

Market-consistent valuation and the risk margin

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The SST requires a market-consistent valuation of all assets and liabilities. Assets traded in liquid markets are valued at market prices. Liabilities, for which no market prices exist, are valued as the best estimate of the expected future cash flows, discounted with risk-free interest rates, plus a margin that reflects the cost of transferring the liabilities to a third party.¹ This approach broke with the tradition of statutory accounting, in which technical reserves were calculated with prudent assumptions and fixed technical interest rates, so that hidden reserves and hidden losses could accumulate without being visible in the balance sheet.

The market-consistent balance sheet has the merit of transparency. It shows the effect of falling interest rates on the value of long-term guarantees as soon as the rates fall, while mismatches between the duration of assets and liabilities become visible as well. The approach also has disadvantages. Because changes in market prices flow through directly to the risk-bearing capital, the SST ratio is volatile, particularly for life insurers with long-term liabilities. A decline in the long-term interest rate can reduce the SST ratio of a life insurer by dozens of percentage points within a few months, even if nothing has changed in the insurer's long-term ability to meet its obligations.² This volatility became a central issue in the years of low interest rates after 2008.

The risk-free interest rate curves used for discounting are published by FINMA for the principal currencies. For maturities beyond the range in which the bond market is liquid, the curves must be extrapolated. The method of extrapolation can have a considerable effect on the value of very long-term liabilities, such as annuities, and the choice of parameters has repeatedly been discussed between FINMA and the industry.³ Unlike Solvency II, the SST does not provide for a matching adjustment or a volatility adjustment that would allow insurers to discount their liabilities with rates above the risk-free rate when they hold matching assets to

maturity. Swiss insurers have argued for comparable mechanisms. FINMA has generally maintained that the economic reality should be shown in the balance sheet, although the revision of 2024 introduced some flexibility in this area.⁴

The market value margin (*Marktwertmarge*) represents the amount that a third party would require to take over the insurer's liabilities. It is calculated with a cost-of-capital approach: the third party would have to hold capital against the transferred liabilities until they have run off, demanding a return on that capital above the risk-free rate.⁵ The concept rests on the idea that the policyholders should be protected even in the event of the insurer's failure, because the remaining assets should suffice to induce another insurer to take over the portfolio. The market value margin is thus the bridge between the economic valuation of the SST and its ultimate purpose, the protection of policyholders in a run-off scenario.

1 Notes

1. Arts. 30–35 AVO (as revised) and FINMA SST documentation on the market-consistent valuation of assets and liabilities and the best estimate of liabilities. To be verified. ↩
2. On the volatility of SST ratios and their sensitivity to interest rates, see the sensitivity analyses published by Swiss insurers in their Financial Condition Reports and the FINMA Risk Monitor. To be verified. ↩
3. FINMA, annual publication of the SST risk-free yield curves and the extrapolation methodology; compare EIOPA's Smith-Wilson method and ultimate forward rate under Solvency II. To be verified. ↩
4. On the absence of a matching or volatility adjustment in the SST, the industry position (Swiss Insurance Association, SVV) and the changes introduced by the revised AVO in 2024, see FINMA's explanatory report on the revision of the AVO and the SVV's statements. Status to be verified. ↩

5. On the market value margin and the cost-of-capital rate in the SST (historically 6% above the risk-free rate) and in Solvency II (risk margin, cost-of-capital rate of 6%, reduced to 4.75% in the 2025 Solvency II review), see FINMA SST documentation and Directive (EU) 2025/2 amending Directive 2009/138/EC. Rates and status to be verified. ↩

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