INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

ISSUES PAPER ON RESOLUTION OF CROSS-BORDER INSURANCE LEGAL ENTITIES AND GROUPS

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This document was prepared by the Insurance Groups and Cross-Sectoral Issues Subcommittee in consultation with IAIS members and observers. Under the classification of IAIS paper, issues papers are meant to provide background on particular topics, describe current practices and/or identify related regulatory and supervisory issues. Issues papers often form part of the preparatory work for developing standards

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1. Introduction and purpose

1. Since its inception in 1994, the IAIS has developed a number of principles, standards and guidance papers to help promote the development, globally, of well-regulated insurance markets, consistent with one of its objectives under the IAIS By-laws. A further objective of the IAIS under the By-laws is to contribute to broader stability of the financial system.

2. To support these objectives, the IAIS Insurance Core Principles[1] establish the fundamental requirements on all aspects of insurance supervision. Of particular relevance to this Issues Paper, the existing ICP 16 states that "*The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedure for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders*".

3. It is acknowledged that the failures (i.e. not meeting policyholder's obligations) of insurers cannot be prevented in all circumstances and indeed an orderly failure of an insurer may actually help to foster market discipline and avoid moral hazard on the part of the insurers and policyholders. ICP 16 sets out the benchmark for the necessary supervisory requirements that are expected to be in place for the orderly winding-up of an insurance legal entity but does not address this issue from a cross-border insurance entity/group perspective. Given that the winding-up of a cross-border insurance entity / group is more complex, this Issues Paper is aimed at identifying the complexities involved and proposing the way forward in addressing these challenges at the international level.

4. The near collapse of a comparatively few number of large financial conglomerates including operating cross-border insurance entities / groups in the financial crisis that began in 2007, though primarily caused by problems in the non-insurance entities, underscores the need to identify the obstacles to orderly resolution that are currently present.[2] This will allow remedies to be considered and put in place in order to enhance the preparedness of insurance supervisors to deal with the next financial crisis whenever it arises. The disorderly resolution of certain cross-border financial institutions during the financial crisis exacerbated the situation by adversely affecting market confidence, heightening risk aversion and negating the resolution efforts of individual jurisdictions. The question arises whether the tools available to insurance supervisors to resolve financial problems for entities within cross-border insurance groups have kept up with the evolution of the groups themselves in terms of their complexity, geographical and cross-sectoral interconnectedness. Further, there is currently no international insolvency framework for insurance entities.

5. Although the scarcity of actual resolution experience of cross-border insurance entities may indicate effective regulation and supervision, it presents challenges in identifying the issues that are commonly encountered when dealing with such situations. This Issues Paper therefore draws on the limited experience of insurance supervisors (from a survey among IAIS members conducted in April 2010 with 27 jurisdictions responding) and also relevant reports from the Basel Committee on Banking Supervision Cross-Border Bank Resolution Group and the IMF report on *Resolution of Cross-border Banks – A Proposed Framework for Enhanced Coordination*. It is, however, emphasised that the resolution mechanisms in the banking sector do not read across to the insurance sector due to differences in business models, products and resolution process.

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[1] At the time of publication, the Insurance Core Principles (ICPs) were being reviewed. The revised set of ICPs will be available in October 2011.

[2] The paper is intentionally silent on naming specific institutions as they may still be in existence currently.

2. Scope and definitions

6. For the purpose of this paper, cross-border insurance entities include insurance groups operating in multiple countries. The primary focus of this issues paper is on insurance groups with subsidiaries (i.e. legal entities) in multiple jurisdictions. Aspects of cross-border insurance entities with branch offices in multiple jurisdictions are also covered to the extent relevant. This paper does not deal with issues relating to financial conglomerates (except to the extent of insurance groups belonging to a financial conglomerate) which are under the purview of other rules.

7. The term “resolution” is defined broadly as any action by an authority, with or without private sector involvement, to deal with serious problems in an insurer or cross-border insurance group that imperil the viability of the insurer or the cross-border insurance group[2]. Non-viability includes not only insolvency but also triggers of regulatory solvency control levels as well as other serious financial or non-financial compliance failures, e.g. governance issues.. In a group-wide context this raises issues of the relationship between viable and non-viable entities and the implications of this for the viability of the group as a whole. It also raises issues regarding the relationship between insurance and non-insurance entities including cross-sector regulated entities and non-regulated entities such as holding companies.

8. The term “insolvency” has different meanings since it may relate to various financial positions. There may also be differences in the legal effects of an insolvency, and there may be differences in impacts on legal entities and/or groups. In most jurisdictions, the definition of insolvency is specified in the corporate and/or bankruptcy law and relates to the legal entity. The group as such does not become insolvent but, through contagion, an insolvency problem for one group entity can lead to the insolvency of some other, or all, legal entities of the group.

9. “Insolvency” is usually defined in terms of excess of liabilities over assets (no surplus or equity left) (see Section 1 of Annex I for survey findings). Once an insurance legal entity reaches the status of insolvency (irrespective of whether it is standalone or part of a group), bankruptcy proceedings, including possibly in some cases corporate reorganisation, are initiated. Actions will then be taken by the supervisor or by the liquidator. The decision making authority of the management is at least restricted, if it not replaced by another body. The practices vary across jurisdictions (see section 2 of Annex I for survey findings).

10. The focus of this issues paper is therefore on the stage at which an insurance legal entity or group is considered to be no longer viable in its existing form. This may occur at any point before or when the insurer becomes insolvent (as defined by accounting, corporate and/or bankruptcy law) or when it breaches its regulatory capital requirements (as defined by the solvency regime). It is important to highlight that the underlying causes that may result in an insurer becoming non-viable not only relate to a deteriorating financial position but also to other factors, for example significant weaknesses in risk management and governance.

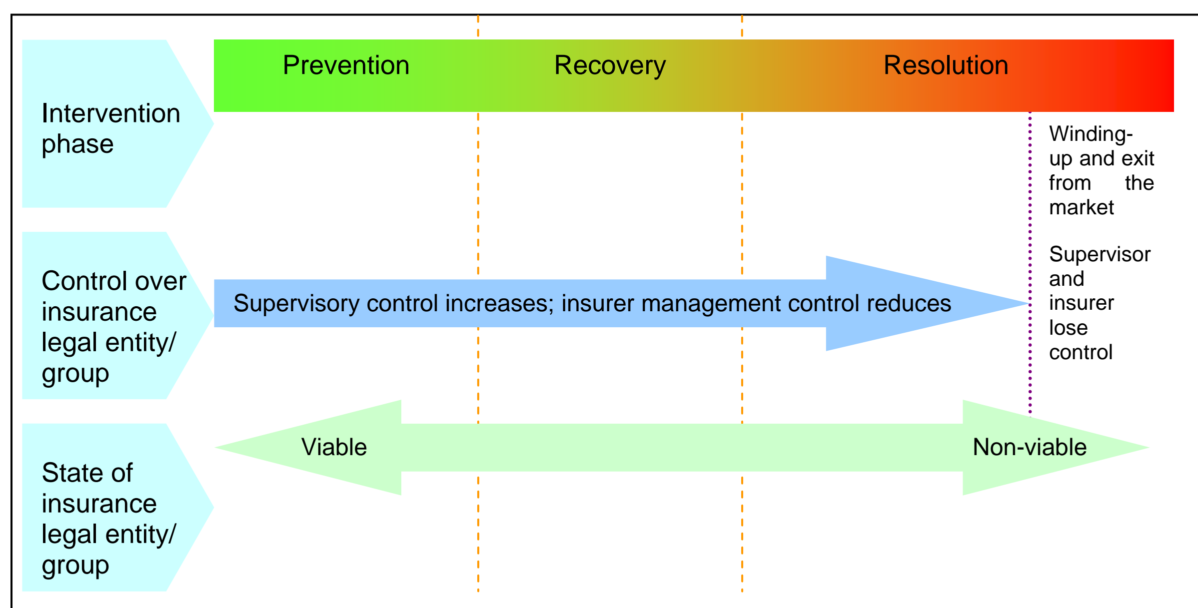
11. Earlier stages of financial difficulty when problems are building-up are addressed in the IAIS Standard on Cross-border Cooperation on Crisis Management.

12. In most jurisdictions, the supervisor will intervene with a range of measures if there are issues which may pose serious threats to the viability of the insurance group and/or insurance legal entities, including if the solvency of the insurance group or insurance legal entities is inadequate. The supervisor will usually attempt to take prompt corrective actions well before the insurance legal entity or group becomes non-viable as the scope of actions

[2] This definition is consistent with the BCBS Cross Border Bank Resolution Group publication.

available to the supervisor will become more limited as the situation of the insurance legal entity or group deteriorates. These corrective actions can be taken by the supervisor in conjunction with the management of the insurance legal entity or group. Regulatory capital requirements are often used as triggers for supervisory intervention as discussed in ICP 17.

13. The different phases of an insurance legal entity or group moving towards a point of non-viability need to be distinguished. The following diagram illustrates the phases from being viable to becoming non-viable:



3. Financial Stability Board developments

14. The Group of Twenty Leaders (G20) in their communiqué of November 2008 called for standard setters, regulators and other relevant authorities as a matter of priority to strengthen cooperation on crisis prevention, management and resolution. Further to this, the Financial Stability Board (FSB) published the *Principles on Cross-border Cooperation on Crisis Management* in April 2009 that set out expectations on how the relevant authorities should cooperate in making advanced preparations for dealing with financial crises and managing them. The IAIS translated these FSB Principles into an insurance context and adopted the *Standard on Cross-border Cooperation on Crisis Management* in October 2010.

15. At the G20 Toronto Summit in June 2010, the G20 countries committed themselves to design and implement a system where they will have the powers and tools to restructure and resolve all types of financial institutions in crisis without taxpayers ultimately bearing the burden. They also agreed to support changes to national resolution and insolvency processes and laws where needed to provide the relevant authorities with the capacity to cooperate and coordinate resolution actions across borders. The G20 has also endorsed the FSB's policy recommendations to address problems associated with, and resolve, systemically important financial institutions (SIFIs) at the Seoul Summit in November 2010. The FSB's recommendations aim at making SIFI resolution a viable option as part of the overall policy framework to reduce moral hazard risk posed by SIFIs. The recommendations cover three key areas:

- Comprehensive resolution regimes and tools (designating resolution authorities in each country; restructuring and recapitalisation mechanisms)

- Effective cross-border coordination mechanisms (mandates that allow resolution authorities to cooperate and share information across borders, institution-specific cooperation agreements)
- Sustained recovery and resolution planning.

16. Although this Issues Paper is not focused specifically on potentially systemically important insurers (but rather cross-border insurance entities more generally), it is expected to be used as basis for insurance input in the follow-up work by the FSB in close cooperation with the IAIS, BCBS, IMF and IOSCO to develop criteria for assessing the resolvability of SIFIs by mid-2011.

4. Causes of non-viability

17. Experience has shown that the major underlying cause of insurance company non-viability is related to failures of corporate and internal governance, although even a well managed company can become non-viable in extreme circumstances. Within a group, the non-viability of one subsidiary may adversely impact other parts of the group or in extreme cases lead to the non-viability of the group as a whole. An excessive level of growth and a failure to understand and manage risk can also be causes of insurance company non-viability.

18. At a more detailed level, there are a number of factors[3] that could potentially cause the financial distress of an insurance company which in the absence of effective recovery actions by the firm's management or supervisors may result in it becoming non-viable. At the insurance legal entity level, some examples of such factors include one or more of:

- Poor risk management.
- Actual incurred claims that exceed expected claims due to random variations in claim amounts or frequency.
- Actual underwriting results lower than expected due to premium deficiencies.
- Actual claims paid and/or future expected claims relative to reserving assumptions.
- The impact of external events such as improving mortality experience on a company specialising in annuity business, or the unexpected inflation of medical care costs.
- Actual expenses exceeding expense assumptions due to poor expense control.
- Actual expenses exceeding expense assumptions due to the impact of fixed costs and lower than assumed business volumes.
- Investment returns being lower than reserving or pricing assumptions.
- Investment losses on funds backing the solvency margin requirement.
- Failure to monitor credit risk
- The impact of having to compensate policyholders following a specific event, such as mis-selling.

[3] For a more detailed analysis, please refer to the Sharma Report - http://ec.europa.eu/internal_market/insurance/docs/solvency/impactassess/annex-c02_en.pdf.

- The impact of a catastrophe or asbestos type loss, where there is a concentration of risk.
- Litigation
- Reputational damage.
- Failure to adequately identify, price and provide for the risks inherent in the business.
- Failure to adequately identify and manage risks arising from other entities within the group.
- Operational failures such as the mispricing of unit-linked investment contracts.
- A failure to allow sufficiently for the impact of taxation.
- Failure to receive reinsurance recoveries.
- Failure to receive reimbursement of funds lent to third parties.
- A lack of liquidity leading to an inability to pay current claims if illiquid assets cannot be realised within the required timeframe.
- Incorrect valuation of assets and liabilities due to errors, fraudulent practices or criminal acts.

19. At the group level, the potential non-viability of a member of a group is often able to be mitigated by support from within the group, such as transfers of funds or granting of guarantees from other group entities, including a holding company. Non-viability at a group level normally only arises when the failure of one or more legal entities of the group is so significant that support from within the group is insufficient to make up any shortfall in funds. Typically this can arise when there is one dominant company in the group with a number of smaller companies. The non-viability of the dominant company can result in the non-viability of some or all the smaller companies if they are relying on support from the larger company or if the smaller companies have loaned funds to the larger company. Reputational issues impacting one part of a group can also have a knock-on impact on other parts of a group and in an extreme case result in non-viability.

20. The approach to the resolution of a non-viable group depends to some extent upon the cause of the failure. If the non-viability was caused by an unexpected number of large insurance claims or investment losses but the business is still deemed to have value, it may be possible to arrange for the business to be taken over, or for portfolios to be novated or transferred, either as a whole or in parts, to another insurer. If on the other hand the non-viability was caused by a major corporate governance failure which resulted in fraud, systematic under-reserving or under pricing of risk, the chances of the business being sold as a going concern are reduced and either run-off or winding up is likely to be required. If the non-viability was caused by a loss of reputation, the purchase of some or the entire group by another entity could lead to a successful resolution as the troubled business would often trade under a different name or the name of the purchaser.

5. General challenges and considerations in the resolution of cross-border insurance entities

21. There are a number of additional challenges that have been identified for the effective resolution of cross-border insurers within an insurance group as opposed to the resolution of insurers or groups situated in a single jurisdiction. These challenges stem from the existence of different legal and regulatory requirements as well as different practices among jurisdictions. These differences may lead to conflicts among the involved supervisors and to a sub-optimal resolution outcome for the group as a whole. Many of these differences stem from legal systems over which supervisors have limited influence, or competing liquidators. This is particularly the case once the entity actually exits from the market or is wound-up. In the near future, it is unlikely that legal systems will be amended in favour of multilateral arrangements because national Governments then need to relinquish national powers. Orderly resolution of cross-border insurance groups and insurers therefore depends crucially on appropriate actions prior to the non-viability stage, ideally to avoid non-viability of parts of, or the entire group, in the first place or to ensure an orderly resolution of the business if involuntary market exit is unavoidable. This section of the paper identifies differences between jurisdictions and the challenges they pose.

22. There are various insurer or group structures which can create cross-border issues. These include,

- i. Groups with subsidiaries and activities in several countries
- ii. Single insurers with activities in several countries via
  - a. Branches (usually regulated and with certain tied asset requirements in each host country)
  - b. Reinsurance (which may be regulated and have tied asset requirements in some host countries but which may not be regulated in other host countries and only home country laws apply)

23. The main focus of this paper lies on foreign subsidiaries within an insurance group. However, there are also cross-border issues with branches. The legal implications are different as there is no separate balance sheet for a branch. Also, branches may be supervised differently from legal entities. Insurance branches are usually regulated and certain tied assets may be required to be held or “localised” in the host country. Reinsurance branches are regulated in some countries but some jurisdictions do not supervise them on the basis that reinsurance is a business to business arrangement and there is no direct policyholder protection needed. Further, reinsurance is often cross-border, even if it is done directly from one legal entity on a worldwide basis. Many countries do not have any regulation for this. However, there might be some regulatory collateral requirements in place (e.g. in Canada and USA).

24. The resolution of insurers is complicated when they operate cross-border and/or are part of an insurance group. While financial difficulties may initially or primarily impact only one aspect of an entity’s (or group’s) operations, depending on the nature or severity of those difficulties, they may spread or ripple through other operations of the entity or group. For example, financial difficulties in a major business of the entity may spread to other areas of the entity or group as a result of reputational issues, diminished financial capacity or intra-group support measures. This may make it difficult to raise new capital, attract new business or dispose of operations in other areas of the entity or group. On the other hand, the difficulties might be readily isolated and resolved on their own without impact on the larger entity or group. Further, difficulties felt at the group level may not mean that all entities in the group need be resolved. Indeed some successful subsidiaries (for example) may be able to continue operating with fresh sources of capital, independent of any actions being taken to resolve other parts of the group.

25. Examples of areas that can differ between

i. Jurisdictions:

  a. Measurement of assets and liabilities
  b. Regulatory capital requirements
  c. Insurance laws
  d. Insolvency laws
  e. Administrative and civil laws and criminal laws
  f. Priorities given to policyholders in wind-up
  g. Scope and coverage of insurance guarantee schemes and pledged assets
  h. The existence of other types of policyholder protection schemes
  i. International private and public law

ii. Supervisors:

  a. Intervention processes and powers
  b. Bilateral/multilateral recognition/agreement between home and host regimes
  c. Planning for stress and resolution situations

26. Differences stem from both national supervisory and regulatory frameworks as well as corporate or bankruptcy law. Insolvency legislation applies to individual legal entities within a jurisdiction and triggers statutory actions, including closure to new business and winding-up, usually by officially appointed national administrators. The role of the relevant group-wide supervisor and involved supervisors in insolvency proceedings is likely to be limited. The principle of policyholder priority may be subject to the rights of secured creditors in relation to certain assets (e.g. in the EU). Where such assets are held in another jurisdiction the rights will be governed by the law of that jurisdiction. In this case, protection of policyholders may be achieved through deposit-back or other security arrangements in favour of a firm's policyholders.

27. Policyholder protection schemes often vary significantly between jurisdictions. Some schemes only cover life business while others cover non-life as well. The proportion of claims covered also varies significantly. Within the EU, consideration is being given to developing a coherent framework for insurance guarantee schemes (July 2010 White Paper) but consistency of schemes internationally is a long way off.

28. While efforts to bring national arrangements more into line are to be encouraged, progress is unlikely to be rapid. In these circumstances supervisory actions prior to non-viability which would trigger a winding-up are of key importance. Broadly two types of supervisory actions are available.

29. If necessary, cross-border insurance groups could be required to structure their local entities to fit more closely into existing national insolvency laws and related legal structures so as to facilitate resolution if the need arises. However, given that insurers and insurance groups generally experience longer term resolutions than banks due to their different core product and business model such requirements should be applied flexibly and proportionately to the nature, size and complexity of the group as well as its systemic relevance.

30. More immediately important is the need for coordination and cooperation arrangements between involved supervisors of cross-border insurance groups to be in place on an on-going basis in order, particularly, to manage issues of intra-group connectivity (see paragraph 33). This would include bilateral and/or multilateral agreements between involved

supervisors covering the exchange of information and also supervisory cooperation and coordination arrangements including planning for stress and resolution situations. In particular, effective supervisory college and/or other supervisory coordination arrangements need to be in place prior to any insolvency proceedings to ensure necessary channels exist for the exchange of information and that there is appropriate cooperation and coordination of supervisory actions. In this regard the recent IAIS Preliminary Views on the FSB Policy Recommendations on SIFI Resolution includes the following statement on cross-border coordination:

> "As stated in the IAIS supervisory materials, insurance supervisors are expected to cooperate with other supervisors (including from other sectors) on a legal entity and group-wide basis. The IAIS strongly supports the use of supervisory colleges as a supervisory cooperation tool for international insurance groups. In addition, insurance supervisors are expected to develop and maintain plans and tools for dealing with insurers in crisis and seek to remove any practical barriers to efficient and internationally coordinated resolutions. The designated group-wide supervisor is expected to coordinate crisis management preparations with involvement from other relevant supervisors.
>
> On information exchange, insurance supervisors are expected to put in place efficient cooperation procedures and share the relevant information regularly. The IAIS would like to emphasize the importance of respecting jurisdictional confidentiality requirements under such arrangements. Multilateral Memorandum of Understandings (MMoU) are useful to facilitate such information exchange."

31. The IAIS Preliminary Views also refers to recovery and resolution planning:

> "Insurance supervisors are expected to maintain plans and tools for dealing with insurers in crisis. Recovery and resolution plans should not be limited to only liquidity and capital arrangements.
>
> While not specifically targeted for resolution, the Insurance Core Principles do provide for insurance supervisors to deny/withdraw the license when the organisational (or group) structure hinders effective supervision which could be applied in a crisis situation.
>
> Insurers are expected to be capable of supplying, in a timely fashion, the information required by supervisors in managing a financial crisis."

32. However it should be noted that, in contrast to a number of proposals from the FSB, this statement is made in the context of arrangements between involved supervisors rather than a requirement for firms and groups themselves to maintain Recovery and Resolution Plans (RRP). In this respect awareness of potential actions by involved supervisors triggered by supervisory control levels and other early warning solvency tools on insurance legal entities within a group is essential to avoid or limit insolvency of group entities. Awareness of group risks or solvency control levels established by jurisdictions within the group is also important. For example, information within an Own Risk and Solvency Assessment (ORSA) could help to assess and, if necessary, respond to the assessment of the solvency position of a group as a whole. Ultimately, awareness by involved supervisors of potential supervisory intervention triggers (group or legal entity) will help facilitate coordination and possible action on a group-wide basis. This could be particularly helpful if there are potential constraints due to different entity-specific or national legal requirements.

33. There are a number of specific aspects related to insurance groups, and particularly their inter-connectedness, which should be taken into account in the event of a need for resolution. Some common intra-group transactions and exposures are:

- Reinsurance transactions among group entities
- Loans or letters of credit made among group entities

- Cross shareholdings
- Guarantees or letters of support between group entities
- Other agreements such as cost sharing, profit & loss sharing, etc.
- Dividends

34. In contrast to the banking sector, individual insurance entities within an insurance group are, in principle, able to continue business despite stresses in other group entities. This is due to the nature of insurers' core product and business model mentioned above. However reinsurance transactions and other intra-group transactions, including loans, guarantees and letters of support, are common features of insurance groups which have led to increased inter-connectivity between group members. Such transactions can be a source of strength to a group which is fundamentally healthy even though certain members of the group are experiencing stress. However they can also create contagion and complicate the process of unwinding transactions in the event of insolvency.

35. Increasing complexity of group structures, including non-insurance and non-regulated entities and non-operating holding companies, has become a major consideration with respect to resolution of insurance groups. The IAIS Guidance Paper on the Treatment of Non-regulated Entities in Group-wide Supervision (April 2010) highlights the financial contagion and reputational risks resulting from intra-group transactions and exposures. In particular intra-group relationships between regulated entities and non-operating holding companies and non-regulated operating entities may negatively affect regulated entities within a group or the group as a whole.

36. In these circumstances, access to and exchange of information, subject to confidentiality requirements, on group structures and intra-group transactions is essential. Supervisors have traditionally been reluctant to impose requirements regarding group structures but in the wake of the financial crisis insurance groups should at least be able to demonstrate to supervisors how they would address problems arising from complex group structures.

37. Other issues specifically related to the cross-border aspects of resolution include:

- Legal requirements or political pressure resulting in priority being given to the protection of local policyholders.
- Inability of some jurisdictions to recognise decisions made by foreign courts.
- The ability or willingness of insurance supervisors to share information with other supervisors.
- Jurisdictions have different powers to deal with companies that do not meet their minimum solvency margin requirements in terms of their ability to stop the company writing new business or forcing a merger or other restructuring.
- Some group structures are overly complex which would increase the difficulty of resolution.
- Ring-fencing: If assets of an insurance legal entity are insufficient to cover certain claimants within a jurisdiction, such claimants as well as politicians might put pressure on the government and supervisory authority to keep assets and cash inside the country. Thus, obligations arising from intra-group transactions may be deferred. The worse the insolvency, the more likely jurisdictions may seek to ring-fence the local assets, even after supervisors have assessed adequate capital.

38. Corporate and bankruptcy legislations are usually legal entity specific as well as nationally or regionally based. This factor could present fungibility of capital risks for a group even though this has not been tested due to limited experience on non-viability involving cross-border insurance groups. Nevertheless, there is a strong need for jurisdictions to

coordinate on how they intend to protect all policyholders and claimants in line with the respective jurisdictional laws and frameworks that afford certain rights to those policyholders and claimants. In these circumstances, supervisory intervention measures prior to non-viability are crucial.

Insolvency Legislation

39. Insolvency legislation can take different forms in different jurisdictions. In particular:

- The insurance supervisor could have the responsibility for acting as receiver or liquidator of an insurer or alternatively a private firm could be appointed either by the insurance supervisor or by a Court.
- Specific legislation may exist in respect of the resolution of insurance companies or alternatively resolution may rely on general insolvency law.
- The initiation of a resolution process can be made by some or all of the following parties: insurance supervisor, company management, creditors, shareholders and policyholders.
- The legislation in some jurisdictions permits the recognition of a decision by a foreign court whilst in others it does not.

Localized Resolution Frameworks

40. While many insurance groups operate globally, the frameworks for addressing their distress and failure are local and apply to distinct parts of the group rather than to the group as a whole. By allowing insurers under their supervision to establish presences in a range of jurisdictions, home authorities expose themselves to the reality that the legal frameworks for facilitating cross-border insurance in stable periods are typically more effective than the cross-border resolution arrangements that are available in times of distress.

41. While the existing localised approach is due to a number of factors, a fundamental reason is the fact that resolution frameworks are established by national law and, absent the cooperation of the national authorities of other jurisdictions, are only enforceable vis-à-vis those institutions—or branches of institutions—operating in their territory. In the absence of an international legal framework that empowers a supranational entity to resolve global institutions, the resolution of such institutions are subject to different national or regional frameworks and, accordingly, authorities must proactively coordinate their actions to avoid the significant costs and risks of an uncoordinated approach.

42. Moreover, the legal frameworks of many jurisdictions do not sufficiently facilitate or even allow coordination. Legal frameworks in some jurisdictions do not sufficiently empower their supervisors or the relevant resolution authorities to share information with their counterparts in other jurisdictions. In the context of an ailing insurance group, the ring-fencing of assets by host jurisdictions may undermine an effective resolution. Court or regulator appointees may face difficulties in having certain recovery operations, such as "purchase and assumption" transactions, implemented in the host jurisdictions of insurance branches.

43. Effective coordination is also hampered by the absence of a minimum level of harmonization. National or regional legal and regulatory frameworks often differ in key areas. In the context of insurance insolvency, there is no universally-agreed approach to questions such as triggers for the commencement of insolvency proceedings or powers available to the supervisors to deal with an insolvent insurer.

44. Even where there is at least a minimum degree of harmonization, the multiplicity of involved regulatory bodies may make coordination difficult. Overlapping competencies and difficulties in discerning the scope of various national supervisors' responsibilities could emerge.

45. Finally, ring-fencing can be used as a critical tool that allows a supervisor to safeguard assets, until appropriate global due diligence, coordination and collaboration can be appropriately evaluated. When supervisors are faced with the distress or failure of an insurer within their jurisdiction, they could give primary consideration to the potential impact on their own stakeholders: namely, policyholders and/or creditors to branches or subsidiaries located within their jurisdiction and local taxpayers. In these circumstances, national priorities translate into a "territorial" approach that could effectively preclude coordination where in the event of failure of a domestic branch of a foreign insurer, local assets are "ring-fenced" for the benefit of policyholders and creditors of the branch only and are not available to the insurer as a whole. Thus, the practice of ring-fencing could be geared to protect the interests of policyholders and creditors in an insurer's local market to the detriment of stakeholders in other jurisdictions. While the principle of universality implies no ring-fencing and places all similarly ranked international claimants and creditors on an equal footing, the practical issue is that to achieve this universality every jurisdiction would need to agree on the ranking of claimants and the level of equitable distribution that is deemed fair for varying insurance products and debts.

6. Approaches to resolution of insurance entities

6.1 Resolution regimes on legal entity basis

46. This section discusses resolution regimes on a legal entity basis. There is a wide disparity in the principles underlying insurance resolution regimes throughout the world. These differences are attributable to the pace of economic development, fundamental cultural differences, legal environments, varying products and public policy decisions (e.g. what a jurisdiction deems to be fair).

47. In many jurisdictions, traditional court proceedings are available for the winding-up resolution of insurers. However, distinctions need to be drawn between a resolution in the face of an insolvency and resolution in the face of a potential problem that imperils the viability of the legal entity and which may be remedied by recovery measures. In either case, most regimes do not allow policyholder interests to be compromised by the interests of other parties.

Winding-up as a resolution tool

48. An example of a traditional winding-up resolution is the U.S. liquidation proceeding, where an insurer that is not deemed susceptible to a successful conservation or rehabilitation may be placed in liquidation. The liquidation process ordinarily includes the seizure, marshalling, and liquidation of the insurer's assets; a determination of the insurer's liabilities; collection of reinsurance recoverables based on the approved claims; and distribution of the insurer's assets to claimants with approved claims. All parties' rights and liabilities are fixed as of the date of a liquidation order, all actions against the insurer other than the filing of proofs of claims are stayed, and the claims need to be settled at the values they would have if the insurer had not needed to be liquidated. The entire business, parts of the business, insurance operations or assets may be sold or the corporate shell dissolved at any point in the proceedings.

49. The Canadian insurance insolvency regime is another traditional winding-up resolution. Characteristics include:

- Distinct statute for financial institutions;
- Federal statute, so there is one law consistently applied across Canada;
- General bankruptcy legislation does not apply;
- In Ontario and in some other provinces, there is a specialized Commercial List Court supervision;
- "Single-proceeding" is the theme: virtually all matters/disputes relating to the insolvency are dealt with by the one designated court;
- By statute, the Canadian regulator may authorise the liquidator to send Canadian assets and claimants to the head office insolvency, if the Canadian court approves.
- Canadian court will enforce and collect reinsurance of Canadian liabilities, even if the treaty is a non-Canadian head office treaty;
- Canadian insolvency set-off law is restrictive in terms of timing requirements;
- Canadian priority scheme gives priority to policyholder claims including reinsurance.

There are also specific characteristics for Canadian branches of Non-Canadian insurers as well:

- Distinct regulatory and insolvency regime for Canadian branches;
- Conservative capital adequacy and deposit rules;
- Non-Canadian receiver/liquidator may be allowed access to the assets or at least the surplus in Canada.

50. In many jurisdictions there are also legal powers to appoint interim examiners, controllers, administrators or legal processes. An example is Chapter 11 in the U.S. that allows non-insurance entities that are part of an insurance holding company system to operate with court protection while options are being explored. Additional broad comparisons of resolution frameworks can be found in ANNEX 1.

51. Common characteristics that can be found within most winding-up resolution regimes include:

- Changes to policies or reductions to policy claims or benefits cannot be effected without either the informed and voluntary consent of the individual policyholders, applicable court approval and/or the express legal authority provided to the supervisor.
- Writing new or renewing existing policies.
- Maintaining reinsurance coverage and corporate insurances.
- Guidance on the settlement of claims.
- Adherence to priority distribution schemes set by law.
- Consistent and timely notice to policyholders and creditors.
- Procedural safeguards to ensure court and/or supervisory approval for all significant actions.

- Desire to safeguard insurer assets for the payment of claimants.
- Provisions adopted by the United Nations Commission on International Trade Law (UNCITRAL). Link: http://www.uncitral.org/pdf/english/texts/insolven/Practice_Guide_Ebook_eng.pdf
- Winding-up proceedings are pursued when all preventative actions and proceedings have been exhausted.
- Winding-up proceedings can be instigated by the supervisor, groups of policyholders or commercial creditors.
- An insurer may be deemed to have inadequate capital if it is unable to meet its regulatory capital requirements.

52. There are key considerations that should be evaluated when analyzing winding-up resolution regimes on a legal entity basis. Evaluation of how these considerations are addressed at a legal entity level in a particular jurisdiction's resolution regime may enable IAIS members to better understand potential challenges that could arise with cross-border resolutions.

53. Examples of key considerations of legal entity winding-up resolutions are as follows:

- Whether policyholders may have a right to vote or comment on the resolution (e.g. restructuring plan or liquidation proceeding). Usually that right is available when the plan or proceeding does not require that policyholder contracts be fulfilled in their entirety.
- Whether the resolution provides sufficient transparency.
- Whether the entity in charge of the resolution is held accountable to the supervisor or courts.
- How and by whom the authority/authorities in charge of resolution is/are determined.
- Whether there is a legal framework which allows a forced resolution.
- Whether it is possible for policyholders and reinsureds to be compelled to accept a resolution that requires that they make economic concessions. The plan may require approval upon the votes of creditors, or it may simply require regulatory or court approval.
- Whether a jurisdiction has provisions establishing a framework if a policyholder cannot find acceptable coverage to replace that provided by the resolution.
- Whether policyholders have claim priorities over other unsecured creditors and this priority is strictly observed.
- Whether reinsureds are treated as general creditors.
- Whether a resolution may entail insurance cover being transferred to other insurers or reinsurers with whom policyholders and reinsureds had no prior relationship.
- Whether a jurisdiction has provisions which allow for claims acceleration and estimation in a proceeding.
- Different requirements or legal processes may apply to long term business as opposed to general insurance business.

- Whether a jurisdiction has a policyholder protection scheme or other similar mechanisms to protect policyholders.

Run-off

54. Run-off is the process of discontinuing the writing of new business while continuing to administer existing contractual policy obligations for in-force business. Claims are paid against the existing reserves of the insurer. The decision to cease writing new business can be taken by the insurer for various business reasons (e.g. business is no longer attractive) or can be imposed by the supervisors because the viability of the insurer is threatened. A run-off can be solvent or insolvent, depending on the sufficiency of reserves and capital to pay off all claims. A solvent run-off is often managed by the insurer's management under the control or supervision of the supervisors. An insolvent run-off is usually managed by the authority, an administrator or another third party.

55. The duration of the run-off depends on the portfolio (property vs casualty vs life insurance) and the strategy chosen. Supervisors should monitor the different run-off strategies.

56. In the context of an insurance group, the run-off may be done for some or all insurance legal entities in the group. During this process, supervisors of the jurisdictions involved need to cooperate in order to guarantee a smooth process. Special consideration needs to be given to intra-group transactions in order to ensure that they are not misused to the disadvantage of certain insurance legal entities in the group.

Other forms of resolution tools

57. Some regimes allow alternative schemes or mechanisms that can have advantages to winding-up proceedings. These alternatives may offer a faster resolution of the underlying financial challenge, or provide a less costly implementation process; and/or serve to preserve coverage that might otherwise have to be terminated in the context of formal wind-up proceedings. However it is important to ensure that they do not reduce supervisor and/or judicial oversight or compromise policyholder interests.

58. Examples of such alternative schemes include:

   i. Schemes of Arrangements: These schemes are essentially statutory compromises or arrangements between an insurer and its creditors requiring majority creditor approval, confirmation by regulators of no objections, and court sanction. The process has evolved over the years and includes a process for both insolvent and solvent insurers.

   ii. Portfolio Transfers: A number of jurisdictions allow such transfers. Typically this enables an insurer to move all or certain of its insurance business to another insurer without the consent of each and every policyholder subject to approval by the regulatory authorities and other interested parties. Such transfers may, in full or in part, allow the maintenance of insurance contracts beyond insolvency and therefore safeguard the interest of the policyholder to a maximum.

   iii. Merger, transfer of ownership or take-over by state-owned insurer(s) or other parties

6.2 Resolution regimes for cross-border insurance groups

59. Winding-up proceedings can trigger a number of unique technical measurements in a given jurisdiction (e.g. preferential treatment considerations), but may not receive the same treatment in other regimes. The extent to which economic support may be obtained from parents and/or other entities of a group in cross-border jurisdictions is governed primarily by the laws of the jurisdictions of those parents and other entities. However, ultimately the jurisdiction in which the parent or affiliate is domiciled is particularly influential over the fate of subsidiaries in other jurisdictions. Thus, a common goal between supervisors to communicate and coordinate in cross-border resolutions to the best of their legal ability is imperative.

60. Lastly, it has been noted that an emerging trend is to defer to the jurisdiction with the centre of main interest and/or to the jurisdiction with a legal framework and precedent able to handle such unique situations. Such situations might not necessarily result in the domiciliary jurisdiction of the non-viable insurer leading the resolution. While further discussion of these issues is beyond the scope of this issue paper, the subject merits careful consideration in circumstances where it may be considered and/or actually implemented.

61. At present, resolution is rarely possible at the group level, but usually possible at the legal entity level. Resolution of a group as a whole is rarely possible due to a number of legal obstacles, especially significant differences in resolution regimes in various jurisdictions. The issue of powers and responsibilities allocated in particular jurisdictions and a lack of possibility to transfer them is also the case.

6.3 Policyholder protection schemes

62. There are different forms of policyholder protection schemes in place in various jurisdictions. For an overview, see the OECD paper[4] on policyholder protection schemes.

63. The presence of policyholder protection schemes provides additional or alternative assurance to policyholders that their contractual obligations will be met when due. A policyholder protection scheme may be more important for jurisdictions that grant weaker privileges to policyholders in the insolvency procedure of insurance companies.

64. Their presence has several implications for insurance supervisors, including:

- Protection schemes have a direct interest in any payments from the scheme and can provide detection and intervention assistance. Such assistance would be complementary to the direct role of the supervisor. Any assistance would need to be subject to appropriate confidentiality and/or MOU agreements.
- Protection schemes can contribute to the predictability and availability of procedures which contribute to an orderly resolution of a non-viable insurer.
- Conversely, the presence of multiple protection schemes for an insurer operating in multiple jurisdictions contributes additional complexity to the resolution process as a result of differing scheme design and stakeholder interests.

[4] Refer to the OECD website for further information: www.oecd.org.

7. Meeting the challenges of resolution of cross-border insurance entities

65. Due to the particular characteristics of insurance business models and products, which in general allow a longer time-frame for addressing problems than, for example, in the banking sector, a wide range of potential approaches to resolution of cross-border insurance entities and groups is available. At the same time the wide range of structures and arrangements for conducting cross-border insurance activities means that particular approaches to resolution are not necessarily appropriate in all circumstances. Measures might need to be distinguished between life and non-life insurers and possibly credit insurers and also between subsidiaries and branch structures. This section set out some areas for consideration in relation to resolution of cross-border insurance entities and groups without attempting at this stage to provide specific recommendations for particular courses of action.

i. Harmonisation of insurance restructuring and insolvency laws
ii. Harmonization of insurance regulation and supervisory approach in respect to restructuring and insolvency
iii. Acknowledgement of insolvency laws and regulations in various jurisdictions
iv. Supervisory colleges
v. Crisis core colleges
vi. Recovery and Resolution Plans
vii. Contingency Funding Plans
viii. De-Risking Plans
ix. Ring-fencing
x. Ranking
xi. Licensing

66. Harmonisation of insurance restructuring and insolvency laws: Ideally, there would be a global insolvency and recovery law which would deal with cross-border resolution and which would allow an orderly exit for an insurance group with entities in multiple jurisdictions. However, this is, as already stated earlier in this paper, unrealistic to achieve in a short time frame, if at all. Nevertheless any progress towards aligning the appropriate laws in the various jurisdictions as far as possible will be of benefit to effective resolution outcomes.

67. Harmonization of insurance regulation and supervisory approach in respect to restructuring and insolvency: Progress towards a common approach by different jurisdictions to regulation and supervision of cross-border insurance groups is likely to facilitate effective resolution outcomes. Further, supervisors need to have the legal basis and power to take measures before an issue threatens the viability of an insurance group.

68. Acknowledgement of insolvency laws and regulations in various jurisdictions: This would facilitate group-wide application of measures taken by one authority as it becomes possible to accept a measure taken by another supervisor in its own jurisdiction. Of course, such supervisory measures should be taken in cooperation with other involved jurisdictions. Ideally, they can be discussed and decided within the supervisory college or the crisis core college.

69. Supervisory colleges: The existence of an effective and well-led supervisory college helps early identification of problems within an insurance group and facilitates faster communication in crisis situations. Contingency planning amongst supervisors and the existence of MoUs (ideally in the form of the IAIS MMoU) will serve as preparation for

handling a crisis. (Reference is also made to the IAIS guidance paper on the use of supervisory colleges in group-wide supervision from October 2009.)

70. Crisis core colleges: A standing subset of the supervisory college consisting of the most important supervisors of an insurance group may on the one hand prepare for crisis situations (e.g. establishing recovery and resolution plans) and be in a position to act quickly in a crisis situation.

71. Recovery and Resolution Plans: Timely consideration of potential recovery as well as resolution plans by both insurance groups as well as authorities is likely to promote satisfactory recovery and resolution outcomes. A recovery plan may, amongst other things, include how a portfolio transfer would work taking time issues, legal issues, costs & resources (staff, systems, etc.) into consideration.

72. Contingency Funding Plans: The insurance group together with home and host supervisors (maybe within the supervisory college or crisis core college) should consider contingency funding strategies in order to address liquidity issues in various potential crisis scenarios.

73. De-Risking Plans: The insurance group together with home and host supervisors (maybe within the supervisory college or crisis core college) should consider de-risking strategies in order to address capital issues in various potential crisis scenarios.

74. Ring-fencing: The issues of ring fencing should be analyzed with all their advantages and disadvantages (reduction in contagion vs privileging some policyholders over others).

75. Ranking: The legal ranking of policyholder funds in the event of insolvency needs to be taken into consideration.

76. Licensing: During the licensing process of a new insurer belonging to a cross-border insurance group, or at a later stage if appropriate, supervisors should consider the interconnectedness of the applicant with the rest of the financial group. In particular, a clear understanding of implicit and explicit intra-group guarantees and capital flows should be acquired before granting the licence. Further, additional collateral or deposits may be considered at the time of licensing as a way to gain the needed level of comfort to deal with the group structure in a potential crisis situation. In addition, comprehensive reporting information such as the capital adequacy of the main insurers within the group should be taken into account and be available on a regular basis. The licensing authority should coordinate with the group-wide supervisor throughout the licensing process including discussion on the reporting requirements.

8. Next Steps

77. This paper highlights that there are a number of important issues and challenges to be considered in establishing effective resolution regimes for cross-border insurance legal entities and groups.

78. One of the recurring key points set out in this paper is for supervisors to act proactively in supervising insurance legal entities and groups as the ability to intervene effectively and the likelihood of the insurer recovering becomes less as it approaches the stage of non-viability.

79. It is expected that this paper will serve as a basis for the IAIS to contribute relevant insurance perspectives to international discussions on resolution of complex cross-border financial institutions.

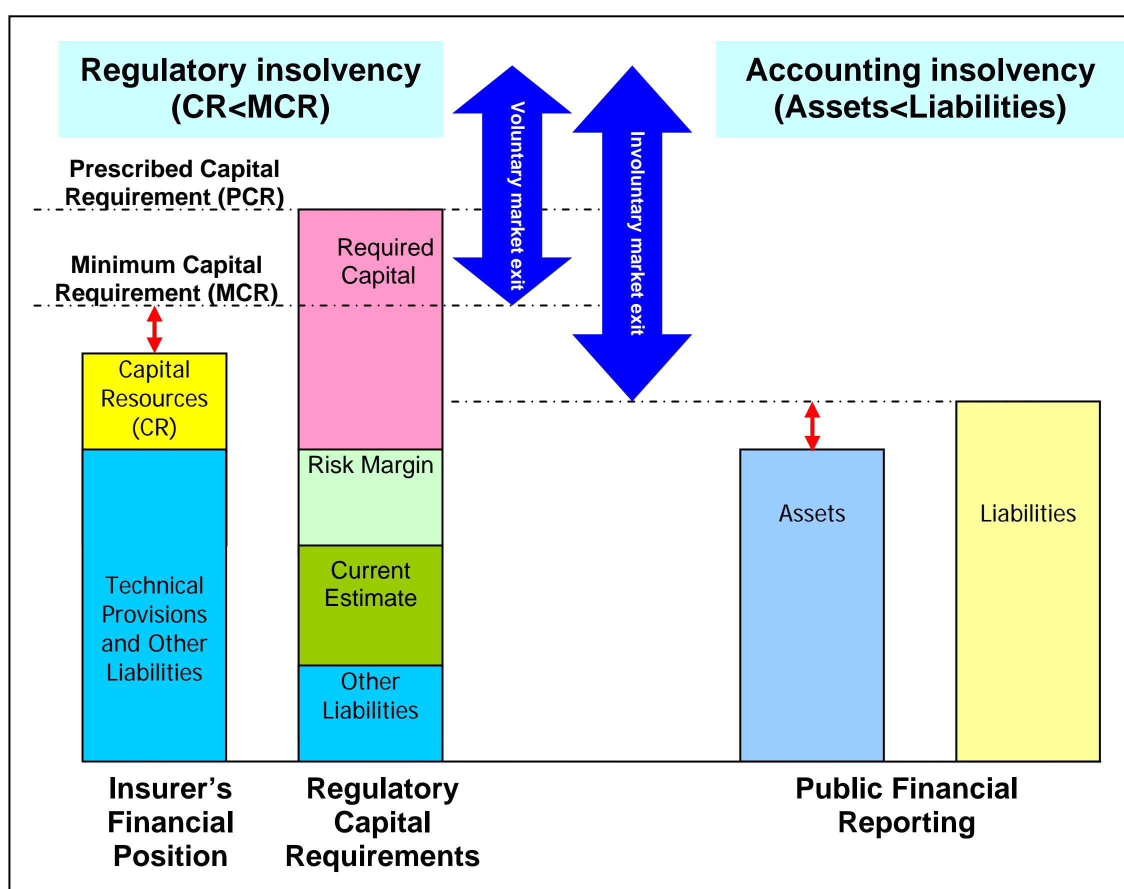
80. The exploration undertaken in this paper is preliminary and it is recognised that there is a clear need for further analysis and consideration within the IAIS on this complex topic in taking forward the broader agenda on group-wide supervision. In particular, there are significant challenges for the resolution of branch insurance operations and this paper has focused mainly on the resolution of groups which operate via subsidiaries in either the same, or various, jurisdictions.

Broad comparison of resolution frameworks in selected jurisdictions [5]

1. No common definition for regulatory insolvency

Minimum Capital Requirement (MCR) is defined differently in the different jurisdictions. This means that the point at which insurance legal entities, though potentially part of the same insurance group, are wound up is different in different countries. However, given that almost all of the respondents to the IAIS survey have adopted the IFRS, there seems to be convergence on the definition of insolvency from an accounting perspective.

Figure 1: Illustration of differences between regulatory and accounting insolvency



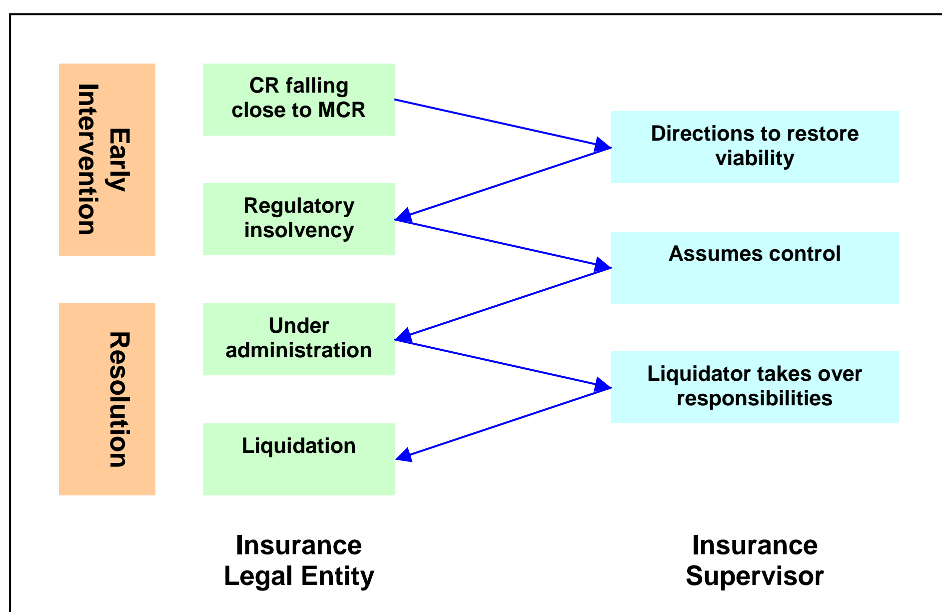
None of the surveyed jurisdictions has a definition for regulatory insolvency at the insurance group level.

[5] Information provided in this Annex is based on the results of a survey carried out among IAIS Members in April/May 2010. The sample of jurisdictions is meant to illustrate the different ways these jurisdictions deal with threats to the viability of an insurer. They are intended to be purely for illustrative purposes only and are not meant to be comprehensive. Note that the jurisdictions listed here are not meant to represent the wider harmonized framework to which they may belong.

2. A simplified resolution process for involuntary exit from the market

The resolution process of an insurance legal entity differs across jurisdictions. The different early intervention stages could potentially result in different supervisory actions or triggers being applied on an insurance legal entity depending on its location. Effectively, insurance legal entities with the same financial situation may receive different supervisory treatments in different jurisdictions.

Figure 2: An example of a resolution process



3. Similarities of legal authority and supervisory power to deal with regulatory insolvency

Insurance supervisors have largely similar legal authority and supervisory power to take various possible actions when an insurance entity becomes insolvent. These similarities provide opportunities and scope to coordinate on a cross-border basis should the need arises to resolve insurance entities operating in multiple jurisdictions.

Legal Authority/Supervisory Power	Australia	Canada	Japan	Switzerland	UK	US
Share information with foreign authorities	✓	✓	✓	✓	✓	✓
Request and obtain the necessary information	✓	✓	✓	✓	✓	✓
Carry out emergency examination of the insurance group	✓	✓	✓	✓	✓	✓
Restrict sale of products	✓	✓	✓	✓	✓	✓
Provide guarantees						

Legal Authority/Supervisory Power	Australia	Canada	Japan	Switzerland	UK	US
Force mergers between an insurance entity and a non-insurance entity						✓
Force mergers between insurance entities	✓			✓		✓
Force the winding down or restructuring of certain operations or businesses	✓	✓	✓	✓	✓	✓
Provide neutral space for interested institutions to discuss potential resolutions	✓	✓	✓	✓	✓	✓
Facilitate the group's effort to seek an acquirer	✓	✓	✓	✓	✓	✓
Limit intra-group transactions	✓	✓	✓	✓	✓	✓
Impose asset maintenance requirements for branches in local jurisdiction	✓	✓	✓	✓	✓	✓
Delay immediate operation of contractual terminal clause	✓		✓	✓	✓	✓
Void intra-group transactions carried out over "suspect period" just before insolvency proceedings	✓	✓	✓		✓	✓
Shield a solvent insurance entity from a failing parent company	✓	✓	✓	✓	✓	✓
Recover monies from responsible individuals or entities					✓	✓
Remove directors or senior management and hold them to account	✓	✓	✓	✓	✓	✓

4. Supervisory toolkit to wind-up an insolvent insurer

Similarities are observed on the supervisory tools available in the different jurisdictions that could be used to wind-up an insurance legal entity which is being forced to exit the market on an involuntary basis.

Tools	Australia	Canada	Japan	Switzerland	UK	US
Restructuring of liabilities		✓				✓
Transfer of liabilities	✓	✓	✓	✓	✓	✓
Transfer of assets		✓	✓	✓	✓	✓
Sale of assets		✓	✓		✓	✓

Tools	Australia	Canada	Japan	Switzerland	UK	US
Termination of contracts						✓
Long-term solvent run-off under supervisory management	✓			✓		✓
Long-term solvent run-off under current management or ownership	✓	✓	✓	✓	✓	✓
Liquidation	✓	✓	✓	✓	✓	✓
Bankruptcy proceedings		✓	✓	✓		
Merger with another non-insurance financial institution						
Merger with another insurer	✓	✓	✓	✓	✓	✓

5. Other key features

Not all jurisdictions have the legal authority or supervisory power to resolve an insurance group totally or partially. Most of the surveyed jurisdictions require insurance groups to have and maintain contingency plans.

	Australia	Canada	Japan	Switzerland	UK	US
Power to resolve an insurance group totally or partially	✓	✓			✓	✓*
Power to force subsidiarisation	✓					✓
Requirement for insurance groups to develop and maintain contingency plans						✓
Recognition of resolution decisions by foreign courts or authorities	✓	✓			✓	
Institution specific arrangements with foreign authorities						✓
Regulatory/supervisory incentives to reduce complexities of insurance groups						✓
Availability of insurance guarantee schemes	✓	✓	✓		✓	✓

* Redomesticate

ANNEX II

CASE STUDY 1: Confederation Life Insurance Company, Canada

Overview

The liquidation of Confed was one of the largest and most complex liquidation of a life insurance company in North America. In August 1994, Confed's policyholder liabilities were approximately $12.4 billion worldwide and it had in excess of $10 billion of assets under administration in various funds. In addition to its life insurance business, Confed operated other financial services businesses in a number of jurisdictions. Over a million people depended on Confed for income support of all kinds, including life insurance, health and disability benefits, and pensions. Confed operated in the US and the UK through both a branch and subsidiaries and in Bermuda and Cuba through branches. It sold commercial paper of hundreds of millions of US dollars and of subordinated notes in British pounds and Luxembourg francs. After the failure of concerted efforts to rescue Confed and avoid a liquidation, winding-up orders were made in August 1994.

Results:

- all policyholders in all jurisdictions received their full policy benefits;
- all ordinary creditors were paid in full, together with interest;
- all subordinated debt holders will receive payments of about 95% of their claims; and
- the creditors of Confed's treasury and depositors and creditors of its trust company subsidiary were paid in full, together with interest.

In total, payments of $900 million will have been made after all policyholders received full benefits.

Factors Contributing to the Success included:

a) The building of a co-operative relationship with the US Rehabilitator and his regulatory and credit constituencies from the outset that allowed both estates to make progress before they reached a settlement, and then to reach a settlement, avoiding litigation that could have seriously delayed the liquidation and prejudiced the results;

b) The establishment of a governance structure that enabled major stakeholder groups to contribute expertise, and that built credibility for the process among stakeholders and in the Canadian and international business communities that were the market for billions of dollars in assets and policy liabilities; and

c) Immediate action at the beginning of the liquidation that preserved goodwill in the individual life and group life and health block, leading to substantial benefits to the policyholders and the estate;

Overview of Approach to the Major Jurisdictions

United States

As noted, Confed did business in the U.S. as a branch and through a subsidiary Confederation Life Insurance and Annuity Company ("CLIAC"). Through Confed, CLIAC provided the annuities that funded structured settlements in tort actions. Close to (U.S.) $1

billion of structured settlements, providing income to the victims of accidents, in some cases, catastrophic, were funded by CLIAC. CLIAC was totally dependent on the annuities issued from Confed's U.S. branch.

Confed's U.S. branch wrote approximately (U.S.) $6.173 billion of life insurance, including policies sensitive to competition from other carriers and annuities that funded pensions. For example, Michigan's civil service's retirement programs had acquired a $100 million annuity contract from the U.S. branch. The U.S. branch was in total about twice the size of the estate in Canada.

To be licensed as an insurer, Confed had to deposit assets in trust in Michigan, its U.S. port of entry, to support its insurance liabilities. Prior to its liquidation, CTSL had removed cash from the Michigan trust account, replacing it with CTSL promissory notes. In August 1994, when the liquidation orders were made, about (U.S.) $640 million of notes were in the trust, which CTSL could not repay, and about (Cdn.) $350 million of mortgages and private placements located in Canada were pledged to the trust, but were effectively under the control of the Liquidator because of the winding-up. Although the Canadian estate faced an apparent shortfall to policyholders, it was clear from the outset that the shortfall to U.S. policyholders would be significantly greater. There was a high risk of extremely complex and costly litigation, with ensuing uncertainty and delay to the administration of both estates that would seriously prejudice an orderly wind-up in both jurisdictions.

In order to assess the best interests of the estate, efforts were made to determine the likely range of results under various scenarios involving unitary proceedings or separate proceedings. Estimating the ultimate realization from Confed's assets required the exercise of judgment in quantifying the expected results of future events. These estimates were, by necessity, influenced by many factors that made precision virtually impossible.

The Liquidator and Rehabilitator negotiated an interim arrangement while different avenues for dealing with the two estates were being explored, pursuant to which they would consult on all material transactions, given the possibility of combining the U.S. and Canadian proceedings, and given that as a result each was the major stakeholder in the other's estate. Further, at the request of the Rehabilitator, the Liquidator spoke at many U.S. stakeholder meetings, acknowledging the Liquidator's obligation to all policyholders of Confed wherever situate, providing the same level of disclosure as to Canadian stakeholders, and building credibility for a negotiated solution.

In June 1996, a settlement was reached that was approved by both supervising courts without opposition. The major provisions of the U.S. Settlement Agreement included:

a) a full and complete release from the Rehabilitator on its own behalf and on behalf of all U.S. claimants in favour of Confed, the Liquidator and the Canadian estate;

b) payment by the Liquidator to the Rehabilitator of $225 million;

c) a "true-up" mechanism" under which, if the claims of Canadian policyholders were paid in full, any remaining residue would be paid to the Rehabilitator until U.S. policyholder claims were paid in full, and if U.S. policyholders' claims were paid in full, any remaining residue would be transferred or paid to the Liquidator; and

d) agreement that, if the claims of U.S. policyholders and Canadian policyholders were paid in full, any remaining assets would be placed under the control of the Liquidator and applied to the payment of claims of creditors

(including creditors of CLIC (U.S.)) in accordance with the provisions of the Canadian *Winding-up and Restructuring Act*.

The Liquidator initially paid $225 million to the Rehabilitator, and $309.2 million was returned to the Liquidator, under the true-up mechanism.

U.K.

Confed had extensive operations in the U.K. Prior to the liquidation, it had been in negotiations with Sun Life for the sale of the U.K. business. A number of the terms negotiated previously were not appropriate in liquidation. Given the substantial liquidity provided by the completion of the transaction, which in turn helped to complete other reinsurance transactions, the Liquidator completed the negotiations with Sun Life, including escrow arrangements, during the weekend of August 12, 1994. The escrowed funds secured and limited Confed's liability for representations, warranties and taxes, and ultimately saved the estate hundreds of millions of pounds sterling as pension mis-selling became a major issue in England.

Bermuda

Confed was licensed under Bermuda law to conduct most types of life insurance and annuity business in non–Bermuda currency and with non-Bermuda entities, on both a direct and reinsurance basis. Confed's Bermuda branch targeted an international market of high net worth individuals. The Bermuda branch business had approximately 170 outstanding policies with a face amount of approximately $170 million (plus various term certain annuities), policyholder liabilities of approximately $7 million, and annual premium income of approximately $3.1 million.

By order of the Supreme Court of Bermuda in August 1994, a Bermudian liquidator was appointed for the Bermuda branch. In March 1995, responsibility for administration of the Bermuda branch was transferred, by that Court's further order, to the Liquidator.

Following this, the Liquidator set up an escrow arrangement whereby premiums for the Bermuda branch policies would continue to be received and held, pending completion of an assumption reinsurance transaction which was completed in July, 1995, with the approval of the Bermuda and Ontario courts.

Cuba

Confed operated a branch in Cuba. The Cuban government had prevented the assets of the Cuban branch from being removed from Cuba and had passed a decree ordering insurance companies not to pay any policyholder who left Cuba permanently in the 1950s. The liabilities of the Cuban branch were primarily payable in Cuban pesos, which were not readily negotiable outside of Cuba. The books and records remained at the Cuban branch, access to which required a visa, and remained in the control of the Cuban government. The Liquidator's best estimate of the liability in respect of policies issued through the Cuban branch to policyholders who had left Cuba permanently was in the range of (U.S.) $2 million to (U.S.) $4 million. The Liquidator, with the assistance of the Canadian government, negotiated an agreement with the Cuban government that ensured all policyholders of the Cuban branch, whether resident in Cuba or not, would be paid. In addition, the Cuban government caused periodic payments totalling (U.S.) $9 million to be paid to the Liquidator.

The effect of the agreement was to ensure all policyholders of the Cuban branch were covered, to allow the Liquidator to realize a recovery in respect of the Cuban branch assets in a liquid form, notwithstanding that they were denominated in Cuban pesos and had been

seized by the Cuban government, as well as ensuring that the Liquidator had access to the books and records of the Cuban branch to allow it to deal with policyholders resident outside of Cuba.

Some lessons learned:

a) Confed US had authority to restructure policies, which gave it far greater flexibility in selling blocks of business. Canada now has adopted legislation permitting limited restructuring of policies. *Take away – authority to restructure policies can create value.*

b) There were significant issues between Confed US and CLIAC. *Take away – do not think of cross border issues as being just between countries but also as being between entities within the same country. Issues within a country can be as intractable as those between them.*

c) Governance and information sharing issues arose as between the National Organization of Life and Health Guaranty Associations (NOLGHA) and the Rehabilitator in the US and between Assuris and the Liquidator in Canada and with respect to the handling of strategic issues between the jurisdictions. . *Take away – the consumer protection organizations are part of the process and need access to information on not only about their own jurisdiction but also the rest of the conglomerate, at least to the extent it might impact them.*

d) CTSL, the treasury subsidiary, managed Confed's derivative book and also acted as a market maker in its own right maintaining what was supposed to be a matched book of business and transferring funds among entities that required liquidity. *Take away –you cannot consider the consolidated assets and liabilities in resolving a multi-national financial institution insolvency. Each entity and jurisdiction will need to be considered on its own, even if there is the potential for some of the jurisdictions to accept a universalist approach. In addition, when there are allegations of fraud, all participants have a tendency to go into a shell to protect themselves and their position, which can be counterproductive, so it is important to be careful in making such allegations.*

e) Confed's head office in Canada provided processing and other services for the entire group, without which parts of it could not function or would at least have had difficulty. Agreements to provide access to services helped establish a co-operative relationship between jurisdictions and there were some services that were sold. *Take away –do not do something that upsets the business operations and structure in the process of winding up a multi-national entity that may destroy value. Recovery plans can help this kind of situation.*

f) The UNCITRAL Model Law not been developed in 1994. While intended mainly for commercial enterprises, it does have a number of attributes which should apply to financial institutions. Further, the UNCITRAL Cross Border Guide on Insolvency (approved by the General Assembly in 2009) has a number of very useful and important comments on cross border issues. *Take away –the UNCITRAL provisions, including a recovery plan with a protocol on how to deal with assets could add to the timely development of a working relationship among the restructuring jurisdictions and add value.*

CASE STUDY 2: Lumbermens Mutual Group, USA

Background

Lumbermens Mutual Group (the Group), fka-Kemper Insurance Group, a large international property/casualty insurance group with multiple affiliated insurers, wrote workers' compensation, environmental, professional, excess casualty, bond and surety, disability, and loss control insurance products. The Group voluntarily stopped issuing new and renewal insurance contracts early in 2003 and was placed into supervised run-off status by the Illinois Department of Insurance in mid 2004 after operating under a series of corrective orders that began in 2003. These measures were taken to prevent the insolvency of a Group with direct loss and LAE liabilities of over $11 billion.

Causes of Trouble

The Group reported deterioration in capital due to uncertainties with respect to its asbestos and environmental exposure and challenges with respect to the restructuring of its pooled operations. During 2002, Lumbermens surplus notes, which accounted for nearly all of surplus on an un-stacked basis, were lowered to junk status. In January 2003, various rating agencies downgraded the Group following news that it would repurchase a $125 million investment by Berkshire Hathaway, Inc. and that its president and chief operating officer had retired, leading to questions about the competence level of the Group's management. In 2002, the Group reported $450 million in adverse loss reserve development, resulting in a directive by the Board of Directors to cease underwriting of insurance business. The loss of surplus lowered Lumbermens statutory risk based capital to the Authorized Control Level.

Corrective Actions by Supervisor

The Group had attempted during 2003 to sell its middle-market lines of business to an investment consortium, but negotiations were called off after a definitive agreement could not be reached. Recognizing the Group's inability to resolve its mounting issues, in 2004 the IL Insurance Department developed a supervised run-off plan in an effort to protect policyholder's interests. Additionally, regulators began on-site supervision to closely monitor the firm's liquidity as it attempted to meet policyholder claims. Without the run-off plan, regulators indicated that the Group was projected to run out of cash by early 2005. With the plan in place, the Group has been able to successfully execute transactions with large policyholders in order to reduce gross liabilities and preserve statutory surplus. This was accomplished through the use of buy-backs, novations, trust agreement transactions, and reinsurance-based transactions. The Group also utilized employee layoffs and other cost-saving measures to downsize its expense structure. For example, as of August 2010 direct loss and LAE liabilities had been reduced down to $1.7 billion from the initial $11 billion.

Company officials contended that a supervised commercial run-off plan would be more beneficial to the Group's policyholders and less disruptive to the market than a receivership. The Group's plan included buying back coverage obligations to large commercial policyholders and commuting reinsurance agreements to the extent those actions were consistent with the Group's need to maintain positive surplus and ensure sufficient liquidity to pay claims and general expenses.