is also possible that the premium is not paid by the insured, but e.g. by a policyholder or another person differing from the insured (e.g. SFSC decision 2C_410/2010, no. 3.2).

iii) Performance by the insurer: The contract must include the obligation of the insurer (and thus the right of the insured) to perform to the insured or a beneficiary differing from the insured in case the insured risk materializes. Usually, the insurer pays to the insured an amount of money, but performance may also consist in a payment in kind, in the waiver of a claim against the insured or in any other conduct or benefit in favor of the insured or according to his will, including omissions (SCD 76 I 370, no. 4). According to more recent legal literature, performance may also consist in the rendering of services (Helmut Heiss/Ulrike Mönnich, in: Hsu/Stupp (eds.), Basler Kommentar zum Versicherungsaufsichtsgesetz, Basel 2013, art. 2 N 27; for the legal protection insurance, see art. 161 Swiss Federal Ordinance on Insurance Supervision ("ISO") (emphasis added): "Under a legal protection insurance contract, an insurance undertaking assumes the obligation, in exchange for a premium, to reimburse costs resulting from legal matters or to provide services in connection with such matters").

iv) Independence of the operation: This means that the insurance agreement must not be a mere modality or subsidiary agreement of a non-insurance contract, but must have a certain independent importance. E.g., a clause in a credit agreement whereby the creditor waives his right to the repayment of the outstanding loan in case of the debtor's death does not have independent importance and, therefore, does not yet result in a qualification of the agreement as an insurance contract (regarding warranties see question 8 (ii)).

v) Compensation of risks according to the laws of statistics (systematic business activity): Case law has not developed one single definition for this element. Instead, various court decisions have emphasized different criteria, namely the systematic business activity (SCD 58 I 262, no. 6; 114 Ib 247, no. 4), the distribution of risk according to the law of large numbers (SCD 58 I 262, no. 6; 107 Ib 61, no. 5; SFSC decision 2C_410/2010, no. 3.4), the consideration of the principles of statistics, at least implicitly (SCD 2C_410/2010, no. 3.4) and the requirement that the earnings equal or supersede the expenses (SCD 92 I 132, no. 3). In legal literature, the view prevails that an undertaking may not free itself from insurance supervision by not complying with the principles of statistics and insurance mathematics (see e.g. Heiss/Mönnich, op. cit., art. 2 N 37). Further, the Supreme Court

has held that it is not necessary that the business activity must be based on insurance mathematics (SCD 92 I 132, no. 3; 107 Ib 61, no. 5; SFSC decision 2C_410/2010, no. 3.4). Therefore, if an undertaking intends to assume a large number of similar risks, the element of compensation of risks according to the laws of statistics is likely to be given.

2. <u>Does an insurance contract require an element of uncertainty? Please describe.</u>

Yes, of the five elements, in principle, required for the qualification of a contract as an insurance contract (see above in the answer to question 1) the element of risk or danger includes the element of uncertainty: Risk may be defined as a future event whose occurrence is both uncertain and in fact possible (see also the further remarks in the answer to question 1); it depends on the factors of the probability and the potential magnitude of the event.

3. <u>Does an insurance contract need to provide for a transfer of risk from the one party to another to be recognized as an insurance contract?</u>

Yes, an insurance contract needs to provide for a transfer of risk from one party to another. This follows from the qualifying elements of a "risk or danger" and a "performance by the insurer" (see above, question 1, elements 1 and 3): The risk is transferred from the insured to the insurer by the promise of performance of the insurer in case the risk materializes. The prevailing view among scholars is that this transfer of risk against the payment of a premium (see above, question 1, element 2) are the core elements (i.e. *essentialia negotii*) of the insurance contract (see e.g. STEPHAN FUHRER, Schweizerisches Privatversicherungsrecht, Zurich 2011, N 2.5). Without a transfer of risk, there is no insurance contract.

4. <u>Does the insured party need to have an economic, legal or any other interest in the subject matter of an insurance contract (usually called 'insured interest')?</u>

It is controversial in legal literature whether the subject matter of an insurance contract is someone's "interest" or "economic interest" in the non-occurrence of an event (the so-called "theory of interest", *Interessenlehre*) or whether the subject matter of an insurance contract is simply a physical object, a person or certain assets ("theory of objects", *Gegenstandslehre*) and the concept of an "interest" thus superfluous (in favor of the theory of interest e.g. Fuhrer, *op. cit.* (question 3), N 4.8 et seq.; in favor of the theory of objects e.g. Christian Boll, in Honsell/Vogt/Schnyder (eds.), Basler Kommentar zum Versicherungsvertragsgesetz, Basel 2001, art. 48 N 3 *et seq.*, and Christian Boll/Andrea Stadelmann Stöckli, in Honsell et al. (eds.), Basler Kommentar zum Versicherungsvertragsgesetz, Nachführungsband, Basel 2012, art. 48 ad N 4, both with further references). However, this debate can be left aside at least as far as the qualification of an agreement as an insurance contract is concerned. This is because representatives of both sides of the controversy agree that the protection of an abstract interest is not sufficient, i.e. there must be a tangible and valid economic interest and the occurrence of the insured event must have a negative economic impact on the policyholder, insured or beneficiary.

This rule also applies to fixed sum insurance contracts. Under these contracts, the insurer undertakes to perform upon the occurrence of a triggering event (e.g. the disability or death of the insured), irrespectively of whether this triggering event has caused any loss or damage. Nevertheless, there still must be a economic interest of the policyholder, insured or beneficiary in order to distinguish it from contracts of gambling and chance (see also below, question 8 (i)).

5. <u>Is it required that an insured interest attaches to the policyholder (i.e. the party entering into the insurance contract) or can it be attributable to a third party? In the later case, must this third party be the beneficiary under the insurance contract?</u>

No, it is not required that the insured interest attaches to the policy holder. E.g., the following constellations are possible (Fuhrer, *op. cit.* (question 3), N 14.7):

- The policyholder can take out an insurance policy where the triggering event is the harm (a) to an insured different from the policyholder or (b) to such insured's property, but the policyholder receives the insurer's performance, i.e. the policyholder is the beneficiary of the policy, but the danger is attached to someone else.

  E.g., a contractor can take out a contract works insurance policy (*Bauwesenversicherung*). Here, the contractor insures his interest in the builder-owners building: Under Swiss property law, the unfinished building belongs to the builder-owner (because the ownership in the building is attached to the ownership in the real property), but if the unfinished building is damaged, the contractor will have to repair the damage at his own expense based on the contract for work and labor (except if the builder-owner is responsible for the damage).

  However, the law provides for restrictions to this type of insurance in the area of life insurance to avoid or reduce the potential risk of criminal acts inflicted by the policyholder on the insured. According to art. 74 para. 1 ICA, the insurance on the life of another person is null and void if the person whose death shall be insured did not

consent in writing prior to the conclusion of the contract.

- The policyholder can take out an insurance policy where the triggering event is the harm (a) to an insured different from the policyholder or (b) to such insured's property, but whereby a third person, the beneficiary, receives the insurer's performance. In this constellation, the policyholder protects the interest of another person and the danger is attached to yet another person.

  E.g., a mother (i.e. policyholder) takes out an insurance policy that pays an amount to her children (i.e. beneficiaries) in the event of death of their father (i.e. insured).

  Consent restrictions apply to life insurances according to art. 74 para. 1 ICA as mentioned above (i.e. the insured person must give his prior written consent).

- The policyholder can take out an insurance policy where the triggering event is the harm (a) to an insured different from the policy holder or (b) to such insured's property and the insured receives the insurer's performance, i.e. the policyholder protects someone else's interest and the danger is attached to that person.

  E.g., a mother (i.e. policyholder) takes out an insurance policy that pays a capital amount to her children (i.e. insured and beneficiaries) in the event of their disability; or a carrier (i.e. policyholder) takes out a transport insurance policy for the benefit of the owner of the transported goods (i.e. insured and beneficiary).

- The policyholder can take out an insurance policy where the triggering event is the harm to the policyholder or his property, but where someone else receives the insurer's performance as beneficiary, i.e. the policyholder protects someone else's interest, but the danger is attached to himself.

  E.g. a parent (i.e. policyholder/insured) takes out an insurance policy that pays an amount to his spouse and kids (i.e. beneficiaries) in case of his death.

6. <u>Is it necessary or relevant that the risk assumed by the insurer will be mitigated by the simultaneous insurance of a larger number of similar risks (called also the 'law of the large numbers')? If yes, does it affect the classification as an insurance contract or is it merely a supervisory and actuarial issue?</u>

The "law of the large numbers" or element of compensation of risks according to the laws of statistics is predominantly an insurance supervision requirement (see question 1, element 5). This means that, as a general matter, it cannot be deducted from the fact that an undertaking does not apply the law of large numbers to diversify or compensate the risks under the contracts with its counterparties that such contracts would not qualify as insurance contracts from an insurance contract law perspective. The element of compensation of risks may however serve as an additional criterion in the qualification of a contract in that a contract offered by an undertaking fulfilling all the elements outlined in question 1 (and which is subject to FINMA insurance supervision) in its usual conduct of business is likely to qualify as an insurance contract.

7. <u>Does the definition of an insurance contract differ between life insurance and non-life insurance (obviously apart from the subject matter)?</u>

No, but there are different statutory rules applying to life insurance contracts, such as art. 36 para. 3 ICA, which states that if the policyholder withdraws from a life insurance contract, he may claim back the policy reserve. Further, art. 73-96 ICA contain special provisions regarding personal insurance, e.g. stating:

- That the insurance on the life of another person is null and void if the person whose death shall be insured did not consent in writing prior to the conclusion of the contract (art. 74 ICA; see also above, question 5);

- That subject to existing pledges, neither the policyholder's insurance claim nor the beneficiary's insurance claim are subject to debt enforcement proceedings in favor of the policyholder's creditors if the policyholder's spouse or descendants are the beneficiaries of the insurance policy (art. 80 ICA).

Distinction from Similar Types of Contracts and Exemptions

8. <u>Please consider whether an insurance contract has similarities to the following contractual arrangements existing under the laws of your jurisdiction. Please describe if these are regarded as a type of insurance contract or, if not, what the distinction is.</u>

i) Contracts of gambling and chance

The difference between an insurance contract and a contract of gambling and chance is that the parties to an insurance contract intend to protect an (economic) interest of the policyholder (or insured or beneficiary), i.e. the insurance contract offers protection against the possibility of future damage or loss. A well-known example to illustrate the difference between a gambling contract and an insurance contract is the "insurance" that was taken out in medieval times for the event that the pope should die prior to an agreed upon date. The "insured" would suffer no damage or loss by the occurrence of the "insured" event. Thus,

such a contract does not protect an economic interest of the contractual counterparty and is therefore not an insurance but a gambling contract (Fuhrer, *op. cit.* (question 3), N 4.12)

ii) Warranty, guaranty or any other surety contracts

Warranties, guaranties or other surety contracts, can, depending on the individual case, often be distinguished from an insurance contract by application of the element of "independence of the operation" (see above, question 1, element 4). Warranties or guaranties are often modalities or subsidiary agreements of non-insurance contracts (such as sales contracts) and do not qualify as independent or autonomous agreements. Therefore, they do not qualify as insurance contracts.

In SCD 107 Ib 54, the Swiss Federal Supreme Court had to qualify a 12 month warranty of a producer of motor oil additives, covering the costs for reparation of the motor and the gearing mechanism. The warranty was sold and upheld under the condition that the motor oil additives were used in the car, but the warranty was not restricted to damage caused by the motor oil additives. The Swiss Federal Supreme Court decided that this warranty was an independent operation and therefore an insurance contract. The reason was that the warranty could have been sold independently from the motor oil additives and that the prize of the warranty (CHF 140; paid by partnering garages) was higher than the prize of the motor oil additives themselves (CHF 73).

In many cases, a warranty, guaranty or surety contract can be qualified as an independent operation and may fulfill all of the five elements that define an insurance contract (see above, question 1). It is therefore difficult to distinguish these contracts from insurance contracts. These difficulties arise in particular with regards to surety contracts issued by banks. The law does not differentiate between banking contracts and insurance contracts and there are no clear-cut criteria to make this distinction. In these cases, an important, but not necessarily conclusive, indication for either a banking or an insurance contract is whether the contract has been concluded by a licensed bank or by a licensed insurance undertaking.

iii) Financial contracts such as hedging contracts/swaps/derivatives

Similar to the surety contracts as referred to above, financial contracts may contain all elements of an insurance contract, especially if the counterparty enters into a contract for hedging purposes. Here too, there are no clear-cut criteria to distinguish between financial contracts and insurance contracts and the decision may be strongly influenced by the question of whether a financial institution or an insurance undertaking has entered into the contract.

Similar considerations apply in connection with risk transfer contracts entered into between (re-)insurance companies and special purpose vehicles which in turn emit (direct or indirect) cat bonds. Such contracts must likely be deemed not to constitute reinsurance contracts on the basis that the relevant special purpose vehicle is not a licensed reinsurance company (Christian Schaal, Risikotransfer durch Katastrophenanleihen, Zurich 2010, p. 44).

9. <u>Do exceptions or exemptions exist to the effect that contracts, which in principle meet the characteristics of an insurance contract, are not treated as such?</u>

As stated under question 8 (ii) and (iii), there are contracts that fulfill all the five requirements of an insurance contract but may not qualify as insurance contracts under a holistic view taking into account all the circumstances of the case.

10. <u>Does a close legal or economic nexus to a non-insurance transaction provide for such exception?</u>

De facto, yes. There are no clear-cut criteria to distinguish between banking/financial contracts and insurance contracts. Therefore, a qualification may be strongly influenced by the question whether the seller of the protection or product is a bank (or another type of financial market participant) or an insurance undertaking (see also questions 8 and 9).

Impact of Qualification – Supervisory law

11. <u>Can a party as risk-taker enter into a contract with qualifies as insurance contract only on the basis of a permission/license?</u>

Yes, in principle, any insurance undertaking subject to ISA must obtain a license from FINMA in order to engage in the business of insurance (art. 3 para. 1 ISA). The following insurance undertakings are e.g. excluded from Swiss insurance supervision and must therefore not obtain a FINMA license (art. 2 para. 2 ISA):

- Insurance undertakings domiciled in a foreign country that only engage in reinsurance in Switzerland;
- Insurance businesses, to the extent that they are subject to specific supervision under federal laws or laws of the cantons, e.g. occupational pensions institutions (registered in the register of occupational pension plans), mandatory health insurance or insurance business of building insurers of certain cantons.

12. <u>What are the legal consequences for the risk-taker acting without license?</u>

A risk-taker willfully carrying out an activity requiring a license without having obtained such license is liable to a custodial sentence of up to three years or to a monetary penalty (art. 44 para. 1 of the Swiss Financial Market Supervisory Act ("FINMASA")).

Persons acting negligently are liable to a fine of up to CHF 250,000 (art. 44 para. 2 FINMASA). In addition, such sanctions might e.g. affect the fit and proper test requirement should the sanctioned person be or intend to be in the board or executive management position of a financial institution subject to prudential supervision.

13. In the laws of your jurisdiction, is there a prohibition for licensed insurance companies to enter into non-insurance business? If yes, please briefly explain the scope of such prohibition.

Yes, according to art. 11 para. 1 ISA, an insurance undertaking may only engage in insurance business or types of business that are directly related to insurance business. FINMA can approve the conduct of other types of business if they do not endanger the interests of the insured (art. 11 para. 2 ISA).

Insurance undertakings that have obtained a specific license within the subset of life insurance licenses are allowed to conclude capitalization contracts, i.e. contracts without insurance coverage for any biometric risks (Appendix 1 of the ISO, classification A.6), although such capitalization contracts strictly speaking do not qualify as insurance contracts. The insurers that conclude such contracts remain under insurance supervision and do not fall under banking supervision. Such capitalization contracts may, however, not be labeled as insurance contracts. Furthermore, apart from these capitalization contracts, insurance undertakings engaging in primary life insurance may, in addition, only engage in accident and health insurance (art. 12 ISA) but not in any other types of insurance.

14. Do the terms and conditions of insurance contracts need to be

i) submitted to the regulator as a kind of formal requirement or

ii) approved by the regulator prior to entering into effect?

In principle, there are no such submission or approval requirements, except e.g. for the insurance of all risks in occupational pension plans and for the supplementary insurance to the mandatory health insurance (art. 4 para. 2 lit. r ISA). However, in the area of natural hazards insurance (*Elementarschadenversicherung*), FINMA still reviews the premiums (art. 33 para. 3 ISA) and the Federal Council (*Bundesrat*) has the authority to specify the terms of insurance if it deems this necessary (art. 33 para. 5 ISA). Further, FINMA specifies the reference rate for life insurance policies with an interest rate guaranty (art. 121 ISO) and has issued a circular defining, inter alia, the minimal requirements for life insurance tariffs (FINMA-Circular 08/40, Life insurance, no. 6-57).

Impact of Qualification – Law of Contracts

15. Would a contract of insurance issued by a non-licensed party be legally valid or null and void or can it be avoided by either party (e.g. is the policyholder entitled to terminate or contest the contract? Is the policyholder entitled to claim damages?)?

As a general rule, contracts are only null and void if the rule that has been breached by the (conclusion of the) contract explicitly foresees the nullity of the contract or if such consequence follows from the intention and purpose of the rule that has been breached (SCD 134 III 442, no. 2.2; 119 II 224, no. 2). If one of the parties was not allowed to enter into a certain contract, this will in principle not render the contract null and void (e.g. SCD 117 II 50, no. 2 c). Therefore, if an insurance contract is issued by a non-licensed party, the contract will under Swiss private law not be null and void, but in principle valid and binding upon the parties. However, the insured may, depending on the circumstances of the individual case, be entitled to reject the obligation due to fundamental error (*Grundlagenirrtum*: art. 24 para. 1 no. 4 Swiss Code of Obligations ("CO")) or deceit (*absichtliche Täuschung*: art. 28 para. 1 CO) and may in such context be entitled to claim damages, e.g. based on *culpa in contrahendo*.

It is further worth noting that article 36 paragraph 1 ICA grants a right of withdrawal to the policyholder in the event that an insurance undertaking's license is revoked by FINMA. The policyholder is in such case entitled to reimbursement of the surplus premium or life insurance policy benefits, as the case may be, and may further be entitled to claim damages (art. 36 para. 2-4 ICA).

16. Are there specific legal provisions or statutes applicable to insurance contracts in your jurisdiction? Please identify.

Yes, the Federal Act on Insurance Contracts of 2 April 1908 (SR 221.229.1). Where the ICA does not contain a provision, the CO applies (art. 100 para. 1 ICA).

17. Do these legal provisions or statutes contain for legal requirements with regard to form and the content of an insurance contract? If yes, please outline these requirements.

Form

The validity of the insurance contract is not subject to compliance with any particular form, though the application for an insurance policy and acceptance by the insurer are customarily produced in writing. However, the insurer must issue a (written) policy to the insured stating the rights and duties of the parties (art. 11 ICA).

Content

Under article 3 ICA an insurer must inform the insurance taker prior to the execution of the insurance contract about the identity of the insurer and the key

elements of the contract, including, e.g., the insured risks, the scope of insurance coverage, the premiums due and any other duties of the policyholder, the duration and options for terminating the contract and (particularly with regard to life insurance) the methods, principles and bases for calculating and distributing the surplus profits.

18. Do your laws provide for consumer protection with respect to insurance contracts, e.g. by establishing information or other requirements? If yes, please briefly describe.

The ICA contains a list of mandatory provisions of the ICA that cannot be amended by the parties of an insurance contract (art. 97 ICA) and a list with articles that can only be amended in favor of the insured (art. 98 ICA). However, while not all of the provisions in these two lists specifically favor the insured, at least some of them clearly aim to protect the counterparty of the insurance undertaking, such as art. 3 and 11 ICA described above under question 17 and art. 33 ICA ("If not stated otherwise in this Act, the insurer is liable for all events that display the characteristics of the risk for which the insurance was taken out unless the contract excludes particular events from the insurance in a precise and unambiguous way"). Furthermore, general rules of Swiss civil procedure law and private international law impose restrictions regarding the choice of forum and choice of law in the context of contractual relationships with consumers.

Art. 40 *et seq.* ISA refer to registration requirements and other obligations of insurance intermediaries. The main purpose of these provisions is to protect the insured.

19. Is there anything else you would like to add with respect to your jurisdiction that could be of interest to this project?

n/a

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