

# Resolution Process: Insurance and Non-Traditional, Non-Insurance (NTNI) Activities

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# The Center for the Study of Insurance Regulation School of Risk Management, St. John's University

Established in 2013 as a forum for candid discourse on the subject of insurance regulation among business leaders, lawmakers and other government officials, educators and others involved in developing and implementing public policy in the U.S. and globally

In partnership with renowned law firms specializing in insurance

Organizes an annual insurance regulation conference in October and jointly with other centers

**October 14, 2015 in New York City**

# Discussion Flow

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- **Resolution processes, inclusive of insolvencies**
  - Early detection and insolvency risk management
  - Insolvencies and alternatives
  - Evaluation of existing regulatory structures
  
- **Resolution framework for insurance and NTNI activities**
  - FSB initiatives
  - IAIS initiatives
  
- **Concluding notes**



## Insurance Resolution and Process

[http://www.internationalinsurance.org/files/TC/PDF/Insurer\\_Resolutions\\_W\\_Jean\\_Kwon\\_2015\\_8\\_15\\_Final.pdf](http://www.internationalinsurance.org/files/TC/PDF/Insurer_Resolutions_W_Jean_Kwon_2015_8_15_Final.pdf)

# Resolution Application Types

- **Resolution in the face of a potential problem**
  - That imperils the viability of an insurer but can be remedied with timely and effective recovery measures
    - Informal and formal actions
  
- **Resolution in the face of insolvency**
  - A common outcome is liquidation but other possibilities exist
    - Formal actions



# Government Intervention

## ▪ Informal actions

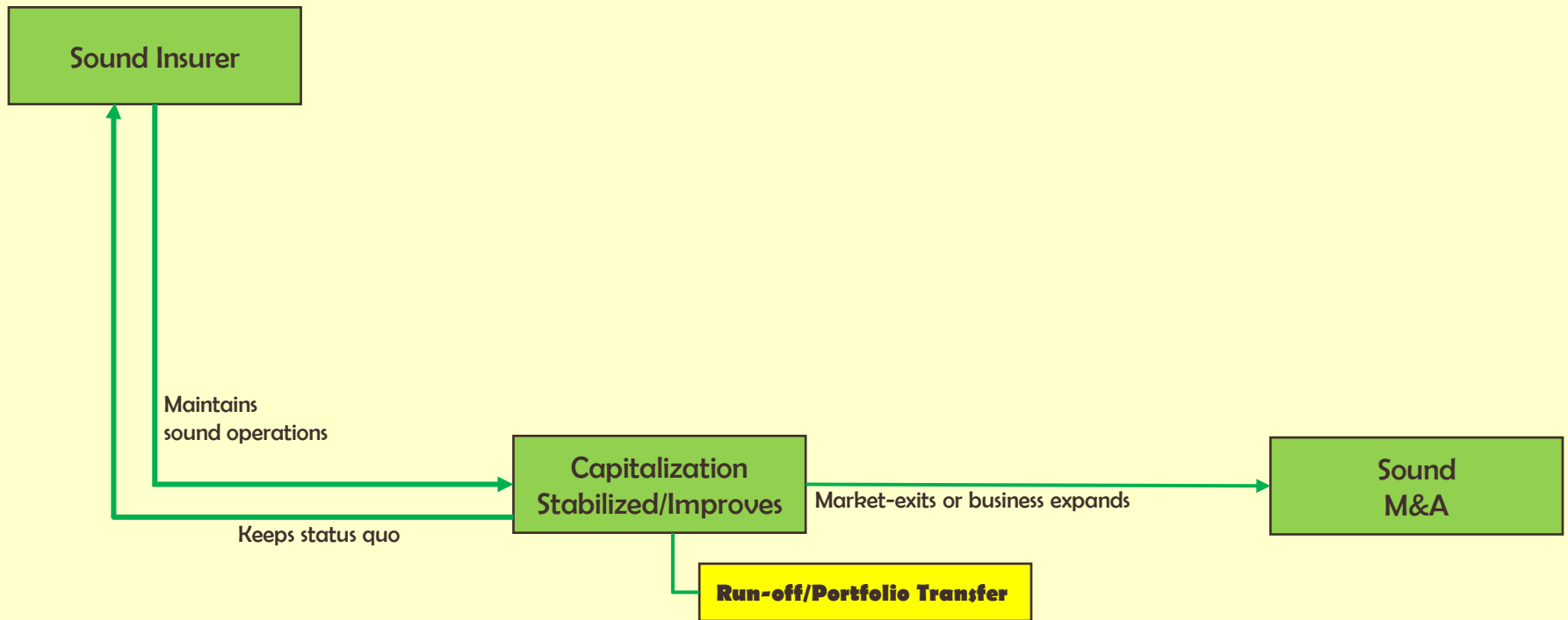
- Commonly at the initial stage and confidentially
- For example,
  - Order for capital injection
  - Restrictions on insurance operations
  - Restrictions on investments and other operations

## ▪ Formal actions

- Often public information
- For example,
  - Receivership
  - **Portfolio transfer\***
  - **Run-off\***
  - Near-miss M&A
  - Involuntary liquidation

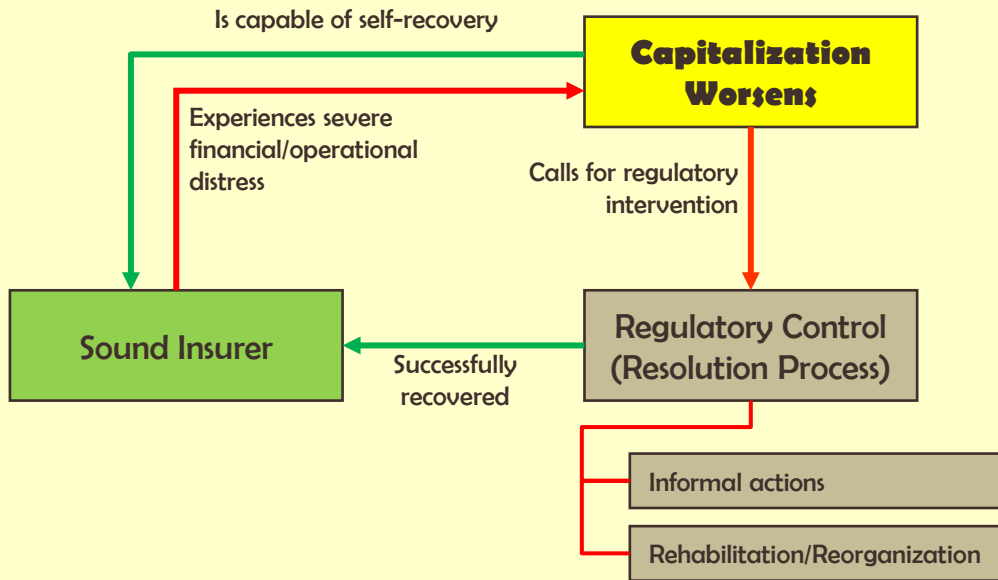
**\* Sound insurers may use them for strategic reasons!**

# Normal Operation



## Normal Operation

## Recovery/Resolution Process

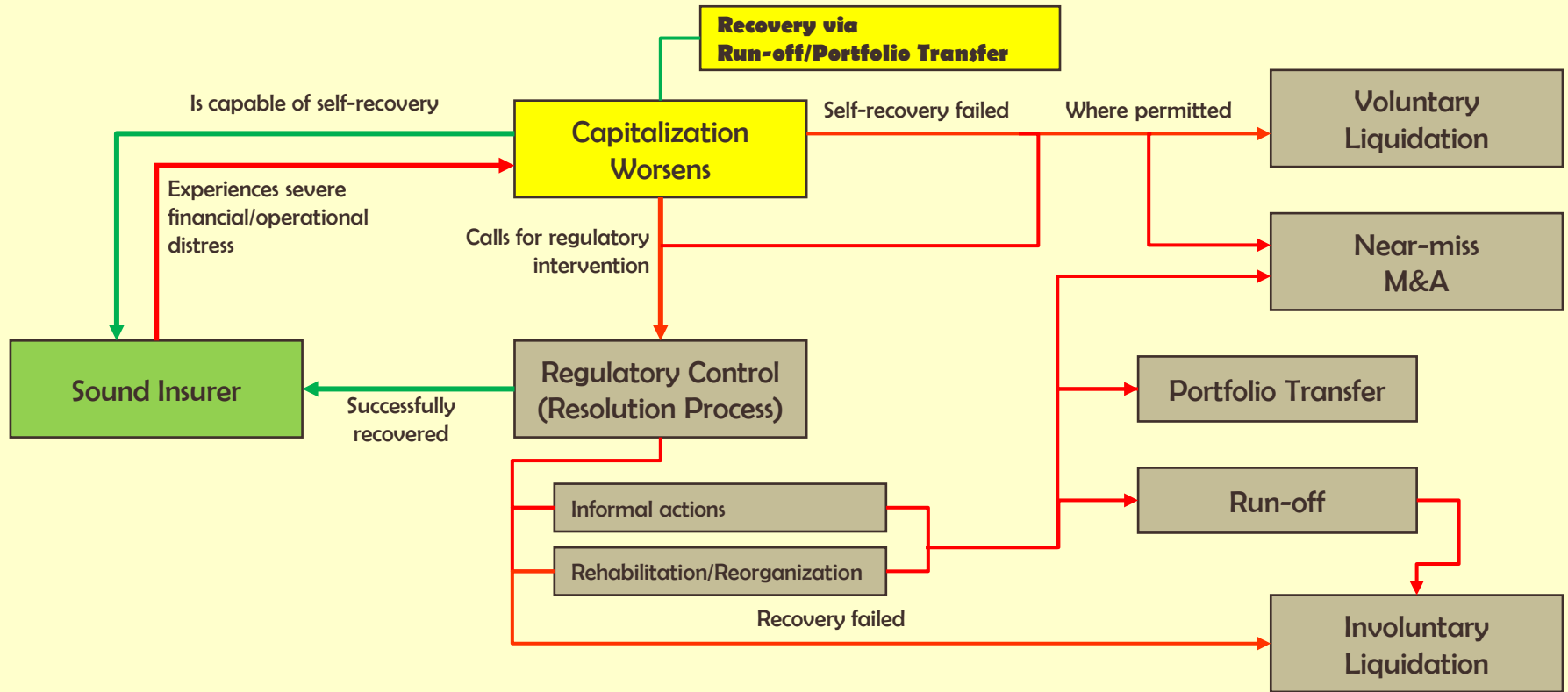




Normal Operation

Recovery/Resolution Process

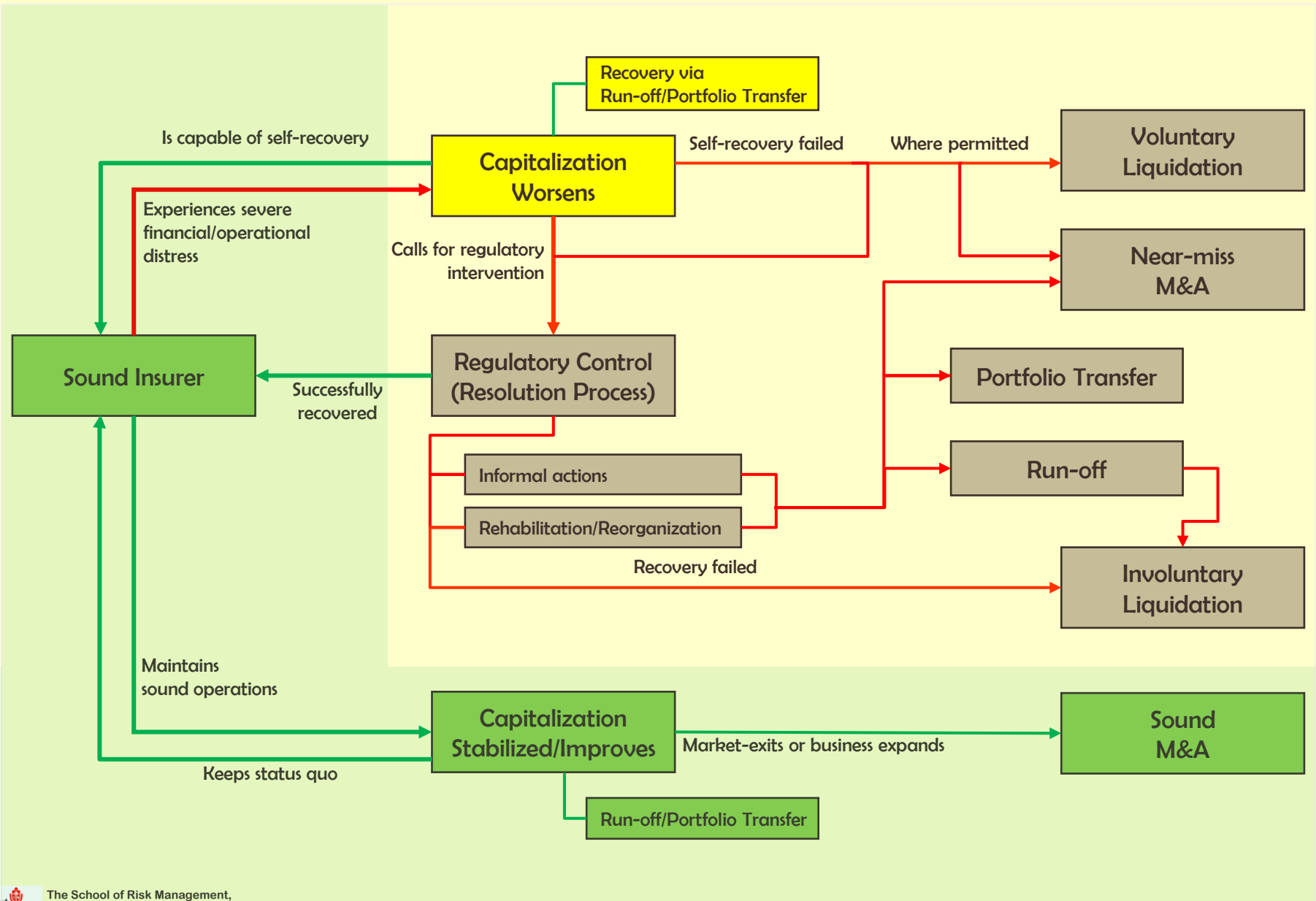
Liquidation/Exit



# Normal Operation

# Recovery/Resolution Process

# Liquidation/Exit



# Insurance Resolution Tools: Australia

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- **The Oversight and Response System (SOARS) classifies insurance companies into:**
  - Oversight - Increased information disclosure and capital
  - Mandated Improvement - Remediation plan for restoration of financial stability
  - Restructure - Authority's assumption of effective operational control
- **Petition for rehabilitation, including:**
  - Re-capitalization
  - Continuation of the business after a period of judicial management
  - Portfolio transfer to another insurer or run-off
- **Winding-up**

# Insurance Resolution Tools: Czech Republic

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- Order of a portfolio transfer or the cessation of new business activity
- Assumption of control of the company's assets
- Demand for a financial reconstruction plan
- Placement of the company under forced administration
- Revocation of the company's license and liquidation

# Insurance Resolution Tools: China

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- Order for capital injection
- Restriction of business scope, including purchase/allocation of assets and scale of operational costs
- Restriction of shareholders' dividend payments
- Limit on the remuneration of directors and officers
- Order of sale of assets or transfer of insurance portfolios
- Prohibition on accepting new business
- Agreement of a rectification plan
- Restriction on the establishment of branches, new business or advertising
- Limitation of premium income
- Increase in reinsurance cessions or transfer blocks of business
- Order of the sale of invested assets or a change in investment policies
- Authority's organizing a take-over of the company or any other necessary measures

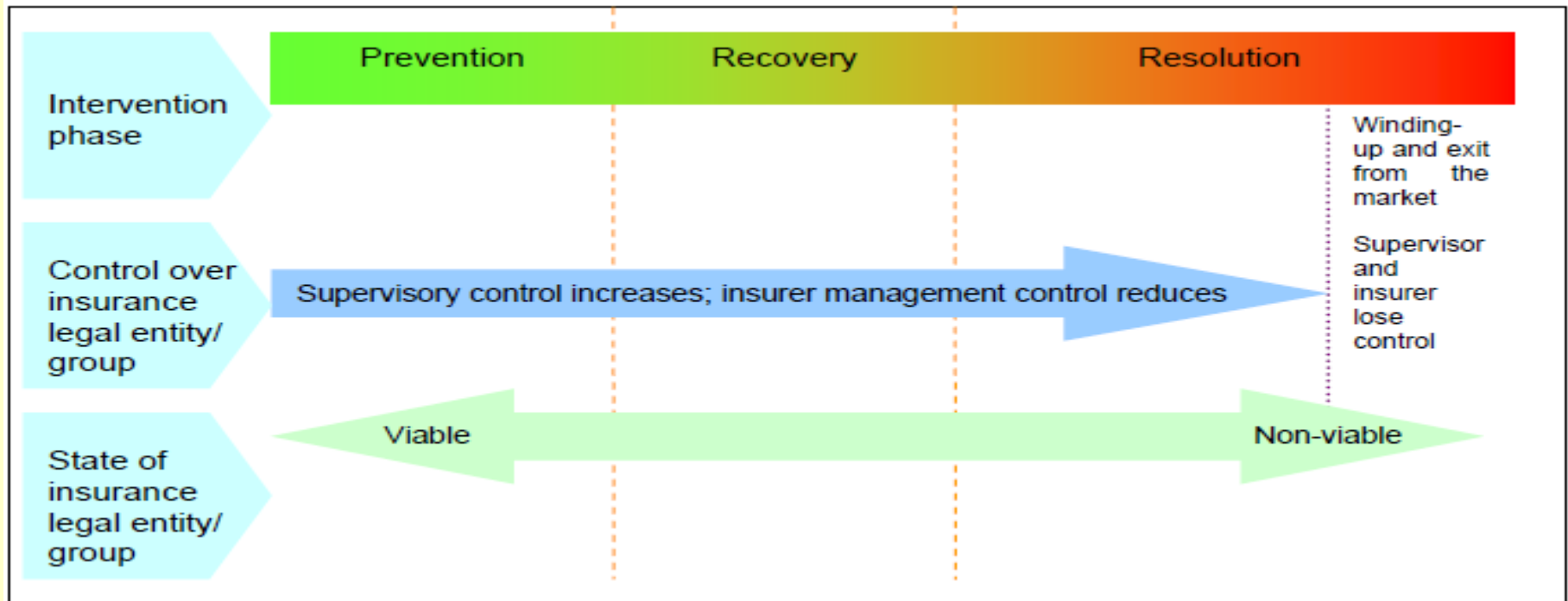
# Insurance Resolution Tools: Madagascar

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- Plan to resolve solvency margin inadequacy
- Blocking disposal of some/all of assets or transfer any assets of the insurer into an escrow account at the central bank
- Order to revise premium rates in the case of inadequacy in premium rates
- Declaration of insolvency by the finance minister, followed by withdrawal of business license
- Appointment of a liquidator for managed disposal of assets within 60 months (under the supervision of a magistrate court)

# IAIS Approach

Source: IAIS (2011)



# Public's Perspective: Issues

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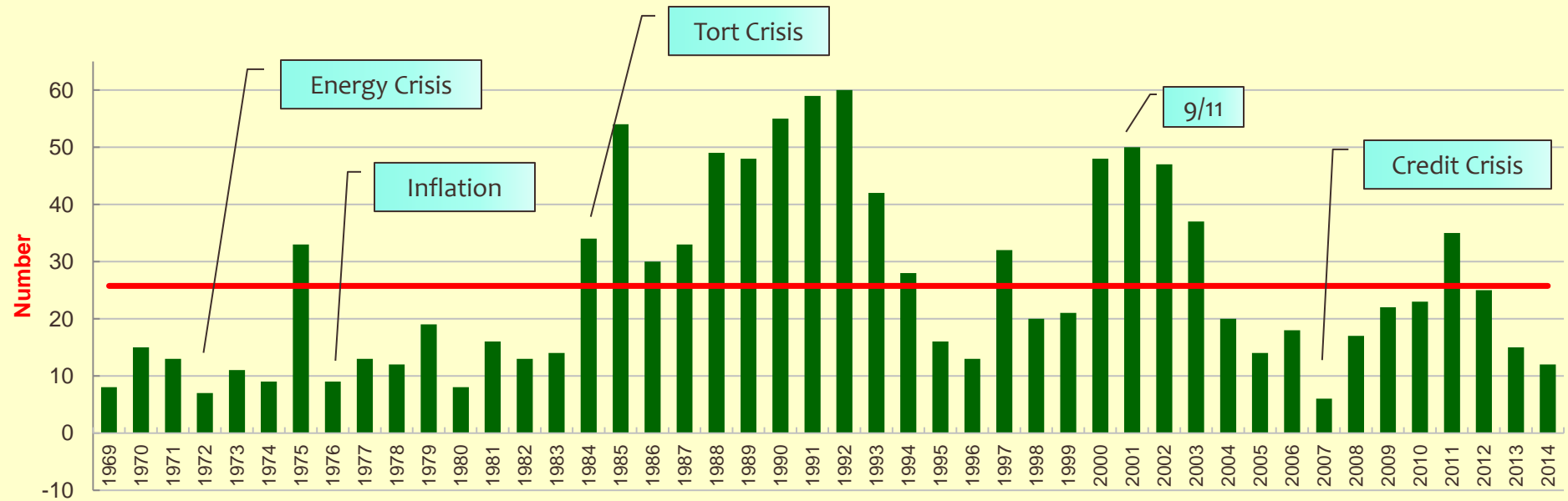
- **No clear separation possible regarding**
  - Healthy M&As and near-miss M&As
  - Portfolio transfers and run-offs exercised by healthy firms and as part of a government-led resolution process
  
- **Calling for prudence in insurance regulation for**
  - Protection of policyholders and
  - Preservation of soundness in insurer operations
  - Trust in insurance mechanism and societal stability





**Insurance Markets Remain Sound....  
(Some Data)**

# U.S. Nonlife - Financially Impaired Companies (FIC): By Number (1969~2014)

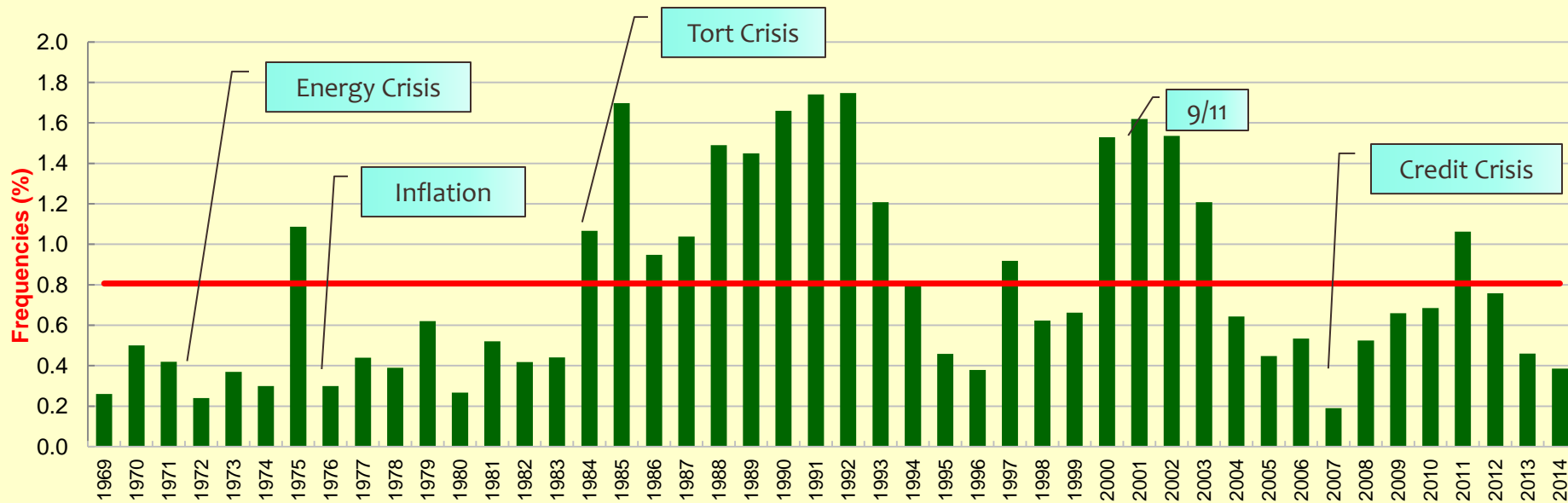


Source: A.M. Best (2015)

“Financially impaired” as of the first official action (for example, cease-and-desist order, suspension, involuntary liquidation, receivership, license revocation, supervision, etc.) taken by the regulatory authority

In 2015, there were 2,623 nonlife insurance companies.

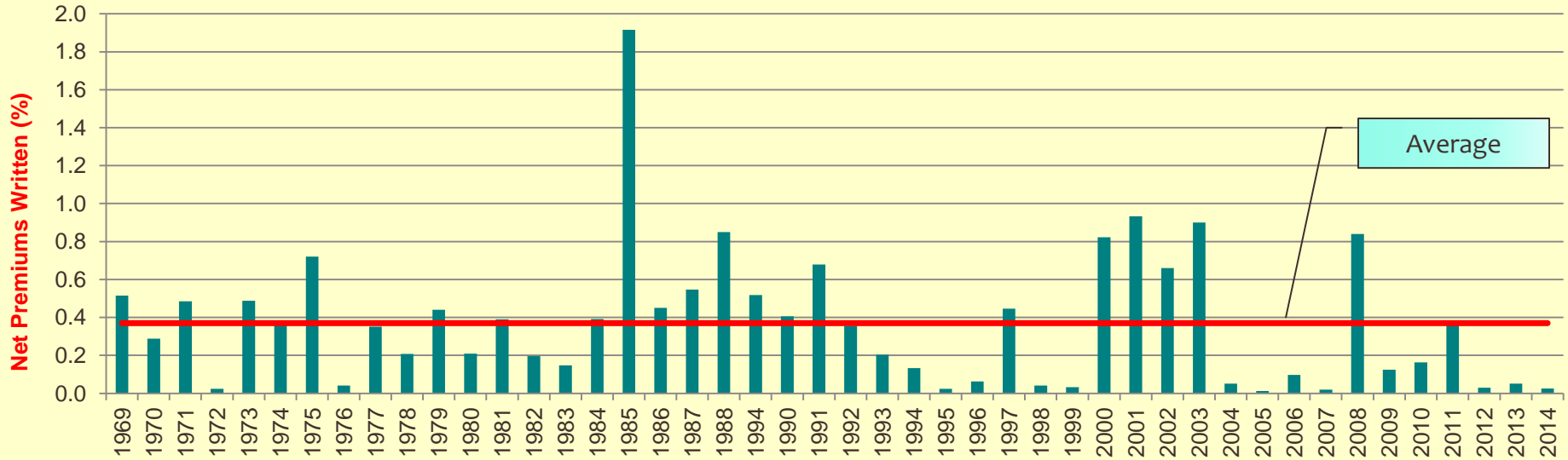
# U.S. Nonlife - Financially Impaired Companies (FIC): By Percentage of Total Companies (1969~2014)



Source: A.M. Best (2015)

In 2015, there were 2,623 nonlife insurance companies.

# U.S. Nonlife - Financially Impaired Companies (FIC): By Market Share (1969~2014)



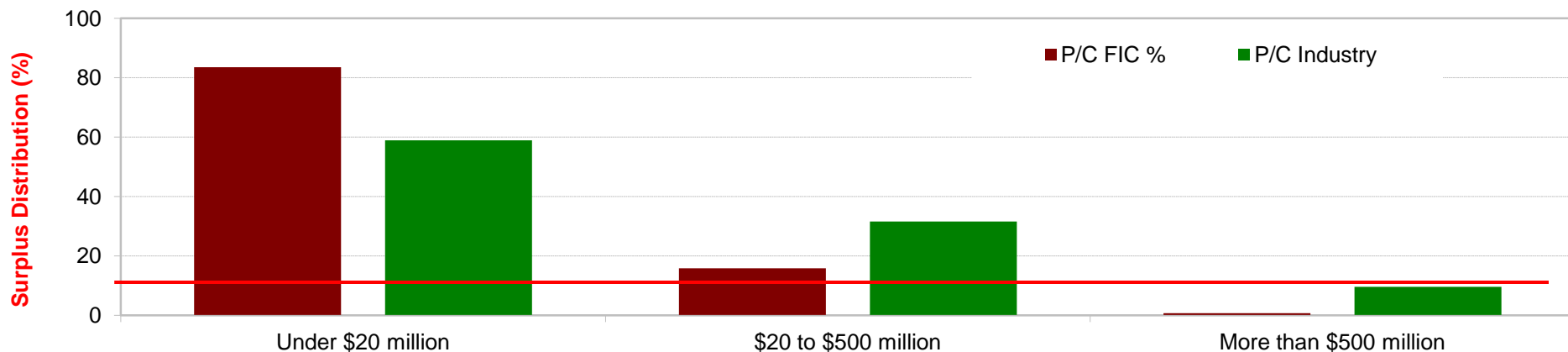
Source: A.M. Best (2015)

# Default Rates of Insurers that Went into Resolution: (2008~2012) (Exclude bailouts/governmental supports to rescue insurers)

Percentage of world (2012) assets		2008	2009	2010	2011	2012	2008–2012
27%	United States	0.042%	0.006%	0.012%	0.013%	0.004%	0.0151%
24%	Japan	0.078%	0.000%	0.000%	0.000%	0.000%	0.0147%
12%	United Kingdom	0.000%	0.001%	0.000%	0.000%	0.001%	0.0002%
9%	Germany	0.000%	0.000%	0.000%	0.000%	0.333%	0.0075%
5%	France	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%
3%	Netherlands	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%
3%	Switzerland	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%
3%	Sweden	0.355%	0.002%	0.034%	0.056%	0.004%	0.0820%
2%	Denmark	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%
1%	Ireland	0.000%	0.000%	0.867%	0.000%	0.000%	0.1613%
1%	Italy	0.058%	0.012%	0.078%	0.017%	0.000%	0.0326%
1%	Spain	0.000%	0.005%	0.056%	0.000%	0.009%	0.0155%
0%	Belgium	0.000%	0.000%	0.000%	0.052%	0.000%	0.0102%
<b>94%</b>	<b>Global default rate</b>	<b>0.038%</b>	<b>0.002%</b>	<b>0.020%</b>	<b>0.006%</b>	<b>0.005%</b>	<b>0.0139%</b>

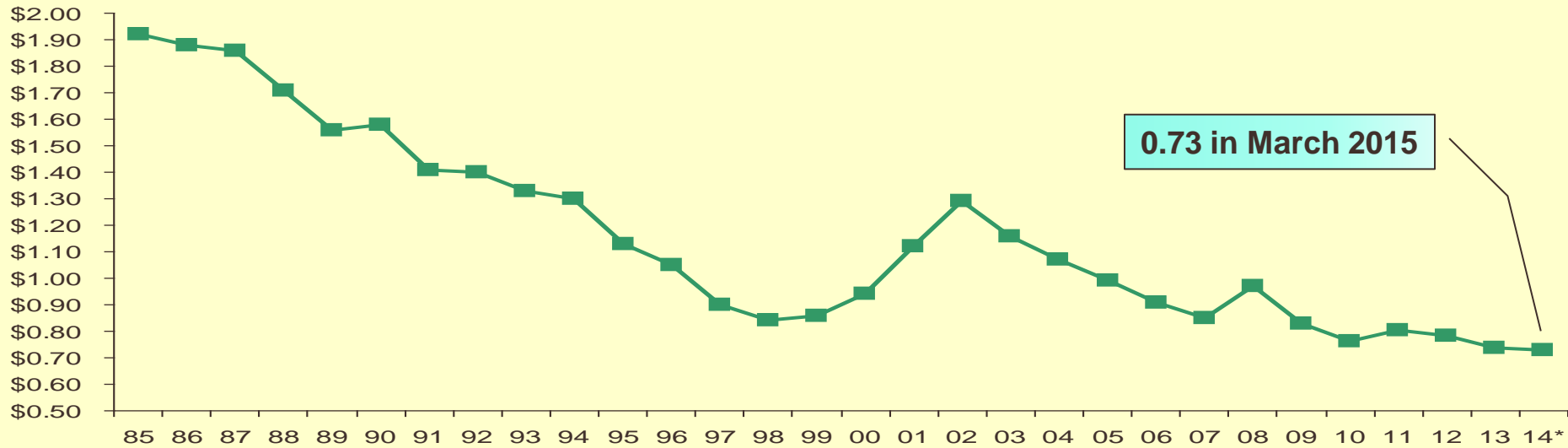
Source: Geneva Association (2015)

# U.S. Nonlife - Financially Impaired Companies (FIC): By Distribution of Surplus (Capital) (1969~2014)



Source: A.M. Best (2015)

# U.S. Nonlife Net Premiums Written-to-Surplus Ratio: (1980~2014)



0.73 in March 2015

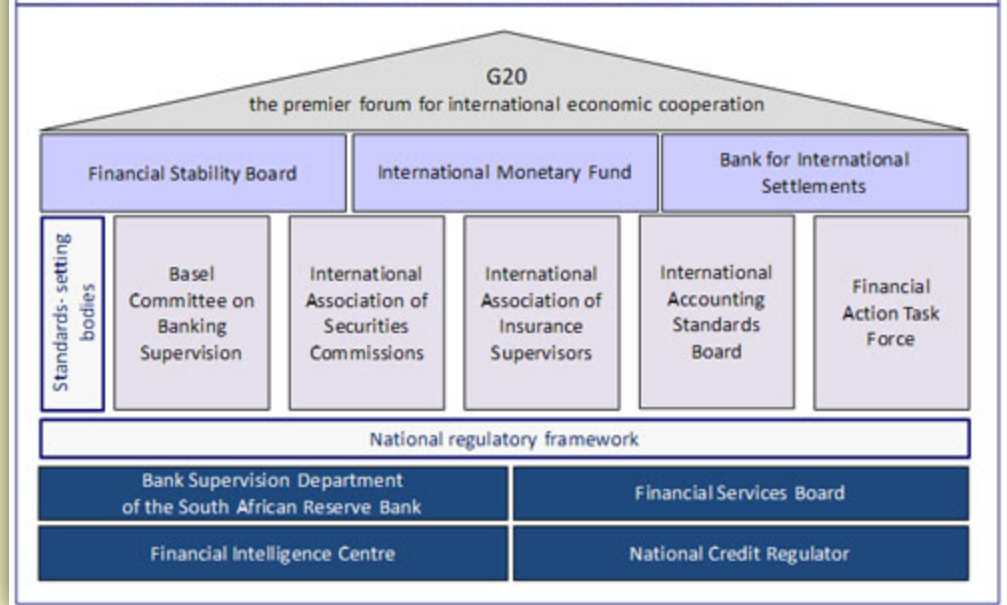
# Resolution Process for Insurance Activities

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- Insurance markets relatively well structured and functioning
  - Failures are an inevitable byproduct of capitalism
  - Nevertheless, room for some improvement remains
- Traditional insurance activities tend **not** to create or amplify interest, market, credit, liquidity and other risks inherent in capital markets. Instead, insurance companies perform **relatively well** within the prevailing economic environment.
- The traditional insurance market is **less likely a source of systemic risk**.



Figure 1: International financial architecture – driving national implementation



## Resolution Framework for NTNI Activities and of Insurance Groups

**FSB and IAIS**



# Financial Stability Board

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- Insurer's failure could systemically impact the insurance market, which can be contagious
- Run-offs and portfolio transfers as resolution tools may not work when the business of a failed insurer is complex, or when there is no corresponding market for portfolio transfers
  - Especially so for the failure of an **insurance group** with NTNI activities
- Key Attributes + **II-Annex 2: Insurer Resolutions**

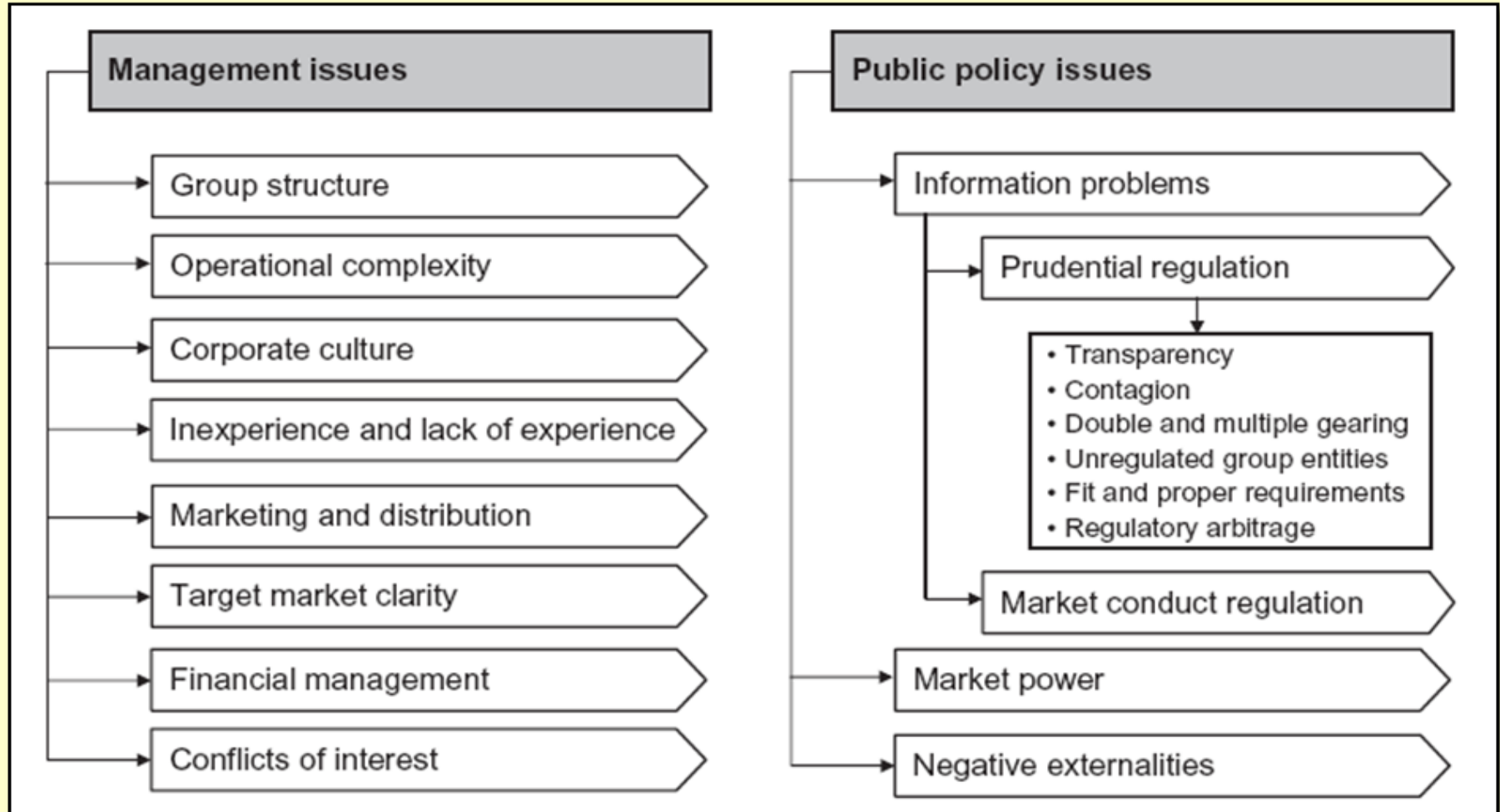
- A structured framework for “orderly” exits of failed insurance companies may foster market discipline and minimize moral hazard of insurers and policyholders.
  - Insurance Core Principles, ComFrames, Supervisory Colleges, ...
  - Internationally Active Insurance Groups (IAIGs) and Global Systemically Important Insurers (G-SIIs) and **new capital standards**
  
- Group-wide supervisor with direct powers to supervise consolidated holding companies, even as it is primarily charged to monitor NTNI activities at the group level to, among others:
  - Ensure the self-sufficiency of the separated entities in terms of structure and financial condition
  - Prevent creating non-regulated financial entities

# NTNI Activities.... Framework to be Built

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- **Segmentation of insurance group operations by traditional and NTNI activities necessary to:**
  - Carry out the regulation of the groups effectively and
  - Apply a resolution process when necessary
  
- **In practice, such segmentation is challenging due in part to:**
  - Complexity of group operations
  - Interconnectedness of capital and management philosophy
  
- **An issue regarding whether insurance regulatory regimes are prepared to deal with a troubled insurance group which also conducts NTNI activities, and, if so, which authority would become an effective group-wide authority responsible for resolution of the group**

# Issues in Financial Services Integration





**Concluding Notes**

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- A clear separation of funds – preferably also with the separation of a company from its management – is called for.
  - Not all countries have a clear guideline regarding separation of capital funds
- Recognizing the importance of timing differences that trigger regulatory actions exist between traditional insurance and NTNI operations
  - Regulation for traditional insurance to protect policyholders and to guide troubled insurers toward recovery, **not necessarily toward liquidation**

# Concluding Notes

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- **Crisis management coordination based on structured resolution agreements among authorities within a jurisdiction and across jurisdictions**
  - Each authority must remain responsible for achieving the goals of insurance regulation and supervision, with accountability for its actions.
  - Need to refine the responsibilities by each supervisor
  
- **All recovery and resolution measures must be legal and permissible under the governing laws, including the insurance act, in each jurisdiction.**
  - We need to refrain from introducing “**not all inclusive**” capital standards or resolution processes



**Thank you!**

