Resolution for insurers

On 1 January 2019, the Act on the Recovery and Resolution of Insurers came into effect. This act seeks to strengthen the protection of policyholders when an insurer is faced with problems of such a magnitude that it can no longer continue independently. The new Act also aims to minimize the impact of a failing insurer on the economy, financial markets and society. This factsheet provides information on several key aspects of the new act.

1

What happens when an insurer experiences difficulties?

As a supervisory authority, DNB will do its best to prevent an insurer from ending up in trouble in the first place. However, despite proper supervision, it is not always possible to prevent an insurer from experiencing difficult times. If the insurer falls below the solvency capital requirements, it must submit a recovery plan in order to bring its capital position back to the required level. But if this recovery plan does not yield results and the insurer can no longer meet its legal requirements and other obligations towards policyholders, shareholders and other creditors, such an insurer is referred to as 'a failing insurer' or as 'an insurer likely to fail'.

2

What does 'resolution' of insurers mean?

Resolution is the careful and controlled winding up of an insurer that has failed or is likely to fail. DNB is responsible for this resolution process. The starting point is that failing insurers are wound up under regular insolvency proceedings. An insurer can only be wound up in resolution if its liquidation under normal insolvency proceedings could have significant consequences for the economy, financial markets or society.

3

How does DNB determine if an insurer is wound up in resolution?

A failing insurer is wound up in resolution if its liquidation under normal insolvency proceedings would cause substantial negative social or economic consequences. Or if resolution can prevent public funds from being used to save the insurer (which is referred to as a "bail out"). Resolution should prevent these consequences better than an administrator would be able to do under regular insolvency proceedings. If that is the case, the insurer has passed the public interest test: resolution is in the public interest. Considering these high standards, most insurers are wound up under regular insolvency proceedings.

In order to determine whether there may be substantial negative social or economic consequences,
several criteria are considered, amongst others:

- the size of the insurer,
- the number of policyholders,
- the type of insurance product,
- the 'interconnectedness' of the insurer with the financial system,
- and the current economic situation.

The Explanatory Memorandum to the Act indicates that resolution is the likely procedure if an insurer has more than 1 million policyholders, or has more than EUR 1 billion in technical provisions, i.e. the value required to meet all insurance obligations.

At first glance, between 10 and 20 insurers in
The Netherlands appear to pass the public interest test.

Example 1:

An insurer offers a large number of products that contribute to the income of policyholders, such as pension annuities. From an economic and social viewpoint, it is important that such payments are continued: people depend on them for their daily income. Such an insurer may therefore be eligible for resolution.

Example 2:

An insurer offers a product that is relevant to certain economic activities, which at the same time is not or hardly provided by other insurers. An example of this would be export credit insurance. Resolution could ensure that this insurer can continue to provide this coverage, thus preventing detrimental effects on the economy.

4

Which phases can be distinguished in a resolution process?

The Act makes a distinction between the preparation phase and the winding up phase.

In the preparation phase, the act introduces two new obligations for DNB and the insurers. First of all, the Act imposes the obligation on the insurers to be prepared for problems or a crisis. They must draw up pre-emptive recovery plans to do so. This offers both the insurers and DNB more insight in the recovery options. Secondly, DNB draws up a resolution plan for some insurers, in which it details how the insurer can best be wound up in resolution in case it fails. When DNB identifies obstacles that could stand in the way of an orderly resolution, the insurers have to resolve these impediments beforehand. Examples of such impediments include complex legal and financial interconnectedness of business units, or insurer's ICT systems that are used by more than one business unit. Such structures and practices could make it difficult for DNB to

wind up the insurer in a controlled fashion. The resolution planning hence allows DNB and the insurers to be better equipped to take swift and effective action when an insurer has failed or is likely to fail.

In the winding up phase, the Act provides new powers for DNB and the administrator to wind up the insurer in a controlled manner, when the insurer can no longer be protected from failing. Both DNB and the administrator have the option to make interim payments – under certain conditions - for instance when policyholders rely on the pay-outs for their daily living. In addition, DNB has new resolution instruments, such as the bail-in or the bridge institution, which it can employ when an insurer is eligible for resolution (see also question 6). The administrator also has additional instruments under insolvency proceedings (question 9).

5

What does resolution planning by DNB in the preparation phase entail?

DNB draws up a resolution plan for insurers that are eligible for resolution. In order to arrive at an adequate plan, DNB first requests data from the insurer which accurately describe the business model and structure of the insurer.

The plan contains a detailed resolution strategy and identifies potential impediments to the execution of the plan. Elements of the strategy are the considerations from the public interest test, the use of resolution instruments and ensuring the operational and financial continuity. The latter part means that DNB considers how the critical services and operations of the insurer can be continued both during and after resolution, with minimum damage to policyholders. DNB updates these plans at least every three years, or in case of material changes of the insurer. The plans are not made public, but DNB does provide a summary of the plan to the insurer concerned. Subsequently, the insurer has the opportunity to respond to this summary.

If DNB identifies impediments to the execution of the resolution plan, it will consult the insurer to resolve them. If the insurer fails to address the impediments, DNB may issue an instruction to the insurer, ordering the insurer to remedy them. The impediments may be of a financial or operational nature. Examples include adjustments in complex IT infrastructures, operational interconnectedness or financial intra-group positions. DNB applies proportionality assessing potential impediments. For example, an insurance group still has to be able to make use of the synergy benefits of a group. Removing all interconnectedness is not a goal in itself and would also not be proportionate.

6

Which instruments does DNB have to execute resolution in the winding up phase?

If DNB commences a resolution process for an insurer, it has four resolution instruments at its disposal which it may employ independently or in conjunction to wind up an insurer in a controlled manner:

1. With a bail-in, DNB can allocate losses to shareholders and creditors. It is possible that any remaining losses may also have to be borne by policyholders. By applying the bail-in instrument, the deficits of an insurer can be offset (see question 7 for an extensive description).

2. DNB can sell the insurer, or part of the insurer, to a third party. This does not require the consent of the board, shareholders or a court. By transferring the policies to a third insurer, the party acquiring the policies can continue the insurance of the policyholders.

3. DNB can place the insurer, or parts of the insurer, in a temporary bridge institution. The bridge institution allows insurances to be continued while DNB is looking for buyers, for instance.

4. DNB can split off loss-making business units of a failing insurer. This way, the other business units of the insurer may be sold at better prices.

In the resolution process, DNB also has other special powers, such as suspension of payments, replacing board members, or converting the legal form.

7

Who carries the losses of a failing insurer?

Which party carries the losses depends on the size of the losses. If an insurer has failed or is about to fail, it is usually due to a lack of capital. By employing resolution instruments, DNB can allocate the losses to the institution's creditors to solve the deficit. The losses have to be allocated in the same order of priority as under insolvency proceedings. This means that the first loss is always borne by the shareholders. Considering the fact that the liabilities of insurers are largely made up of insurance obligations, it cannot be excluded that policyholders also have to contribute to a solution. This can be achieved by reducing the benefits accrued or adjusting the premiums. However it is important to note that all creditors, including the policyholders, may not suffer losses in resolution that would exceed the losses under insolvency proceedings. This is referred to as the "No Creditor Worse Off" (NCWO) principle.

Despite an amendment of the insurance policy in resolution, resolution may be better for the policyholder. After all, DNB will try to continue the insurances (see also question 9 for the options available to the administrator in cases of insolvency). This means that the policyholder does not have to take out new insurance under new conditions. Taking out life insurance again is often not possible under the same conditions and premiums, which would mean that the policyholder is worse off. In some cases it is even impossible for the policyholder at all to take out the same product again.

8

How substantial can the losses be?

The size of the losses for the shareholders and creditors, including the policyholders, depends on the deficits of the failing insurer. In addition: the higher up in the ranking of creditors, the smaller the losses. For instance, policyholders in resolution and under regular insolvency proceedings are better protected than shareholders and bondholders.

The NCWO principle stipulates that a creditor, such as a policyholder, may not be worse off in resolution than they would have been in the event of regular insolvency proceedings. Prior to the decision to launch a resolution process for an insurer, an independent valuation must be made. When there is a shortage of time, DNB is allowed to make a provisional valuation. During such a valuation, an independent expert determines what the assets and liabilities of the insurer are worth. This valuation determines the limits that DNB must adhere to when applying the possible deduction to the value of the policies.

After execution of resolution, another valuation is carried out by an independent party, which determines whether or not the creditors were worse off in resolution than they would have been in insolvency proceedings. If this is the case, DNB will compensate the creditors.

9

Which options does an administrator have in the event of insolvency?

If an insurer is failing or is likely to fail but it does not pass the public interest test, DNB files for insolvency of the insurer with the court.

In case of insolvency proceedings, the administrator and not DNB is responsible for winding up the insurer. The administrator aims to achieve as much value as possible for all creditors, including policyholders. In order to make this possible, the administrator has several powers under national insolvency law. For instance, the administrator may try to effectuate a full or partial sale of an insurer, just as DNB can do in resolution. If necessary, the administrator may amend the policy conditions, for instance by reducing the duration of the policy or the amount to be paid out.
An important innovation of the Act is that under certain conditions, the administrator has the option to make interim payments to the policyholders. This means that under insolvency proceedings, policyholders can continue to have access to their monthly income.