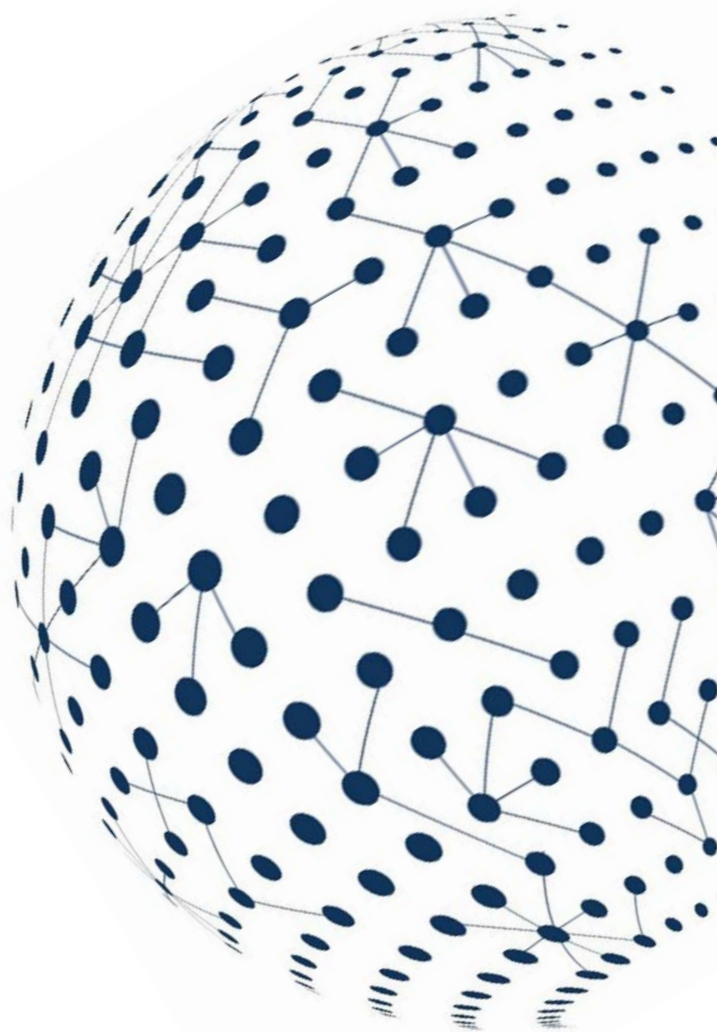


Resolution Funding for Insurers

Practices paper

10 January 2022



The Financial Stability Board (FSB) coordinates at the international level the work of national financial authorities and international standard-setting bodies in order to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. Its mandate is set out in the FSB Charter, which governs the policymaking and related activities of the FSB. These activities, including any decisions reached in their context, shall not be binding or give rise to any legal rights or obligations.

Contact the Financial Stability Board

Sign up for e-mail alerts: www.fsb.org/emailalert

Follow the FSB on Twitter: [@FinStbBoard](https://twitter.com/FinStbBoard)

E-mail the FSB at: fsb@fsb.org

Table of Contents

Executive Summary	1
1. Assessing Funding Needs	2
1.1. Insurers' Liquidity Risk	2
1.2. Resolution Funding Data and Needs to Facilitate Authorities' Preferred Resolution Actions	7
1.3. Foreign Currency Funding	7
2. Sources of Funding in Resolution	7
2.1. Internal Sources of Resolution Funding within Insurance Groups	7
2.2. Liquidity Facility to Distressed Insurers	10
2.3. External Sources of Resolution Funding – PPSs	12
2.4. External Sources of Resolution Funding – Standalone Resolution Funds	13
2.5. Interactions between Multiple Resolution Funds	15
3. Temporary Funding for Resolution Funds	17
3.1. Temporary Funding for Resolution Funds	17
4. Ex-post Recovery of Funds	18
4.1. Mechanisms to Recover Funds Used in Resolution	18
5. Conclusion	19
Annex 1: Business-as-usual Liquidity Facilities for Insurers	20
Annex 2: PPS - The United States' Guaranty Fund System	21
Annex 3: PPSs as Bridge Institutions	22
Key terms / abbreviations	24

Executive Summary

Resolution funding arrangements are essential to facilitate the effective and timely implementation of resolution measures. Besides looking for sources of funding within the insurer or the group to which it belongs, resolution authorities tap on privately funded policyholder protection schemes (PPSs) or standalone resolution funds.

This practices paper on resolution funding (“Paper”) looks at liquidity facilities available to insurers on a business-as-usual (“BAU”) basis for them to manage their liquidity needs (e.g., the tri-party repo market in Switzerland) and presents examples of emergency liquidity assistance facilities that may be available to insurers (e.g., a liquidity line is available from the Deposit Insurance Corporation of Japan to a distressed insurer). It also provides examples of sources of resolution funding in various jurisdictions. In most jurisdictions, PPSs can not only be used for policyholder compensation when winding up an insurer but can also be used for funding portfolio transfers and run-offs which are common resolution actions. In some others, standalone resolution funds exist and are funded on an ex-post basis, taking into consideration that such funds may have a limited scope of usage and an ex-ante funding could entail significant opportunity costs for the industry. Some jurisdictions have both a PPS and a standalone resolution fund. When resolving an insurer who is a PPS member, the PPS may be tapped upon first, before the resolution fund. The Paper also discusses temporary funding sources for resolution funds. The final section of the Paper describes mechanisms in place to recover funds used in resolution.

Policy makers and resolution authorities may use the Paper as reference as they develop their resolution funding framework for insurance.

Introduction

The FSB Key Attributes of Effective Resolution Regimes for Financial Institutions¹ (“FSB KAs”) sets out its expectations on the funding of firms in resolution in KA 6. FSB KAs Appendix II-Annex 2 (Resolution of Insurers) provides further guidance on resolution funding for insurers.

Resolution funding is financing used to facilitate prompt resolution actions in order to achieve the orderly resolution of a firm that could be systemically significant or critical if it fails. Common resolution actions for the insurance sector include transfer of the insurance portfolio and run off. Resolution funding can come from the internal resources of the failed insurer, private or industry financed resolution funds, or temporary access to government funds.

This Paper discusses the different sources of resolution funding, including PPSs and standalone resolution funds, and how they interact with each other when both exist. It also discusses the liquidity profile of insurers, and the liquidity facility that may be made available to an insurer who could otherwise become non-viable and cause financial stability concerns. This Paper focuses on incremental sources of resolution funding and does not cover bail-in, which pertains to reducing or restructuring liabilities. For bail-in, consideration needs to be given to the creditors’ hierarchy of claims in the jurisdiction, and it can be a topic that can be looked into in the future.

The contents of this Paper reflect iCBCM members’ practices and experiences gathered from (i) iCBCM members’ responses to a questionnaire and (ii) subsequent contributions. This Paper does not provide guidance on how resolution funding should be established as jurisdictional circumstances could differ.

This Paper is relevant for supervisory authorities or resolution authorities of any insurer that could be systemic or critical if it fails.

1. Assessing Funding Needs

1.1. Insurers’ Liquidity Risk

Insurers could fail due to insolvency or liquidity problems. iCBCM members were asked about insurers’ liquidity risk and potential liquidity funding needs for insurers in resolution.²

Generally, member jurisdictions think that liquidity risk for insurers depends on various factors, including: occurrence of claims events; nature of the insurers’ liabilities; engagement in banking-style liquidity transformation; and penalty provisions in policy contracts for early surrenders. There are certain circumstances that could give rise to higher liquidity risk and result in potential liquidity funding needs. Such circumstances include:

¹ FSB (2014) *Key Attributes of Effective Resolution Regimes*, October.

² Liquidity funding needs refers to temporary funding needed to support the orderly resolution of an insurer, either before, during or after resolution to meet the firm’s liquidity needs. This could be to ensure operational continuity, or to cope with heightened liquidity needs arising from market volatility, uncertainty surrounding asset valuations, and by an asymmetry of information regarding the firm’s viability. This is contrasted with non-liquidity resolution funding needs which refers to meeting needs for loss absorption capacity.

- Financial contagion from non-insurance entities – An insurer could be exposed to higher liquidity risk, if it has a banking subsidiary and is obliged to provide financial support to it. Nonetheless, this occurrence has not been commonplace in member jurisdictions.
- Investment profile - Given the current low-yield environment, insurers may invest in riskier or longer-term assets. They may also use derivatives to manage market risk exposures, which are subject to margining and collateral requirements. If insurers rely on cashflow from these investments to meet liabilities, they could be exposed to higher liquidity risks. Nonetheless, the respondents also cited existing regulatory requirements on enterprise risk management (ERM) and asset-liability management (ALM) which serve to ensure prudent investment practices.
- Product mix - Certain products may give rise to heightened liquidity risk, e.g., policies with surrender value (could be lapsed if interest rates rise) and variable annuities (the effectiveness of hedges put in place for such products have not been proven in crisis). However, there are mitigants in place such as contractual penalty amounts for early surrenders, and legal flexibility allowing insurers an extended period of time to pay out.

On a BAU basis, insurers tap on BAU liquidity facilities to manage their liquidity needs.

Box 1.1 and Box 1.2 discuss liquidity risk for European insurers in general and Box 1.3 and Box A.1 (Annex 1) provide examples of BAU liquidity facilities for insurers in Switzerland and the U.S. respectively.

Box 1.1: Insurance Groups with Banking Subsidiaries in France: Approach to Theoretical Liquidity Risks

Historically, the French landscape of financial institutions has been dominated by major financial conglomerates that conduct both insurance and banking activities during the past decades. Such financial conglomerates are known as “bancassurance” groups in France.

As large parts of the French insurance market belong to such bancassurance groups, particularly the life insurers, it could - at least in theory - expose insurers to banking liquidity risk. However, the parent company of most bancassurance groups is a bank (for which the recovery and resolution European banking regime applies) owning insurance subsidiaries that do not have high liquidity risks. On the contrary, insurance subsidiaries can provide the banking part of these groups with an additional stable source of liquidity, as demonstrated during the 2008 crisis.

Regarding most bancassurance groups whose parent company is an insurance company, it appears that their banking subsidiaries are typically not material. In this regard, it should be noted that the most significant insurance company in France is waived from supplementary supervision required for conglomerates. It does not need to comply with the financial conglomerates directive n°2002/87/EC on supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate. This is because it does not exceed the thresholds set out in the financial conglomerates directive to assess the significance of cross-sectoral activities. The situation is different for the six biggest banking groups, which are all conglomerates, since they are subject to the aforementioned supplementary supervision for conglomerates, and for which the European Central Bank (ECB) is the supervision coordinator.

Box 1.2: Liquidity Risks Arising from Changing Investment Profile of Insurers. Mitigation measures foreseen in EU/Italy

Background of investment mix of European insurers, and how these have shifted amidst the low-yield environment

In the current macro-financial environment, one of the major challenges for the insurance market is the exceptionally ultra-low/negative level of interest rates, which is ultimately exacerbated by the Covid-19 pandemic. The low interest rates affect insurers through the balance sheet on both the assets and liabilities side. Insurers face difficulties in finding long-term assets that are of sufficiently good quality to meet their long-term liabilities. This results in asset-liability duration mismatch and insurers being vulnerable to declining interest rates. Where the investment yields are below guarantees offered, which are prevailing in some EU countries, the profitability would be gradually affected in the medium to long term, triggering shifts in the asset allocations towards alternative assets, increasing the overall risk of the portfolio. Changes in the asset allocation of the EU insurers have been marginal so far, although with differences across countries³. New regulatory developments could have also incentivised possible risk taking. For example, amendments to the EU delegated regulation 2015/35 introduced lower capital requirements for more illiquid assets such as infrastructure investments, private debt, unlisted equity or long-term equity. However, the shift towards these investments seems to be limited.

Different ways liquidity risk may manifest given the change in the investment profile

With ultra-low interest rates, insurance companies under pressure might have incentives to invest in alternative and/or more illiquid asset classes with potentially higher yields, taking on higher risks or risks that are new and unknown. Low rates also push insurers to invest in derivatives for hedging purposes, or to sell long-term high yield assets, harming asset-liability management. Amid the uncertainty in financial markets, investment decisions on a potential rebalancing of portfolios are challenging, especially if assets and liabilities are not perfectly matched. In this scenario, liquidity strains may arise following changes in market conditions if unanticipated liquidity withdrawals occur, forcing insurers to liquidate own assets within a certain timeframe to pay i) claims and surrender value and ii) derivative margin calls, as further detailed below.

- (i) Liquidity shortages could potentially arise in case of decrease of premiums inflows in the new business exacerbated by an increase of claims and surrender in the in-force life business following the Covid-19 crisis. Effects on liquidity could be also driven by the growth in claims from policyholders for cancelled travel arrangements, business interruption, enforcement of guarantees contained in credit, suretyship, medical expenses and assistance policies. Although this is a possible scenario, EU insurers have not encountered difficulties in meeting payment obligations when they were due, and no liquidity strains have been evidenced so far.
- (ii) Heightened liquidity needs may also arise because of the impact of snapback on the marked-to-market value of derivative contracts. A surge in interest rates could cause losses on derivative positions that trigger additional collateral demands. In the EU, the risk from exposure to derivatives has not been indicated as a top risk, because exposure to derivatives is concentrated in just a few countries and insurers (i.e., big undertakings). This might raise concerns, although no liquidity issues have been detected.

³ Over recent years the fixed income portfolio (corporate and government bonds, structured notes and collateralised securities) showed a slight decrease. An overall increasing trend was observed for unlisted equities, collateralised loans and mortgages (CLOs and CMOs), albeit they remain limited compared to the total investment portfolio. Similarly, a slight shift towards alternative and more illiquid investments, including complex securities with limited liquidity, infrastructure and property was noted. However, government and corporate bonds still account for two-thirds of insurers' total investment portfolios. This was followed by equity and liquid assets which collectively accounted for 66% of total assets at EU level.

EU Mitigating factors/regulatory measures (in place and planned) to limit such risks

Since liquidity risk is recognised as a possible source of systemic risk, strong emphasis has been placed on liquidity risk management, and regulatory requirement to ensure prudent investment practices.

The current Solvency II regulatory framework includes qualitative requirements and micro-prudential measures for liquidity risk measurement and management, complemented by EIOPA Guidelines providing national authorities with more concrete guidance on how to ensure a sound and prudent management of the undertaking's business. These measures include, amongst others, risk management systems and asset/liability management, prudent person principle (PPP), liquidity plans by insurers using long-term guarantees measures (LTG), and own risk and solvency assessment (ORSA).

The Solvency II framework includes little quantitative information for monitoring both individual companies and the entire sector. To form a comprehensive framework on the liquidity profile of the insurance industry, EU initiatives have been addressed within EIOPA and the EU Commission context⁴ to strengthen the monitoring framework, enhance the current reporting, reinforce the macro-prudential dimension of the solvency regulatory framework and define methodologies for the identification and measurement of liquidity risk in stressed scenarios.

Mitigating factors/regulatory measures (in place and planned) to limit such risks in Italy

The Italian supervisory framework foresees several regulatory activities and mitigating measures around interest rate and liquidity risks, ranging from monitoring actions, setting requirements, and issuing orders, statements or recommendations. These measures may include, amongst many, reducing the maximum guarantees / rates for new business, deterring insurers from electing specific assets or asset categories for covering technical provisions, intervening when the investment policy is inconsistent with the business and the risk appetite/profile, prohibiting the sale of certain new products, requiring the establishment of additional provisions for interest rate risk for existing business, intensifying monitoring and/or increasing reporting requirements, and requesting undertakings to include low interest rate scenarios in the ORSA analysis.

These measures also include requesting pre-emptive recovery plans. Insurers, which are subject to enhanced disclosure obligations for financial purposes, and identified as relevant by IVASS, are required to draw up a "pre-emptive recovery plan". Scenario-planning and consideration of potential measures to be taken in relation to low interest rates or liquidity strains are expected to be reported, while the measures identified have to be based on realistic/plausible assumptions and economic sustainability.

⁴ See EIOPA Opinion on the 2020 review of Solvency II, in response to the Call for Advice of the EU Commission, published 17 December 2020: https://www.eiopa.europa.eu/content/opinion-2020-review-of-solvency-ii_en and proposal of the European Commission for amendments to the Solvency II Directive, published on 22 September 2021: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0581>.

Box 1.3: Switzerland's Model of Liquidity Provision for Insurance Sector

The cash driven CHF repo market in Switzerland is mainly constituted by the tri-party repo market operated by SIX Repo Ltd⁵. Trades are concluded on an electronic trading platform with a direct link to the real-time gross settlement payment system (RGTS) and the Central Securities Depository (CSD). In this system, all trades are settled on a fully automated system on a delivery-versus-payment (DvP) basis. On the same platform, the Swiss National Bank (SNB) conducts its open market operations and offers its standing facilities. Most trades are conducted against SNB eligible securities (so-called SNB GC basket) which is also used by the SNB in its operations, containing only HQLA eligible securities.

To access the repo market, a sight deposit account at the SNB is required among other things. Besides the domestic banks, other domestic participants in the financial market (such as insurance companies) may be admitted for opening a sight deposit account at the SNB⁶. In particular, FINMA supervised insurance companies and fund management companies for funds domiciled in Switzerland are able to obtain a sight deposit account provided they contribute to the liquidity in the repo market. In addition to holding a sight deposit account with the SNB, the counterparty must meet the cumulative requirements of all three involved parties (SIX Repo, SIX SIS, SIX SIC) in order to conclude repo transactions. FINMA is involved neither in the application process nor in the decision process of the SNB.

FINMA sets supervisory guidelines for insurance companies that aim to enter into repo transactions within their tied assets, i.e., assets held to safeguard possible policyholder claims. Within tied assets, repos can only be traded via an established repo trading platform satisfying a number of requirements including valuation of collateral and margin transfers at least on a daily basis. Only assets, which are easy to value based on generally available information, may be used for repos; assets obtained via reverse repo, securities lending or similar transactions may not be used in repo transactions. The term may not exceed 12 months. The insurance company has to make sure it retains sufficient liquidity.

Further information on general terms of the repo market is published by SIX Repo Ltd. In case of resolution, close-out netting will be applied on all trades open at this time.

Due to the institutional set-up and the risk mitigating factors, market participants can rely on a deep and liquid repo market, which has proven to be very stable throughout the financial crisis (see various research publications by SNB). Through insurance companies we understand that liquidity also stayed high during the recent COVID-19 crisis and the insurance companies could obtain sufficient liquidity through the repo platform if needed.

Additionally, insurance companies in the repo market have access to the SNB's standing facilities (intraday liquidity and liquidity-shortage financing facility) and may be admitted as counterparties for monetary policy operations. These facilities and operations are conducted by the SNB, FINMA cannot comment on whether and when they will actually make use of this possibility in the future.

⁵ In addition to CHF-denominated repo transactions, there are 13 additional trading currencies available: EUR, GBP, USD, JPY, CAD, AUD, NZD, DKK, SEK, NOK, CZK, HUF and PLN.

⁶ The SNB provides detailed information on the types of admission in an according [instruction sheet](#).

1.2. Resolution Funding Data and Needs to Facilitate Authorities' Preferred Resolution Actions

Jurisdictions perform resolution planning and identify specific information to collect regularly or on-demand from insurers to prepare for timely implementation of resolution actions. This information includes intragroup transactions, product features, asset and liability information, PPS protected liability amounts, and information on critical functions (where applicable). This will in turn inform the need for potential resolution funding.

Most jurisdictions have yet to develop in detail the preferred resolution actions for their insurers. However, jurisdictions have a range of resolution powers available for the orderly resolution of insurers. Common resolution powers include transfer of business (whole or part) to another insurer or bridge institution and placing an insurer in run-off. Many jurisdictions have resolution funding mechanisms in place (e.g. PPS can be used to fund portfolio transfers and run-offs) to facilitate these common resolution actions.

1.3. Foreign Currency Funding

A couple of jurisdictions assessed that payments for risk exposures and contractual obligations denominated in foreign currencies could give rise to foreign currency funding needs. For these jurisdictions, the risk of foreign currency exposure is mitigated by incentives embedded within their solvency frameworks. For example, under Singapore's risk-based capital framework, there is a foreign currency mismatch risk requirement which incentivises insurers to reduce their net open position in each foreign currency.

2. Sources of Funding in Resolution

2.1. Internal Sources of Resolution Funding within Insurance Groups

Apart from bail-in, internal sources could be plausible for resolution funding. Such sources of resolution funding could be entity specific (i.e. entity's own funds) or intra-group. Jurisdictions identified the following firm capabilities that should be in place to ensure that an insurer can accurately determine its internal funding sources (including assets that can be mobilised across the group):

- Systems and processes in place to identify surplus assets that can be used for resolution funding, as well as assets that are unavailable such as encumbered assets. Haircuts on surplus assets should also be considered.
- Ongoing monitoring and oversight of internal funding sources performed at an appropriate frequency. In Germany, the actual value of assets (especially for those assets that are ring-fenced and held in a register for the purpose of policyholder protection) are continuously evaluated and confirmed by board members, trustees, actuaries, accountants and supervisors (10-eye principle) in order to prevent asset gaps.

In determining the internal sources of resolution funding, consideration should be given on potential impediments to the utilisation or movement of the funding source, such as:

- Regulatory ring-fencing by supervisory authorities: Any proposed movement of funds could be blocked by an authority from the other jurisdictions where the group operates, if the movement of funds were to significantly reduce surplus capital and/or result in a breach of local capital requirements. Ring-fencing requirements may also prevent movement of funds out of an entity.
- Assets encumbrance or assets set aside for asset-liability management purposes: Encumbered assets, such as collateralised or pledged assets, cannot be freely withdrawn. There are also assets that are set aside for insurers' asset-liability management purposes to meet contractual guarantees and technical provisions.
- Market-related impediments, leading to uncertainty of liquidity of assets: unfavourable market conditions could also lead to uncertainty in the timing and value of assets that could be transferred as funding sources.

Box 2.1 details the internal sources of resolution funding of insurance groups in the UK and the considerations surrounding these sources of funding.

Box 2.1: UK's Experience in Ensuring Adequate Internal Funding for Insurance Groups

There are 61 insurance groups headquartered in the UK, with assets held at YE2019:

- Collective total is GBP 2.1trn
- Mean is GBP 33.7bn
- Median is GBP 1.8bn
- The range is from GBP 13.8m to GBP 450.4bn
- 39 insurance groups hold more than GBP 1bn in assets
- 19 insurance groups hold more than GBP 10bn in assets
- 5 insurance groups hold more than GBP 100bn in assets

Potential internal sources of funding

- Remittances from other parts of group;
- Intragroup loans;
- Internal sub-debt instruments from Group to a subsidiary that have triggers for conversion to equity at a prescribed level of PCR coverage;
- Group liquidity facility for subsidiaries;
- Existing debt;

- Assets not encumbered that could be used for repo funding; Loans from the with-profits fund (WPF) to the insurer, i.e. the shareholder fund (SHF)⁷; and
- A buy out of the future anticipated shareholder transfers to convert the WPF business from 90:10 to 100:0.⁸

What can affect access to these:

- If certain assets within operating subsidiaries are ring-fenced (e.g. WPF);
- Remittances: insufficient capital generation and or SCR below risk appetite at subsidiary level;
- Failure of operating subsidiaries to pay dividends to group (because they cannot afford it/ the local regulator prohibits it)
- Intragroup loans: supervisory intervention to prevent loans (e.g. if leads to SCR breach, or conduct concerns over WPF lending to the SHF) or lack of resources or binding leverage constraints;
- Other jurisdictional regulators are likely to prohibit the transfer of funds from an operating subsidiary that would cause that subsidiary to breach either its solvency or liquidity risk appetite; and
- Other jurisdictional regulators ring-fencing funds, or other governmental restrictions on funds leaving the country.

Ensuring the firm has timely access

General supervisory measures:

- Deep dive reviews of capital and liquidity management within the Group (i.e. Financial Risk reviews).
- Regular business model analysis of group business plans.
- Regular monitoring of capital and liquidity positions within the group and material subsidiaries
- Regular review of group stress testing and actions which could be taken in response to stress
- Reviews of dividend and deleveraging decisions and the potential challenge to these.
- Regulatory approval required for intragroup investments – restrictions depend several factors e.g. asset admissibility for entity making loan.
- Enabling extraction of surplus assets through “special remittances” to group (i.e. additional unplanned remittances).

More active/invasive supervisory measures:

- Request the insurer to conduct liquidity stress testing. The firm could conduct the analysis itself, or it could be conducted by an independent third party. In the UK, the PRA could require the latter using section 166 FSMA.

⁷ In the UK, WPF assets are ring-fenced under Financial Conduct Authority (FCA) Rules. Funds can only leave the WPF via the payment gateway, which is commonly set at 90/10 for policyholder/shareholder respectively (but other ratios do exist). However, with regulatory approval, the WPF could provide a loan to the SHF. This option could potentially be considered if the loan was deemed to be an appropriate use of capital for the WPF.

⁸ This would constitute a reattribution and therefore require a Policyholder Advocate, which may make the process too slow to be used in response to crisis. Alternative solutions could be constructed to cede certain risks to a with-profits fund (e.g. recapturing a fixed expense agreement) that may reduce the shareholder fund’s capital requirements. Any arrangement would need to not be to the detriment of with-profits policyholders.

- Direct an authorised insurer to take, or not to take, a specific action (for example, to block remittances to group) under section 55m FSMA.
- Direct a group holding company to take, or not to take, a specific action (for example, to block dividends being paid to shareholders) under section 192c FSMA.

2.2. Liquidity Facility to Distressed Insurers

There may be circumstances where an insurer may not be able to meet their liquidity needs through BAU liquidity facilities (see Annex on BAU liquidity facilities for insurers). Some jurisdictions provide emergency liquidity assistance to selected insurers to prevent their failure which may otherwise have a systemic impact.

In Japan, a liquidity line is available from the Deposit Insurance Corporation of Japan (DICJ) to a distressed insurer where without the liquidity line, the insurer may cause systemic risk that would lead to severe disruption to the financial system including financial markets. This liquidity line is known as the Specified Type I Measure. Please see Box 2.2 for details.

Box 2.2: Japan's Deposit Insurance Corporation's role in Orderly Resolution

Background

In light of the international response to the global financial crisis, the Deposit Insurance Act in Japan was amended in June 2013 and the revised Act entered into force in March 2014. The revised Act introduced a framework for orderly resolution of financial institutions with a view to addressing risks that may spread across financial markets. The scope of new resolution measures includes the financial industry as a whole, including banks, broker dealers, insurance companies, and financial holding companies.

Measures and procedures for Orderly Resolution

Two measures, Specified Type I Measures and Specified Type II Measures, have been introduced depending on the situations of the financial institutions, etc. Specified Type I Measures are elaborated below, while Specified Type II Measures are elaborated in Box 2.4.

Specified Type I Measures (Measures for a financial institution that is in the state of no excess debt (solvent))

Description of the measure

- Financial institutions to which the measure is applicable are placed under special oversight by the Deposit Insurance Corporation of Japan (DICJ) and receive a supply of liquidity.

Procedures

- The Specified Type I Measures will be invoked by following procedures;
 1. The Prime Minister, following the discussions at the Financial Crisis Response Council⁹, shall confirm the necessity to take the measures for a troubled financial institution that is in the state of no excess debt (solvent), where a systemic risk with severe disruption in the financial market

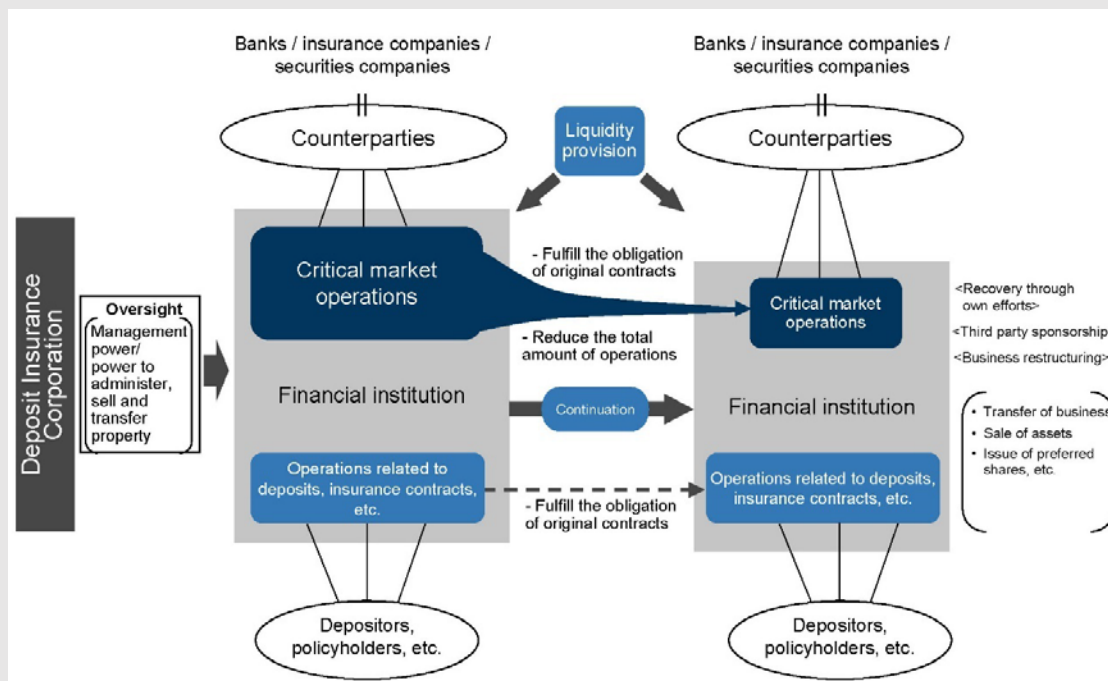
⁹ The Financial Crisis Response Council is responsible for holding deliberations on policy concerning measures to deal with financial crises, such as a chain reaction of large-scale failures of financial institutions, and other important matters upon consultation by the Prime Minister and for overseeing the implementation of measures by relevant administrative agencies based on the policy.

and other financial systems in Japan cannot be avoided, without taking the special intervention measures.

2. Upon the receipt of applications from the designated financial institutions, the DICJ, following the discussions at the Policy Board, determines whether to provide necessary measures such as liquidity and capital supply.

Overview of the Specified Measures under DIA Article 126-2 item (I)

(In the case of a financial institution that is in the state of no excess debt (solvent))



Source: JFSA¹⁰

Crisis Management Account and Specified Contributions

In principle, the financial and liquidity assistance under the Specified Type I and Type II (see Box 2.4) measures will be financed as follows:

- The DICJ keeps the record of expenses of business operations relating to orderly resolution of assets and liabilities of financial institutions in the Crisis Management Account rather than in the General Account.
- Financial institutions must make specified contributions to the DICJ to cover the cost incurred by it in conducting crisis management operations (limited to measures relating to financial institutions recognized as targets of the specified measures and those relating to specified bridge financial institutions).
- When the need arises to take the Specified Type I or Type II Measures, the DICJ raises the necessary amount of funds from the financial market on a case-by-case basis where necessary, taking into account the outstanding amount in the DICJ's Crisis Management Account. If there is a deficit in the Crisis Management Account as a result of financial support through the Specified Type I or II Measures, the DICJ will afterward recover the deficit by charging other financial institutions a certain amount of funds.

¹⁰ Available at: <https://www.fsa.go.jp/en/refer/legislation/20130416/02.pdf>

2.3. External Sources of Resolution Funding – PPSs

In most jurisdictions, PPSs can not only be used for policyholder compensation when winding up an insurer¹¹, but can also be used for funding portfolio transfers and run-offs which are common resolution actions. Specifically, PPSs are not used for no-creditors-worse-off-than-liquidation (NCWOL) compensation. PPSs are either ex-ante or ex-post funded and may have access to back-up sources of funding. Where such back-up sources of funding tap on public monies, mechanisms are in place to recover the losses from the industry. Moral hazard is minimised by imposing losses on shareholders and unsecured creditors of the insurer to fullest extent possible. This paper focuses on how PPSs could be used for resolution funding, rather than how PPSs work in general for winding up purposes. Box 2.3 shows how Australia’s PPS can be used to fund resolution actions. Box A.3 (Annex 3) presents a case of PPSs in Germany where they can be used as bridge institutions.

Box 2.3: Australia’s Policyholder Protection Mechanism

Background

The General Insurance Financial Claims Scheme (GI FCS), established in 2008, is Australia’s PPS for the general insurance industry. The GI FCS provides eligible policyholders with timely access to funds owing as a result of an insurance claim in the event of the insurer’s insolvency. The GI FCS provides compensation for most claims up to AUD 5,000, with claims above AUD 5,000 also covered for eligible “retail”¹² policyholders and certain eligible third parties. The GI FCS is administered by APRA.

The GI FCS aims to ensure that eligible claims are met even when capital is exhausted. It is activated ex-post on the authority of the Australian Government, with the appropriation of public monies limited to AUD 20bn per failure. This is recoverable via an industry levy if the costs of operating the GI FCS, both in terms of payouts to claimants and administration costs, are not fully recovered through the liquidation process.

Historically, the GI FCS has been declared once in respect of a small insurer, with experience in administering the GI FCS serving as a basis for pursuing amendments to enhance the effectiveness of the scheme in recent legislative reforms to strengthen resolution powers in Australia.

Expanded role to support transfers

The *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018* (Crisis Management Act) expanded the scope of the GI FCS by creating an additional payment mechanism to allow APRA to meet GI FCS entitlements through a compulsory transfer of business.

APRA already had extensive powers to facilitate a compulsory transfer of business from one insurer to another. However, the reforms in the Crisis Management Act now provide an additional option for APRA to meet GI FCS entitlements by way of transferring protected policies, backed by GI FCS funds, to a receiving insurer rather than paying them out separately.

In the context of general insurance, a transfer of business, especially for long-tail insurance claims, may be either the only practical or the most cost-effective means of ensuring continuity of an insured policyholder’s protection. Moreover, as a result of these amendments, and reflecting the fact that a transfer of business will usually include assets, it may provide a better financial outcome for the Australian Government than an outright payout of protected policies under the GI FCS.

¹¹ Please refer to the United States’ Guaranty Fund System in Box A.2 (Annex 2).

¹² Including Australian individuals, small businesses and not-for profit organisations.

Pre-conditions for use of GI FCS in a transfer

To date, this new power has not been used, but in order to facilitate a transfer of business backed by GI FCS funds, APRA would broadly expect to proceed on the following basis:

- the Minister has made a declaration;
- APRA has made a compulsory transfer determination, with the identified GI FCS protected policies included in the transfer of liabilities;
- APRA has estimated the total amount to which policyholders of those protected policies are entitled to under the GI FCS (defined as the FCS amount);
- APRA has estimated the total amount of the costs that would have been incurred by APRA if it had administered the GI FCS (defined as the administration amount);
- APRA has calculated a total payment amount being the sum of two further amounts – a GI FCS payment amount and an administration payment amount – which the receiving insurer is entitled to receive; and
- APRA considers it reasonable in the circumstances to make the determination.

2.4. External Sources of Resolution Funding – Standalone Resolution Funds

Few jurisdictions have a standalone resolution fund. Where a standalone resolution fund exists, a key difference from PPSs is that the standalone resolution fund can be used for NCWOL compensation. Similar to PPSs, there are preconditions and operational procedures on the use of standalone resolution funds such as taking into account whether appropriate losses have been imposed on shareholders and unsecured creditors, as well as the availability of funding from private sector. There are also conditions to minimise moral hazard, for example, the funding cannot be used to absorb losses or recapitalise the distressed insurer. Currently, standalone resolution funds are on an ex-post basis, taking into consideration that such funds may have a limited scope of usage and an ex-ante funding could entail significant opportunity costs and is inefficient for the industry. Please see Box 2.4 and Box 2.5 for details of the resolution funds in Japan and the Netherlands respectively.

Box 2.4: Japan's Deposit Insurance Corporation's role in Orderly Resolution

As mentioned in Box 2.2, two measures have been introduced under the Deposit Insurance Act in Japan to ensure orderly resolution of financial institutions. Specified Type II Measures, which apply to a financial institution which has (or is likely to have) excess debt or insufficient liquidity resources, are elaborated here.

Specified Type II Measures (Measures for a financial institution which has (or is likely to have) excess debt or insufficient liquidity resources)

Description of the measure

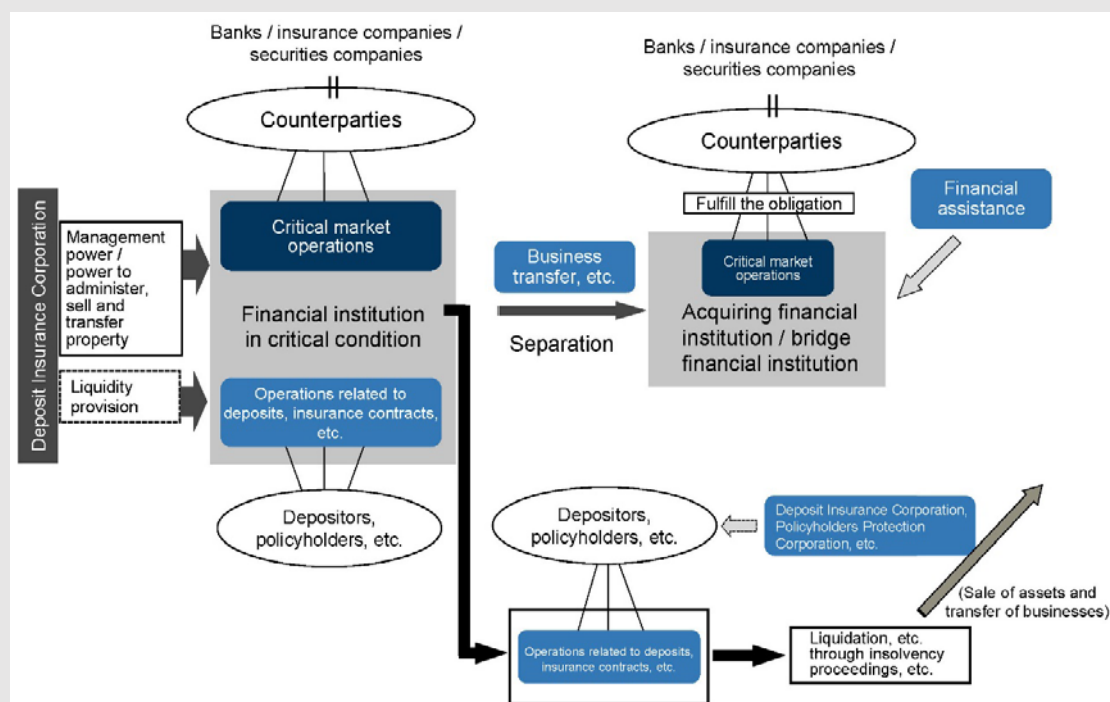
- Financial institutions are placed under special oversight, and the DICJ, while acquiring the right to manage and dispose of their property, transfers the debts, etc. that are essential to stabilizing the financial system to specified bridge financial institutions and has the debt obligations performed by providing specified financial assistance at the time of the transfer.

Procedures

- Specified Type II Measures will be invoked by following procedures;
 1. The Prime Minister, following the discussions at the Financial Crisis Response Council, shall confirm the necessity to take the measures for a financial institution which has (or is likely to have) excess debt or insufficient liquidity resources, where a systemic risk with severe disruption in the financial market and other financial system in Japan cannot be avoided without taking the special intervention measures.
 2. Upon the receipt of applications from a financial institution which takes over the failed financial institution, the DICJ, following the discussions at the Policy Board, decides to provide specified financial assistance on the premise that the Prime Minister recognises the need for a specified merger, etc. only when the prescribed criteria are satisfied. It should be noted that as specified financial assistance, the DICJ may implement measures prescribed under the Deposit Insurance Act, such as monetary grant.

Overview of the Specified Measures under DIA Article 126-2 item (ii)

(In the case of a financial institution which has (or is likely to have) excess debt or insufficient liquidity resources)



Source : JFSA¹³

¹³ Available at: <https://www.fsa.go.jp/en/refer/legislation/20130416/02.pdf>

Box 2.5: Netherlands' Resolution Fund

The goal of the resolution fund is to facilitate resolution of insurers. It is part of the Dutch resolution regime for insurers, which came into effect in 2019. It is funded ex-post by levies on the insurance sector. It can be used 1) to compensate creditors, including policyholders, in case the NCWOL safeguard has been violated; 2) to return to the bankrupt estate any pay-out from a failing insurer that has been deemed too high (i.e. during resolution, pay-outs can be made to policyholders for part of their pensions and annuities which they rely on for their day-to-day living. These pay-outs will prudently be based on expected outcome of the insolvency/resolution. In rare cases the pay-outs may turn out to have been too high, and detrimental to the other creditors. In that case the administrator/DNB will not claim back from policyholders the excess amounts paid to them. Instead the other creditors would be compensated using the resolution fund.); and 3) to cover operational costs of resolution, such as the establishment of a bridge institution. Because of its recent establishment, it has never been used yet.

The resolution fund cannot be used to absorb losses or capitalize a failing insurer. Insurer's deficits are for the account of shareholders and creditors. In the case of large deficits, policyholders may also lose some of the value of their insurance policies. Unlike in the case of banks, there is no guarantee scheme for policyholders. Instead, the resolution fund ensures that policyholders will never be worse off as a result of resolution than as a result of bankruptcy. This allows the resolution authority and the trustee to (partly) continue payments from the bankrupt estate to those policy holders that rely on these payments, after the insurer has failed, and helps transfer insurance portfolios (by covering operational costs of a bridge institution).

Other resolution costs are passed on to the insurance sector retrospectively, separately from the resolution fund. These may include costs for engaging the services of independent experts. DNB also passes the costs of regular resolution planning on to the insurance sector.

2.5. Interactions between Multiple Resolution Funds

Jurisdictions generally do not put in place more than one source of resolution funding. For jurisdictions with multiple resolution funds, the resolution funds may serve different but complementary objectives. For example, in Japan, the resolution fund under the DICJ as detailed in Box 2.4 is used to prevent significant systemic disruption while the Policyholders Protection Corporation (PPC) is to protect insurance contracts. In cases where a Specified Type II Measure is applied to a failed insurance company under the DICJ, PPC can also be activated. The DICJ and the PPC will liaise with each other in carrying out their operations for their respective objectives. In addition, the scope of each resolution fund could also differ. For Singapore, its PPS would be used in resolution if a PPS member is being resolved and the use is within the scope of the PPS' permitted uses. The PPS would be tapped upon first, before the resolution fund. More details on the interactions between the PPS and the resolution fund in Singapore are provided in Box 2.6.

Box 2.6: Interactions between PPS and Resolution Fund in Singapore

In Singapore, the Policy Owners' Protection Scheme (PPS) Funds and the Resolution Fund can be used to fund the resolution of an insurer.

PPS

The Monetary Authority of Singapore (MAS) established the PPS in 2011. Under the PPS, two ex-ante funds, the PPS Life Fund and the PPS General Fund, are being built up over time through levies collected from PPS members. The Singapore Deposit Insurance Corporation is designated as the agency to administer the PPS.

The objectives of the PPS are (a) to reduce disruption to society and economy arising from the failure of an insurer; (b) to focus on providing protection to individuals; and (c) to reduce moral hazard of implicit government guarantee. In the event that a PPS member fails, PPS Funds may be used for the transfer of the whole or part of the business of a failed PPS member to another insurer, or to run off the whole or part of the business of the failed PPS member to ensure the continuity of insurance coverage and minimise the financial hardship to individual policyholders. Transfers and run-offs are two common measures for resolving insurers. Other than transfers and run-offs, the PPS Funds can also be used to pay compensation to any covered party or fund the termination of any insured policy.

The PPS Funds can only be used on PPS members, who are direct life insurers and direct general insurers, and in relation to the protected liabilities of the PPS members. Protected liabilities refer to the policy liabilities or benefits in respect of the insured policies that are covered under the PPS, which may be subject to caps depending on the types of policies. Ex-post levies can be charged to the PPS members in the event that the cost of payouts exceeds the fund size when a PPS member defaults.

Resolution Fund

In 2018, MAS provided in legislation general powers to establish an ex-post Resolution Fund to support a resolution measure undertaken for a financial institution, including an insurer, and other matters relating to the measure. When the Resolution Fund is activated, MAS will provide a temporary loan to the Resolution Fund. This will subsequently be recovered from the industry via ex-post levies.

Interaction between PPS and Resolution Fund

MAS, as the resolution authority, determines when to trigger the PPS Funds and the Resolution Fund.

The PPS Life Fund and PPS General Fund, being ex-ante funds, (a) ensure funding is readily available for compensation pay-out; and (b) impose losses on the failed insurer as it would also have contributed to the PPS Fund(s). While the PPS Funds can be tapped on to implement specific resolution measures, their usage is limited to PPS members and has to be in relation to the protected liabilities of the PPS members. To facilitate the resolution of a PPS member, PPS Funds as an ex-ante financing component will be utilised first before MAS triggers the use of the Resolution Fund. In addition, the costs of resolving an insurer that is systemically important or maintains critical function could be large and building up ex-ante funds of a credible size would entail significant costs and inefficiencies for the industry. Hence the Resolution Fund, being an ex-post recovery mechanism, would have to be relied upon for the funding of resolution measures.

Compensation to creditors to cap their losses at what they would have incurred had the non-viable insurer been liquidated (i.e. no-creditor-worse-off-than-in-liquidation safeguard) instead of being resolved would be paid from the Resolution Fund and not from the PPS Funds.

3. Temporary Funding for Resolution Funds

3.1. Temporary Funding for Resolution Funds

Temporary sources of funding may come in the form of arrangements to obtain back-up lines of credit from the industry or government funding.

In Japan, the PPC can get loans from banks and other financial institutions if permitted by the Prime Minister and Minister of Finance.

In UK, the PPS has access to Government's National Loans Fund which can provide loans at commercial market rates. More details on UK's National Loans Fund are provided in Box 3.1. In Australia, the Financial System Stability Special Account provides up to AUD 10 billion to protect the interest of policyholders and financial system stability.

Box 3.1: UK's Access to Government's National Loans Funds for Insurer Failure

The Financial Services Compensation Scheme (FSCS) provides protection against an authorised firm's failure for claimants owning various types of financial services products (including those with general and long-term insurance policies).

Before the FSCS declares an insurer in default:

The FSCS can first seek continuity of cover for eligible policyholders of a general and long-term insurer that is in financial difficulty. It may do this by facilitating a transfer of the contracts to another insurer or it may look to secure the issuance of new contracts for the policyholders with a new provider to replace those they had with the failed insurer. This might also require the FSCS to provide financial assistance to the business to make a transfer viable.

The FSCS may also provide financial assistance to recapitalise the business of a general or long-term insurer in financial difficulties, even if the cost of doing so is greater than the cost of paying compensation. However, the extra costs must be justified by the extra benefits to the generality of eligible claimants.

After the FSCS declares an insurer in default:

If the FSCS is unable to provide continuity of cover, or if the cost of doing so is prohibitive, then the FSCS will declare a general insurer in default for the purpose of paying out compensation. For long-term insurance, the FSCS is mandated to attempt to provide continuity of cover for eligible claimants. It may do this by facilitating a transfer of the contracts to another insurer or it may look to secure the issuance of new contracts for the policyholders with a new provider to replace those they had with the failed insurer.

For the purpose of payment of compensation, policyholders generally will receive a lump sum. The court will generally determine the value of the contract to the policyholder. The policyholder will then receive 90% or 100% of this sum (long-term and compulsory insurance is protected at 100% and non-compulsory general insurance is protected at 90%) and may receive more (up to 100%) if the assets of the failed company allow it.

Funding

The FSCS is funded by levies paid by participants in the scheme, which can be broken down into a management expenses levy (the costs of running the Scheme) and a compensation costs levy (the direct costs of paying compensation). The levies are based on protected claims falling under FSCS

rules. Annual compensation cost levies are limited to £600m for general insurance and GBP 690m for long-term insurance.

The FSCS policyholder protection scheme is not pre-funded in the sense of building up a stock of funding to be spent on a hypothetical failure that may occur. Rather, levies will generally be collected once per year, taking into account management expenses (i.e., the running costs of the FSCS as an institution) and compensation costs expected to be paid out in the next 12 months in relation to failures that have occurred or likely to occur. If there are no compensation costs, there will still be a levy to cover the management expenses of the FSCS.

Additional levies can be imposed at any time when the FSCS has reasonable grounds to believe that the funds currently available to it are, or will be, insufficient to deal with its expenses.

FSCS retains an annual commercial borrowing facility which it enters into with a number of syndicate banks. This facility provides FSCS with the ability to borrow sums up to the annual levy limit of the class of the borrowing (i.e., GBP 600m for general insurance and GBP 690m for long-term insurance). This provides funding in the short-term until levies can be collected from firms. The funds borrowed need to be repaid in the year of borrowing.

In the event of a failure, it is possible that the costs exceed FSCS' levying ability. In this case the FSCS will need to borrow funds from the National Loans Fund (NLF). Under Section 223 of FSMA the scheme manager may request a loan from the NLF (it is expected that the FSCS will first attempt to levy the industry or borrow commercially before going to the NLF). Any borrowing under the NLF shall be on terms agreed by HM Treasury, and may extend across financial years, at a commercial rate of interest. The NLF will seek to fix the interest rates and repayment period having regard to both the cost of funds to the Government, but also the credit worthiness of firms in the borrowing levy class. Levies received from insurers would then be used to meet the interest payments on any loans and payment of any capital outstanding.

Note: Payment of compensation to policyholders following the default of the insurer triggers the FSCS's ability to 'step into the shoes' of policyholders in pursuing recoveries against the failed insurer and/or other third parties.

4. Ex-post Recovery of Funds

4.1. Mechanisms to Recover Funds Used in Resolution

For PPSs, recovery of funds used in resolution is done through levies on the industry taking into consideration fairness among the industry players. For example, the levy could be by sector and/or line of business. In Singapore, the life and non-life PPSs are segregated, and levy is only imposed from insurers writing the business covered by the PPS that is utilised. This is on the basis that industry players that benefit from financial stability from a successful resolution should contribute. A balancing consideration is that the concept of risk pooling and diversification in insurance could similarly be applied to the recovery of funds. While there is generally no time period for repayment determined up-front, the levy could be subject to caps on annual basis taking into account that the industry could be recovering from a financial shock.

For other resolution funds which are generally ex-post funded, there would not be an existing framework for levy contributions such as those for ex-ante funded PPSs where ex-post levies could follow. This is an area where more work could be done. Considerations cited by jurisdictions to determine the recovery include size of the contributor's balance sheet, systemic importance and risk of contributor, benefit derived from the resolution, general economic

conditions and financial conditions of the contributor. Generally, the resolution authority determines the time period for repayment and has the discretion to extend or delay the imposition of levies depending on financial and economic conditions, and whether the payment would create severe liquidity or solvency problems.

If public monies are used in resolution funding, there are mechanisms in place to recover losses from the industry. For example, in Australia, the Financial Claims Scheme (FCS) is funded by the government. Amounts paid for policyholder claims under the FCS as well as the cost of the administration are priority claims against the assets of the general insurer. Any shortfall in assets to meet this can be recovered from other general insurers via an ex-post levy.

5. Conclusion

Insurers could fail and become non-viable due to insolvency or due to liquidity problems. There are jurisdictions who have in place emergency liquidity assistance facilities that could be made available to an insurer which could otherwise become non-viable and cause financial stability concerns.

Resolution funding is financing used to facilitate prompt resolution actions in order to achieve the orderly resolution of a firm that could be systemically significant or critical if it fails. Resolution funding can come from the internal resources of the failed insurer, private or industry financed resolution funds, or temporary access to government funds.

For internal sources of resolution funding, jurisdictions identified some firm capabilities that should be in place to ensure that an insurer can accurately determine its internal funding sources, as well as the potential impediments to the utilisation of the internal funding sources. External sources of resolution funding include PPSs and standalone resolution funds. Many jurisdictions have resolution funding mechanisms in place to facilitate common resolution actions (e.g. PPS can be used to fund portfolio transfers and run-offs), and they have shared how these are administered.

Different jurisdictions are in different stages of building up their resolution funding framework. The practices, plans and thinking of the different jurisdictions documented in this Paper would serve as a reference for resolution authorities as they consider the design and implementation of a resolution framework suitable for their circumstances.

Annex 1: Business-as-usual Liquidity Facilities for Insurers

Box A.1 United States Federal Home Loan Bank System Funding

Over the past decade, insurance companies have increasingly become members of, and have a borrowing relationship with, one of the 11 Federal Home Loan Banks (“FHLB”). The FHLBs provide their members with short- and long-term loans, called “advances”, through their secured lending programs. The credit limit is determined in large part on an evaluation of the credit worthiness of the borrower. This borrowing capacity provides a growing number of insurers in the U.S. with an additional cost-effective liquidity option.

The FHLBs are private, wholesale banks regionally based throughout the U.S. with a mission to provide reliable liquidity to member financial institutions in support of housing finance and community investment. The FHLBs are federally chartered cooperatives under the Federal Home Loan Bank Act (“FHLB Act”) whereby the FHLB member institutions are both their owners and customers. FHLBs are registered with the Securities Exchange Commission (SEC), regulated by the Federal Housing Finance Agency (“FHFA”), and their business practices are subject to the terms and limitations of the FHLB Act and FHFA regulations. Each FHLB is operated independently and receives no taxpayer assistance.

The FHLBs obtain capital by borrowing from investors around the world and then lend those funds to their members on a secured basis. In order to qualify for advances, a member must pledge high-quality collateral in the form of mortgages, government securities or loans on small business, agriculture or community development. The member must also purchase additional stock in proportion to their borrowing. Once the member’s FHLB approves the loan request, it advances those funds to the member institution.

FHLB advances to insurers are secured by collateral, and are either structured as debt or as a funding agreement. The FHLB advances are fully collateralized, with an amount of over-collateralization required based on the quality and type of collateral pledged. If the insurer defaults on the advance, the FHLB has priority to the collateral. If this occurs, the FHLB liquidates the collateral and returns any excess from the over-collateralization to the insurer.

Annex 2: PPS - The United States' Guaranty Fund System

Box A.2: PPS - The United States' Guaranty Fund System

Although the guaranty fund system in the United States is primarily designed to pay benefits on behalf of insolvent insurers in liquidation, the NAIC Life and Health Insurance Guaranty Association Model Act (#520), also provides a life/health guaranty association with the discretion to take action, subject to certain conditions, if a member insurer is "impaired". In such situations, associations may take measures to cover the impaired insurer's policyholder obligations. The primary purpose of the guaranty associations is to protect policyholders, however, not to bail out impaired or insolvent insurers. Guaranty associations, therefore, have traditionally been extremely reluctant to provide funding before liquidation.

- The Model Act 520 Section 5.K. defines impaired insurers as: K. "Impaired insurer" means a member insurer which, after the effective date of this Act, is not an insolvent insurer, and is placed under an order of rehabilitation or conservation by a court of competent jurisdiction.
- Model Act 520 Section 8.A. provides for limited powers of the Life and Health Guaranty Association in the case of an impaired insurer. A. If a member insurer is an impaired insurer, the Association may, in its discretion, and subject to any conditions imposed by the Association that do not impair the contractual obligations of the impaired insurer and that are approved by the commissioner: (1) Guarantee, assume, reissue, or reinsure, or cause to be guaranteed, assumed, reissued, or reinsured, any or all of the policies or contracts of the impaired insurer; or (2) Provide such monies, pledges, loans, notes, guarantees or other means as are proper to effectuate Paragraph (1) and assure payment of the contractual obligations of the impaired insurer pending action under Paragraph (1).

All 50 states of the U.S., the District of Columbia, Puerto Rico, and the United States Virgin Islands have insurance guaranty associations in place for the payment of covered policy claims, within coverage limits, if an insurer licensed in its state becomes insolvent. Separate guaranty funds for property/casualty and for life/health business exist. The laws of each state specify what types of policies are protected by the fund. Most licensed property/casualty and life/health insurance companies are required to be members of the state guaranty fund, with a few exceptions.

Annex 3: PPSs as Bridge Institutions

Box A.3: Germany's Policyholder Protection Mechanism

German insurance supervision law provides for the set-up of a guarantee scheme for life insurers and a guarantee scheme for health insurers. While the guarantee schemes would be set up as Federal Government funds by the Kreditanstalt für Wiederaufbau Banking Group (KfW) by default, the option to bestow legal persons under private law with duties and powers of the guarantee schemes was used (Protektor Lebensversicherung-AG for life insurance, Medicator AG for health insurance). Both guarantee schemes are constructed as bridge institutions and financed by contributions of the life insurance undertakings and health insurance undertakings belonging to the respective guarantee scheme.

- The purpose of the guarantee schemes is to protect the rights of the policyholders, insured persons, beneficiaries, and other individuals with rights under the insurance contracts in question.
- To this end, the guarantee schemes ensure that the insurance contracts of the insurer in question continue in force.
- The guarantee schemes are constructed as bridge institutions, on which the portfolio of the weakened insurer is transferred to, to receive the benefits for the old-age provision, the risk protection as well as the granted profit sharing. It is not the task of the guarantee schemes to compensate the claims of the policyholders.

Both undertakings administer the guarantee schemes and receives a fee paid out of the common fund to cover the costs of administration. BaFin is responsible for deciding on any objections to administrative acts by a guarantee scheme.

- If the supervisory authority establishes that an insurer which is a member of a guarantee scheme fulfils certain legal conditions, the supervisory authority must inform the guarantee scheme of the situation and notify the insurer in question accordingly.
- If other measures designed to safeguard the interests of the insured are deemed insufficient, the supervisory authority must order that the entire portfolio of insurance contracts held by the undertaking in question, together with all the assets required to cover the liabilities under these contracts, be transferred to the relevant guarantee scheme.
- With the portfolio transfer, the rights, and obligations of the transferor under the insurance contracts, including such rights and obligations in relation to the policyholders, are transferred to the guarantee scheme.
- The guarantee scheme must manage the transferred contracts separately from its other assets and must also account for these contracts separately.
- Without delay, the guarantee scheme must determine the amount necessary to cover the obligations under the insurance contracts in full and make available suitable eligible assets.
- If the assessment of the supervisory authority reveals that the funds available to the guarantee scheme are insufficient to guarantee the continuation of the contracts, the supervisory authority must, in the case of life insurers, reduce the obligations under the contracts by a maximum of 5 per cent of the contractually guaranteed benefits.
- The supervisory authority may also issue orders to prevent an undue increase in the number of premature contract terminations.

- The guarantee scheme may transfer the portfolio of contracts either in full or in part, to undertakings authorised to conduct insurance business in Germany.

With respect to life and health insurance policies, BaFin would always transfer the insurance contracts of a failing insurer to KfW, the administrator of the life and health guarantee schemes, to allow the continuity of the policies to ensure minimal impact to policyholders and the wider system, and will use the industry funded guarantee schemes to fund transfer and the administration of the policies.

Key terms / abbreviations

ALM	Asset Liability Management
BAU	Business as Usual
CMG	Crisis Management Group
DIA	Deposit Insurance Act (of Japan)
DICJ	Deposit Insurance Corporation of Japan
DvP	Delivery-versus-Payment
ERM	Enterprise Risk Management
G-SII	Global Systemically Important Insurer
HR	Human Resources
HQLA	High Quality Liquid Assets
ICBCM	FSB Cross-Border Crisis Management Group for insurance
ICT	Information and Communications Technology
IGT	Intragroup Transaction
KA	Key Attribute
LEI	Legal Entity Identifier
M&A	Merger and Acquisition
MPE	Multiple Point of Entry (resolution strategy)
PPS	Policyholder Protection Scheme
SCR	Solvency Capital Requirement
SHF	Shareholder Fund
SLA	Service Level Agreement
SPE	Single Point of Entry (resolution strategy)
WPF	With-Profits Fund