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Swiss annuities and life insurance

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1. Introduction

The Swiss insurance industry is perceived as one of the **safest** in the world. The country's first insurance company was established in 1857 and the industry has grown substantially since then: it now has 178 insurance companies, 24 of them operating in the life insurance sector.

However, the most remarkable fact is that not a single Swiss insurance company has ever gone bankrupt, failed to meet its obligations or otherwise been forced to close its doors. This track record is unique in the world. In the *United States*, for example, several major life insurance companies have failed or gone bankrupt. And in 2000 even *Equitable Life, Britain's* – and probably the world's – oldest life insurer and once one of the proudest names in the industry, had to close its doors to new business. This case actually raised some fundamental questions about the provision and regulation of private pension insurance in the *United Kingdom*.

In *Switzerland*, things are quite different. The *Swiss Federal Office of Private Insurance* regulates all Swiss insurance business by enforcing the strictest regulations known in the industry. Life insurance companies are required to maintain a **security fund** which covers all their obligations plus an additional security margin. This fund is segregated from the company's operating assets. The investment parameters for the security funds are very conservative, the only priority being their safety and liquidity.

The insurance industry is an important part of the Swiss economy and the Swiss themselves are known to be well-insured: *Switzerland* has the world's highest per-capita spending on insurance premiums overall, and also the **highest per-capita spending on life insurance premiums**, as the following table illustrates.

International insurance ratios

Amount spent on insurance premiums per capita and country (without social security, in US\$, 2004)

		Per capita premiums	Life insurance
Switzerland		5'660	3'431
United Kingdom		4'059	2'617
Japan		3'771	3'003
Ireland		3'670	2'313
USA		3'638	1'658
Denmark		3'116	2'038
Netherlands		3'094	1'562
Belgium		2'876	2'005
Finland		2'714	2'127
France		2'698	1'768
Sweden		2'358	1'602
Norway		2'321	1'323
Germany		2'051	930
Australia		2'041	1'129
Italy		1'913	1'238
Canada		1'872	723
Austria		1'847	811
Hong Kong		1'833	1'484
Singapore		1'621	1'300
South Korea		1'243	874
New Zealand		1'215	272
Spain		1'146	489
Israel		1'041	461
Russia		98	34
China		36	25

Source: sigma/Swiss Re

The extraordinary stability of the Swiss insurance industry is one of the reasons for devoting an entire chapter to it in this book. The special advantages offered by Swiss insurance policies in terms of **asset protection** represent another one. They are based on specific features of Swiss insurance law. Accordingly, Swiss annuities are interesting alternatives to more complex, more costly and less secure asset protection structures such as trusts. Although this feature is particularly relevant to American investors, in other countries too wealthy individuals and families are increasingly looking to protect their assets from frivolous lawsuits and unjustified claims.

Swiss annuities and life insurance can also be forms of investment that offer **tax advantages** as tax-planning vehicles, in many cases allowing significant relief from income, capital gains and inheritance tax. The capital accumulated in life insurance policies is not taxed in several countries when the policy expires, or then only at a very low rate.

2. Key characteristics of Swiss annuities and life insurance

The following types of annuity and life insurance contracts are generally available in *Switzerland*:

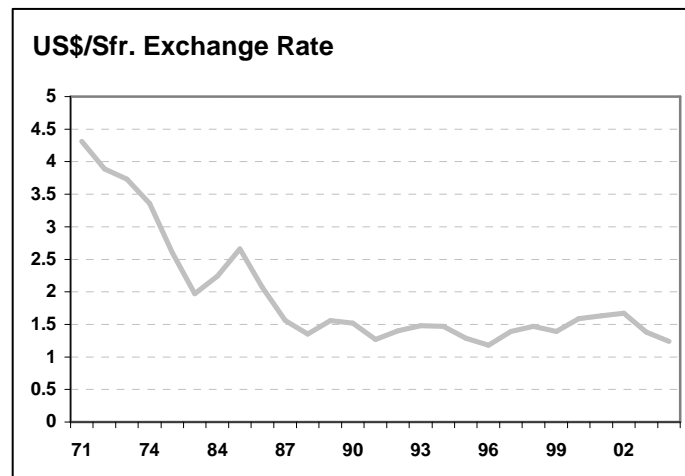
<i>Immediate Annuity</i>	Secures a regular income for life - starting immediately
<i>Deferred Annuity</i>	Secures a regular income for life - starting at a certain date in the future
<i>Pure Endowment</i>	Saves a specific sum of money within a certain time.
<i>Endowment Protection</i>	Saves a specific sum of money within a certain time while also giving life protection during this time
<i>Whole Life Protection</i>	Protects family, personal and business interests with lifetime cover - with the option of receiving a savings component if the protection is no longer needed
<i>Level Term Protection</i>	Protects family, personal and business interests during a certain time only (available only to Swiss residents)

Decreasing Term Protection Protects family, personal and business interests during a certain time only, with the level of protection decreasing in time. This is useful in cases such as the need to pay off a mortgage (available only to Swiss residents)

Annuities and those life insurance policies which have an investment component can be further divided into **fixed** and **variable** products. The term fixed means that the life insurance company guarantees the principal and a certain definite return on the investment, whereas in a variable annuity or life insurance contract the value of the insurance policy depends on the underlying investments which can be chosen more or less freely by the client. Such underlying investments typically consist of a portfolio of funds, stocks and bonds, but in specially structured insurance contracts may also include other assets, including unquoted shares of private businesses and real estate.

Quite generally, Swiss insurance policies **can be tailor-made** to suit the most individual needs. Many **extra features** are available, such as premium waivers in case of disability or death, annuity reduction for joint annuitants, etc.

Although Swiss insurance policies are available in all major currency denominations, most are issued in **Swiss francs**. There are good reasons why foreign investors favour Swiss-franc investments. Thanks to the country's political stability and high economic performance, the Swiss franc has remained strong over decades in comparison with other leading currencies. Indeed, the Swiss franc is arguably **the world's strongest currency**. Of course this trend may be reversed, and investors must be aware that the Swiss franc may also become weaker instead of stronger, incurring the risk of considerable currency losses as well as gains.



2.1 Insurer, insured person, policyholder and beneficiaries

A Swiss standard life insurance contract generally involves four parties:

- The insurer (the insurance company)
- The policyholder
- The insured person
- The beneficiary or beneficiaries

The **insurer** (i.e. the Swiss insurance company) issues the policy and provides coverage in return for payment of either a lump sum or regular payments, or a combination thereof.

The **policyholder** enters into a contract with the insurer and receives coverage for him/herself and/or other persons (beneficiaries). This is confirmed in the **insurance policy**, a document issued by the insurer. As the contracting partner, the policyholder owes the insurance premiums that need to be paid to the insurer in return for providing insurance coverage.

The **insured person** is the one whose life the insurance covers. This can but need not be the same person as the policyholder.

The **beneficiary or beneficiaries** are those persons who are designated by the policyholder to receive the specified capital from the insurer at either a specified date in the future or in case of the insured person's death, depending on the type of insurance contract.

Life insurance is often arranged through an **insurance broker** who advises the insured person and policyholder and liaises between the contractual parties. Brokers are remunerated with a commission paid by the insurance company. As of 2006, all insurance brokers must be licensed to carry on their business in *Switzerland*.

The subject of a Swiss life insurance contract must be a natural person. However, legal entities (companies, foundations, etc) may be beneficiaries and policyholders.

2.3 Estate planning

Many lawyers and estate planning practitioners have expressed concern that it might well be inconsistent with sound estate planning to designate a spouse and/or children as beneficiaries of a Swiss annuity if this is large and/or purchased by large estates. The

asset protection aspect of the annuity may be attractive, but the estate planning limitations are sometimes seen as a hindrance. However, a trust or a legal entity such as a foundation may also be named as an irrevocable beneficiary of a Swiss annuity on the annuitant's death. Accordingly, such concerns could be alleviated by naming the individual's estate planning trust or family foundation as the beneficiary.

3. Asset protection

3.1 Overview

One of the important advantages of Swiss annuities and life insurance is the strong protection it offers to assets placed by any insurance contract of this kind.

A non-Swiss resident (hereafter referred to as the "policyholder") may purchase a life insurance policy from a Swiss insurance company and designate his/her spouse and/or descendants as beneficiaries of the policy, or irrevocably designate any other third party (for instance a legal entity such as a trust) as a beneficiary. **Swiss law then protects** the insurance policy against any debt-collection procedures initiated by the policyholder's creditors and excludes it from any Swiss bankruptcy procedures. Even if a foreign judgment or court order expressly decrees the seizure of the policy or its inclusion in the estate in bankruptcy, the policy may not be seized in *Switzerland* or included in the estate of the bankrupt party.

Unlike the designation of another third party as a beneficiary, in the case where a spouse and/or descendants are so designated, it is irrelevant whether the designation is irrevocable or revocable. The insurance policy will continue to be protected from the policyholder's creditors even if the designation of the spouse and/or descendants is revocable.

Creditors may seize the policy or have it included in the estate of the bankrupt party only if its purchase or the designation of the beneficiaries is regarded as a fraudulent conveyance under Swiss law. This is the case if the policyholder has designated the beneficiaries **less than one year** before the initiation of debt-collection proceedings ultimately leading to a bankruptcy decree against the policyholder or to the seizure of the latter's assets.

The same applies if the beneficiary has been designated with the clear intent to damage creditors or to give some creditors preferential treatment and the designation was made within **five years** of the date of debt-collection proceedings resulting in a bankruptcy decree or the seizure of the policyholder's assets. However, the creditors then have to prove not only the policyholder's intent but also that the beneficiary was aware of the intent to defraud. Such intent obviously cannot be proved when the beneficiaries were designated at a time that the policyholder was solvent and no creditors had yet asserted any claims against the latter that could have rendered him or her insolvent.

If the policyholder has designated his/her spouse and/or descendants as beneficiaries, the insurance policy will be protected from creditor claims irrespective of whether the designation is revocable or irrevocable. The policyholder may therefore designate his/her spouse and/or descendants as beneficiaries on a revocable basis and later revoke this designation before the policy expires if there are no threats from any creditors at that time. When the insurance policy expires, the policyholder will be able to collect the proceeds accruing from the policy, extend the existing policy or roll the proceeds over into a new policy. If a creditor appears or the holder becomes insolvent at the time of expiration, this protection would cover an extended policy but not a new one.

3.2 Protection under duress

An insurer may receive a letter from the policyholder revoking the beneficiary designation (in response to a foreign court order to revoke a past beneficiary designation in order to include the relevant assets in a foreign bankruptcy estate). The insurer may then conclude that the instruction received from the policyholder does not express the latter's true intent, but was forced upon him or her by the foreign judge or court. The Swiss insurance company can only act upon the holder's instructions if the latter's actions are deemed not to have been made under duress. If there is any evidence that the holder has been forced to issue an instruction, the insurance company must refuse to act upon it. In these circumstances, the beneficiaries should inform the insurance company.

3.3 Protection in case of bankruptcy

If the policyholder becomes bankrupt, he/she continues to be protected because **ownership** is then automatically **transferred** to the beneficiaries. Any instructions from the original policyholder that are forced upon him/her must now be ignored; only the latter's beneficiaries, as the new owners, may now instruct the insurance company.

3.4 Fraudulent conveyance

A policyholder's creditors may seize the policy in the above cases if they can prove that the irrevocable designation of a third party or the designation of the spouse and/or descendants as beneficiaries is deemed to be a fraudulent conveyance within the meaning of *article 285 et seq.* of the *Swiss Debt Collection and Bankruptcy Act (Bundesgesetz über Schuldbetreibung und Konkurs; Loi fédérale sur la poursuite pour dettes et la faillite)*. In most cases, the purchase of an insurance policy and the designation of beneficiaries are considered a **voidable preference** under the Swiss rules relating to fraudulent conveyance. In general, all transactions carried out by a debtor during the five years prior to the seizure of assets or the opening of bankruptcy proceedings are voidable if the debtor's intention, apparent to the other party, was to place his/her creditors at a disadvantage or to give preference to certain creditors over others.

3.5 Special protection for foreigners

It should be noted that Swiss law deems the rights under an insurance contract between a foreigner and a Swiss insurance company to be located at the latter's domicile. However, if the policyholder's and beneficiaries' rights are embodied in a policy that must be considered as a security, a creditor could claim that the latter could be seized in accordance with the debt-collection and bankruptcy rules of the country in which it is deposited. After all, securities are normally subject to the debt-collection and bankruptcy law of the country where they are deposited. However, this problem may be circumvented if the insurance **policy is deposited in Switzerland.**

All debt-collection and bankruptcy procedures taking place in *Switzerland* are based **solely on Swiss bankruptcy rules.** This means that life insurance policies are then protected in accordance with Swiss law even if the debt-collection or bankruptcy law in the debtor's domicile would not afford him/her such protection. Specifically, only the Swiss rules on fraudulent conveyance apply here, so the designation of beneficiaries cannot be avoided by creditors unless they prove that the conditions for fraudulent conveyance described previously are met. This remains true even if the purchase or designation was a voidable preference under the rules relating to fraudulent conveyance applicable in the debtor's domicile.

Accordingly, the creditors of a *non-Swiss* resident may not – in *Switzerland* – seize or include in the bankrupt's estate any life insurance policies that are protected under Swiss law even if they have a judgment or a bankruptcy decree that is enforceable in *Switzerland*, unless they can prove that the designation of the beneficiaries of the insurance policy is a voidable preference under the Swiss rules relating to fraudulent conveyance.

A foreign judge or **court may order a policyholder to revoke** a past beneficiary designation in order to include the relevant assets in the foreign bankruptcy estate. The policyholder may comply with such an order or judgment by informing the insurer that he or she revokes this designation. The question then arises whether, under Swiss law, the insurer has to comply with an instruction forced upon the policyholder by a foreign judge or court.

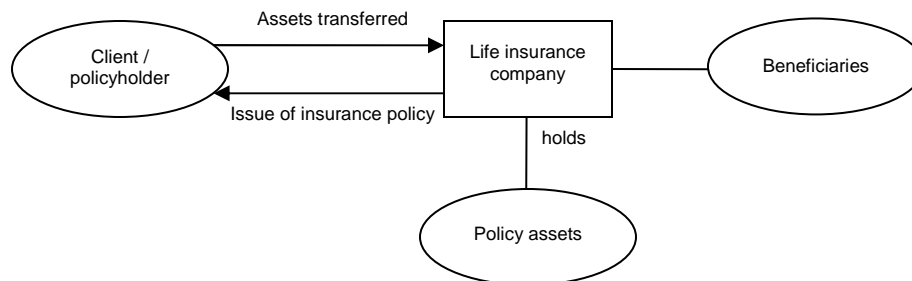
If a third party has been irrevocably designated, an insurer will not comply with the policyholder's instruction because this would contradict this irrevocability status.

4. Tax aspects

4.1 Properly structured insurance contracts can offer tax advantages

In a few cases, life insurance offers no particular tax advantages to an investor. In most circumstances, however, it offers some benefits, and in many cases significant relief from income tax and from inheritance tax.

Naturally, in order to benefit from any tax advantages, a life insurance policy must **comply with the tax regulations** in the policyholder's country of residence (i.e. where he or she has his/her main tax residence). For example, a certain minimum duration may be required or the insurance must include a certain amount of life cover besides the investment component.



Income and capital gains on assets placed in a life insurance policy are generally tax-free in the hands of the life insurance company. No tax is deducted from the policy proceeds, i.e. the proceeds are paid net to the policyholder (or beneficiary, as the case may be). The assets paid into a life insurance policy **do not constitute a gift** as they are generally treated as a premium payment. Furthermore, these assets do not generally form part of the policyholder's estate for inheritance or wealth tax purposes, since the nature of the client/policyholder's interest in the assets is not that of an owner but rather of the holder of an insurance policy. Finally, capital accumulated in life insurance policies is **not taxed in several countries** when the policy expires, or then only at a very low rate.

4.2 Tax exemption in Switzerland

Under Swiss law, both variable and fixed annuities are treated as life insurance policies and are consequently exempt from Swiss income and asset taxes.

Swiss life insurance and annuities are also exempt from the 35% federal withholding tax.

4.3 U.S. excise tax not applicable

Unlike many other foreign annuities (including those issued in *Liechtenstein*), Swiss annuities are exempt from the 1% U.S. excise tax on the purchase of foreign annuity and insurance premiums. This exemption derives from the adoption of a new Swiss-U.S. Double Tax Treaty in 1998 and applies to premiums paid by a U.S. citizen to an insurance company domiciled in *Switzerland*.

4.4 Income from variable annuities may be tax-deferred in the U.S.

As a rule, foreign fixed annuities no longer enjoy tax-deferred status in the *United States*. US tax rules regard a Swiss fixed annuity as a debt instrument, i.e. a “promise to pay a certain sum” in addition to being an insurance contract. The owner of a Swiss fixed annuity (as well as other foreign annuities regarded as debt instruments) consequently pays tax on the accrued income, including currency gains if the annuity is denominated in a foreign currency.

In the view of most tax experts, the loss of tax deferral means that distributions prior to the age of 59½, including loans against the policy, are not liable to the 10% penalty for early withdrawals. So tax-free withdrawals may be taken from a Swiss fixed annuity whenever the policyholder chooses.

On the other hand, income from foreign variable annuities may be tax-deferred. The tax-deferred status of Swiss variable annuities has consequences for early withdrawal in the same way as US contracts. However, the former offer a combination of asset protection, a choice of asset allocation strategies based on an investor’s risk profile and other needs, as well as tax deferral for US investors. They consequently represent ideal long-term investments that use the **power of compound growth** for a retirement portfolio.

5 Other advantages

5.1 No reporting requirements

Swiss insurance companies do not report to any government - Swiss or foreign - if the policyholder is not resident in *Switzerland*. Thus neither the initial purchase of the policy, nor individual payments, nor interest or dividends earned, nor any other information will be reported and all transactions are kept strictly confidential and private between the policyholder and the insurance company.

In addition, insurance contracts are not subject to reporting in many other countries apart from *Switzerland* as they are generally viewed as an (insurance) contract rather than a reportable investment.

5.2 Liquidity

Swiss annuities offer instant liquidity. All capital, plus all accumulated interest and dividends, is freely accessible. Depending on the type of annuity, a minimal penalty in case of withdrawal applies only to an initial period of up to one year. So if funds are needed quickly, they are available and not tied down for a fixed period of time. Furthermore, all Swiss banks will accept Swiss life insurance policies as collateral.

5.3 No-load investment

Swiss annuities are generally arranged on a no-load basis, so there are no additional charges or costs and the investment can be cancelled at any time without loss of principal or accumulated interest and dividends.

5.4 No forced repatriation of funds

Swiss insurance policies would escape any forced repatriation under any exchange controls that may be imposed in future, because they are regarded as a pending contract between the investor and the insurance company.

6 Conclusion

The Swiss insurance industry has an impeccable track record and nowadays offers sophisticated products and services that are attractive not only to Swiss clients but – perhaps even more so – to international investors looking for **safe and stable investments**. Swiss life insurance and annuities are very attractive from various perspectives: not only are they a very safe form of investment, they also offer unique **asset protection**, which is particularly relevant for American investors but also increasingly so for wealthy people elsewhere in the world who wish to protect their assets legally. Depending on the individual situation of the investor, investments in Swiss annuities and life insurance may even offer **tax advantages**. All of these advantages are available in the environment of **legal and economic stability** that Switzerland offers and that is second to none in the world. Accordingly, Swiss annuities and life insurance are truly unique.

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