

INSURERS RECOVERY AND RESOLUTION

Resolution Funding

the Romanian approach

Financial Supervisory Authority,

October, 2018

Legal arrangements

Established to ensure the effective implementation of the resolution tools and measures by ASF, as resolution authority.

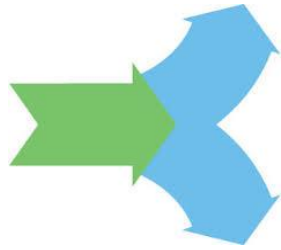
National legislation:

- special chapter in *Law no. 246/2015 on the recovery and resolution of insurers* regarding financing arrangements,
- secondary legislation regarding the management process of the Resolution Fund and regarding financing the Resolution Fund.
- Resolution Fund is managed by the Insurance Guarantee Fund

Financial resources:

- Contributions (0,4% from received premium for non-life and 0,25% from life) from all insurers authorized in accordance with the Romanian legislation,
- loans or bonds by issuance of securities of the Insurance Guarantee Fund, and other forms of financial support from institutions or other third parties.

Placement of financial resources Of the Resolution Fund



Minimizing the risk

Ensuring adequate liquidity

Financial resources available must be placed in low risk assets, in a diversified pool of assets, according to an annual investment strategy:

- state-guaranteed bonds or municipal bonds that hold certain rating requirements;
- deposits / CDs;
- government securities issued by the Member States of the European Union, securities issued by their central banks and securities issued by the US Treasury.

- The Resolution Fund is managed by the IGS but funds for resolution and compensation to policyholders are managed and used distinctively.

The Insurance Resolution Fund

Regulations regarding the quota share for the contributions due to the Insurance Resolution Fund by the insurers are stated in the primary and secondary legislation.

- The quota is relative to received premiums:
 - 0.4% for non-life insurance and
 - 0.25% for life insurance.



- Up to the point when the level of the funds reaches the threshold of 50 million Lei (11 mil Euro).

Today, the fund reached its ceiling, in July 2017, and payments of contribution are therefore halted.

Although there were two cases of insurers under resolution and recovery measures (one ended under liquidation procedures and the other one recovered under early intervention), the fund was never used until today – resolution instruments were not applied.

Use of Resolution Fund resources (1)

The use of the resolution fund resources can only be decided by the Resolution Authority for financing the use of resolution tools, for the following purposes:



- to guarantee the assets or the liabilities of the insurer under resolution, a bridge institution or an asset management vehicle;
- to make loans to the these types of institutions;
- in the transfer process of assets or insurance portfolio of the insurer under resolution;
- to finance a bridge institution or an asset management vehicle;
- to pay compensation to shareholders or creditors in case they incurred greater losses than would have incurred in a winding up under normal insolvency proceedings;
- to pay back loans and associated costs ;
- to take any combination of the actions referred to above.

The financing arrangements may be used to take the actions referred to also with respect to the purchaser in the context of the sale of business or the insurance portfolio transfer tool.

Use of Resolution Fund resources (2)

Any measure of the Resolution Authority regarding the use of the Resolution Fund should aim at minimizing the risk of moral hazard, maintaining financial stability and choosing the appropriate resolution measures in order to

address the resolution objectives in the most effective way possible.



Resolution Objectives*

- to protect the insurance creditors
- to protect public funds by minimizing reliance on public finance support
- to avoid a significant adverse effect on the financial stability of the insurance market, in particular by preventing contagion
- to ensure the continuity of critical functions

*all objectives are equal

Use of Resolution Fund resources (3)



The resolution fund should be used once private sources of funding have been already used (presumably unsuccessful) and strictly in line with the state aid legal framework.

The resolution financing arrangement shall not be used directly to absorb the losses of an insurer. Also, the insurer shall not rely in any way upon public financial support.



There may be a case when the use of the resolution financing arrangement indirectly results in part of the losses of insurer being passed on to the resolution financing arrangement – in this case there are rules that apply regarding governing the use of the resolution financing arrangement (such an example is the principle that shareholders are first to take on losses).



Use of Resolution Fund resources (3)

The resolution administrator implements the resolution measures and is designated by the FSA for up to one year with the possibility of extending this mandate.

The Insurance Guarantee Fund could have this role and can substitute the management body of the insurer under resolution under the supervision of the FSA.

The Insurance Guarantee Fund can also be the sole shareholder of the bridge institution.



Lessons learned regarding **recovery and resolution (1)**

There should be clear rules regarding the triggering of the recovery plan such as trigger points and deadlines for action in each stage of the process.



The recovery and resolution regime should not overlap or contradict with previous recovery related rules regarding financial institutions. When a recovery and resolution regime is implemented there should be a scanning process and a review of all the legislation parts related to the subject.

Lessons learned regarding **recovery and resolution (2)**



In cases where there is no successful early intervention and resolution is triggered after the point where assets are lower than the liabilities, resolution instruments are very difficult to implement.

If there is no successful early intervention and the company has an insurance portfolio dependant on one type of insurance (as is the case for largest insurance companies in Romania – MTPL), resolution should not be considered as a viable option.

In this case, a lengthy feasibility evaluation if at all should be avoided in order not to delay the liquidation process and allow further negative developments of the company.

The mechanism should provide for a quick and timely entry into the resolution before the balance sheet of a company reflects insolvency and before all own funds are fully exhausted. There should be clear standards or adequate viability indicators to support decision-making on companies meeting the trigger for entering the resolution.

Lessons learned regarding **recovery and resolution (3)**



- Triggering a resolution instrument should take place before an insurer is technically insolvent.
- Resolution should be initiated when a firm is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so. The resolution regime should provide for timely and early entry into resolution before a firm is balance-sheet insolvent and before all equity has been fully wiped out. There should be clear standards or suitable indicators of non-viability to help guide decisions on whether firms meet the conditions for entry into resolution.

Lessons learned regarding recovery and resolution (4)

- The legal framework should not allow the exercise by reinsurers of any rights to terminate or not reinstate coverage under an existing contracts of reinsurance that arise by reason only of the entry into resolution of, or the exercise of any resolution power against an insurer, provided the substantive obligations (for example, premium payment) under the contract continue to be performed.



Lessons learned regarding recovery and resolution (5)



When resolution is applied, the principle of general non-discrimination of creditors should be replaced, if possible, by non-discrimination of creditors of the same class of insurance, in order to have the necessary flexibility to move and save parts of the insurance portfolio.

It is only logical to differentiate between different business lines with different critical functions.

For example, the business of life insurance, being different than general insurance should be treated differently in resolution, depending on the critical functions associated and the perspectives of saving a certain business line.



Case study (1)

2014 - 2017 - a period of adverse developments in the Romanian insurance market.

A major insurer was facing major financial problems (mainly MTPL insurance business).

ASF appointed a temporary administrator, namely the Insurance Guarantee Fund (FGA).

A Resolution Plan was made by the FSA in 2016 – first plan of this kind under the new legislation.

An independent auditor made a valuation of the assets and liabilities of the institution under resolution

Case study (1)



There has been made an assessment of resolvability.

Most of the resolution tools couldn't be applied in the this particular case because there were major issues regarding the cost of the resolution tools available (selling portfolio/activity, bridge institution and assets management vehicle) .

There were also issues with technically applying resolution tools - related to the creditor non-discrimination principle, low diversification of the insurance portfolio, low assets, no potential buyer, low chances of recovery.

The Plan concluded that the none of the resolution tools could be technically used without reliance on public finance support.

The company was liquidated under normal insolvency proceedings and the Insurance Guarantee Fund is handling claims from the former insurer's activity.

Case study (2)



Another company considered likely to fail was analysed from the perspective of the available resolution options.

The second case of resolution tools being considered as an option ended up with the company restoring its financial situation.

In this case, there has also been made an assessment in scope of resolution.

The evaluation carried out by an independent auditor found that the insurer made significant improvements in the management process and restored the MCR and SCR.

The company was already in the process of financial recovery between April 2016 and July 2017.

In July 2017, the financial situation of the insurer was restored and the financial recovery procedure was closed with some additional measures to further be taken by the company.

New ideas (1)

- The relationship between the regime of resolution, the insolvency regime and the circumstances in which the resolution regime connects or replaces parts of the insolvency regime should be very clearly explained in the legal framework.
- As a result we are proposing a correlation between resolution law with the insolvency law in order to clarify `the left overs`.



New ideas (2)

- The resolution authority should regularly update, to all stakeholders, on its actions and its resolution policies related to its mandate and statutory objectives at sufficiently frequent intervals to adequately inform stakeholders and the public about its resolution activities and resolution financing arrangements.



New ideas (3)

- The resolution authority or other relevant authority should have the power to recover funds, including variable remuneration, from persons whose actions or omissions have caused or contributed significantly to the failure of the insurer.
- There should be solutions for recovering the benefits granted by the company to those responsible for the company's failure.



New ideas (4)



- Authorities should undertake, at least for significant insurers (taking into account there are funds available to do so) resolvability assessments that take into account the feasibility of resolution strategies and their credibility in the context of the probable impact of the company's failure on the financial system and the global economy.
- Simulating resolution exercises (games) could also be performed.



New ideas (5)

- Actively working with the insurance companies to help them understand the new recovery and resolution mechanism, give feedback on recovery plans, introducing clear reasons for rejecting the recovery plan.



- In some specific cases (meaningful and risk-bearing insurers), the obligation for the recovery plan to contain a chapter on (self) assessment of resolution capacity could be introduced. This assessment could be carried out by a third party contracted by the company.



**RECOVERY
IS
POSSIBLE**