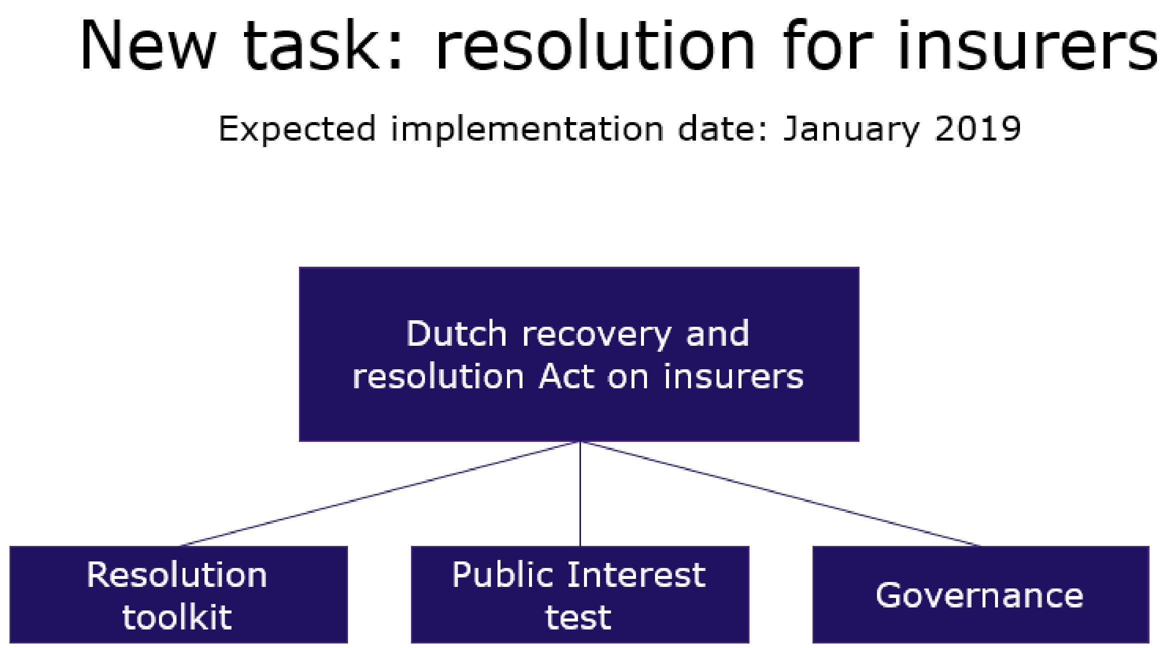
DeNederlandscheBank

EUROSYSTEEM

“The Dutch recovery and resolution regime for insurers”

Speech by Nicole Stolk at the EIOPA Seminar “Recovery and Resolution in Insurance”
Amsterdam, 25 October 2018

At the EIOPA seminar on recovery and resolution in insurance, Nicole Stolk gave an overview of the new Dutch regime for recovery and resolution for insurers. Before an audience of many other European resolution authorities, she sketched the toolkit, the public interest test and the governance De Nederlandsche Bank has set up.



New task: resolution for insurers

The timing of this seminar could not have been better. That is because the Dutch Parliament is just about to pass the new Act on Insurance Recovery and Resolution. At the same time, we at De Nederlandsche Bank still have many details to work out in how we implement this Act. And the clock is ticking. The Act is expected to come into force on the first of January 2019. So we only have a short time to **prepare for this new reality.**

And I am *also* new. A new Director. With a new task. It is special to be here at the start of this new resolution regime. And to help this new reality take shape.

The Netherlands is one of the first countries in Europe to implement a resolution regime for insurers. Why did we decide to move forward on a national level? One of the reasons was that our old toolkit had several shortcomings. Some instruments were not available, or could only be used in limited ways. These shortcomings became very clear when Dutch financial group SNS REAAL, ran into problems in 2013. The government had to step in, and the banking and insurance group was **nationalized**. But if we'd had the new insurance resolution regime back in 2013, the outcome might have been different. With a better toolkit, and the possibility to conduct resolution planning, there might have been alternative solutions.

However, SNS REAAL was **not the only case**. During the crisis, several Dutch insurers needed state support. This showed that not only banks, but also insurers, could be "too big to fail". However, the insurance sector also faces difficulties today. Life insurers are under pressure from low interest rates.

And from changes in Dutch fiscal policy. That is why this new regime is needed. It will **prevent** future bail-outs, and offer policyholders better protection.

But the development of this **new regime** has also sparked **new debate**. Debate on whether policyholders should pay for the mistakes insurers make. Debate on which insurers should fall under the regime. And debate on whether a national framework threatens the level playing field.

Today, I want to give you a bit more insight into how the Dutch recovery and resolution regime for insurers works. Those of you familiar with the BRRD – the Bank Recovery and Resolution Directive – might recognize some of these resolution tools and practices. However, practical implementation for insurers can sometimes be very different than for banks.

I'd like to focus on **three features** in particular:
- the resolution toolkit
- the public interest test
- and governance under the new regime.

These three aspects should provide a good overview of the new regime, and how it works.

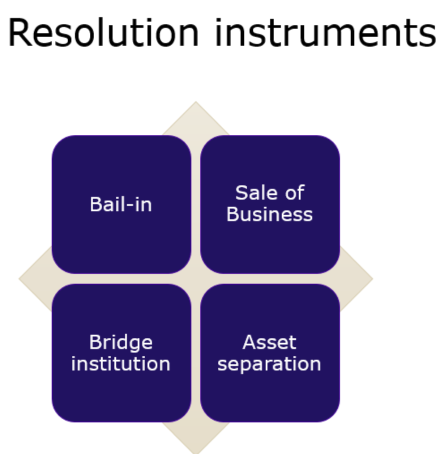
If you would like me to clarify any points during this presentation, feel free to ask. But if you have more general questions, please save them until the end. There will be plenty of time for discussion afterwards.

Part I: The Dutch Resolution toolkit

So let's first look at a couple of items in our resolution toolkit. Some of the resolution instruments are not new to DNB, as they were also part of our previous regime. However, they may have gone under a different name. Or their use may have been subject to more limitations.

Resolution instruments

The **four resolution instruments** are basically the same as in the BRRD: bail-in, sale of business, bridge institution and asset separation. With a bail-in, we can write down or convert equity or debt, or restructure insurance policies. This instrument is not *completely* new, as DNB could already change insurance contracts and pass losses on to shareholders. But there are some differences.



For instance, in the past we were only able to change insurance contracts in combination with a portfolio transfer. The new Act makes it possible to change insurance contracts within an insurer. Another difference is that an ex-ante judicial review is no longer needed before we can use resolution instruments. As of next year, DNB can use resolution instruments without Court permission.

A bail-in can be a **controversial** instrument, especially when it is possible to bail-in policyholders. There is one important point to remember here though. And that is, it is only possible to use a resolution instrument when no creditor will be worse off than in insolvency. With a bail-in, the insurance product can be continued, so policyholders can retain their product and their coverage. Tomorrow, the Dutch Ministry of Finance will provide more details on the bail-in.

The second instrument, the **sale of business,** enables us to sell the shares of an insurance group. Or the shares of a troubled entity within the insurance group. Or to sell an insurance portfolio, without the shareholders' consent. This was already part of DNB's toolkit.

However, the **bridge institution** is an instrument we have never used before. It allows us to transfer an insurer, or an insurance group entity, or part of that entity, to a semi public company. During this time, the insurer is not allowed to compete on the market. The bridge institution is only a temporary solution, and it buys us time for a Sale of Business. When setting up the bridge institution, we can also benefit from our experience in bank resolution.

The last instrument is **asset separation.** This allows us to transfer assets, rights or liabilities to a semi-publicly owned asset management vehicle. In the banking sector, this vehicle is also known as the "bad bank". The toxic assets or liabilities can be removed from the balance sheet, to limit the risk and make the insurer more attractive to other buyers. This instrument is only allowed in combination with one of the other instruments, because the insurer also has to bear some of the losses.

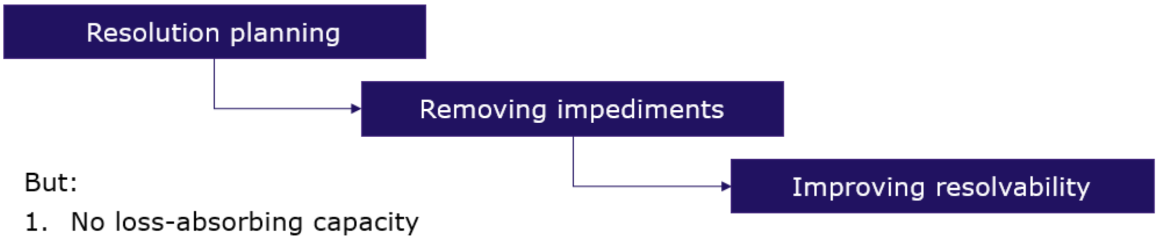
Other resolution toolkit features

Next to the four resolution instruments, the resolution toolkit also provides **another crucial feature:** the possibility to conduct **resolution planning**. We will prepare a resolution plan for insurers that pass the public interest test. I'll go into more detail about this test later on.

The resolution plan identifies possible impediments to resolution. And the new resolution regime gives us powers to remove these impediments, if necessary. This contributes to a resolvable insurance sector. Resolution planning ensures that any failures result in lower costs for society, and reduces the risks for financial stability.

Finally, it is good to point out some **key differences from the bank resolution toolkit**. First, the <u>absence of loss-absorbing capacity</u>. In bank resolution, there is a major focus on loss-absorbing capacity.

Other resolution toolkit features



But:
1. No loss-absorbing capacity
2. No guarantee scheme

The bank resolution experts among you will be familiar with the European and international standards in this respect - MREL and TLAC.

However, the Dutch Finance Ministry has decided not to require insurers to have an additional layer of loss-absorbing debt. Traditionally, this layer is very thin for insurers. That means that a bail-in could affect policyholders sooner.

On the other hand, introducing loss-absorbing capacity could drastically change the business models of Dutch insurers. This could in turn lead to higher costs for policyholders.

The second difference is the absence of a guarantee scheme. Where we have a Deposit Guarantee Scheme for bank customers, there is no such Insurance Guarantee Scheme for Dutch policyholders. This means that a resolution instrument can have a direct impact on society. We have to clearly explain why resolution is still better for that policyholder than insolvency.

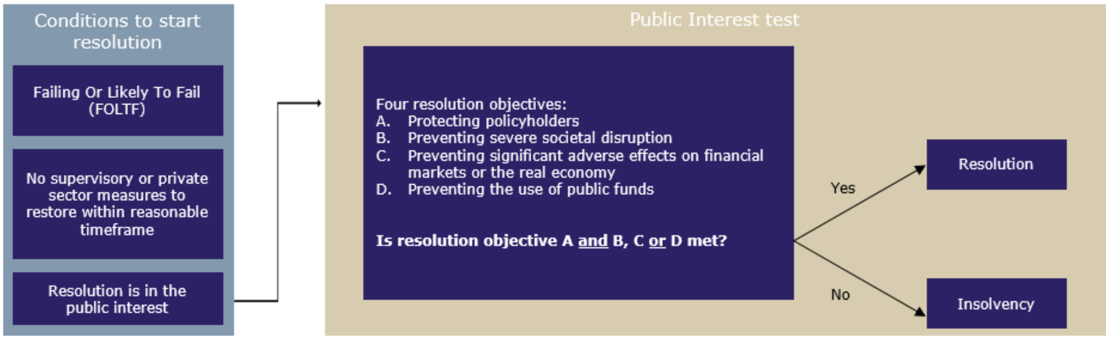
To sum up, the resolution toolkit contains four resolution instruments, and the possibility to conduct resolution planning, including the removal of impediments. But it lacks two of the features that are a central part of banking resolution.

Part II: Public Interest test

This new resolution toolkit is very powerful, but also needs to be handled with caution. That’s why the regime is based on proportionality. The default option for an insurer is always insolvency, unless this causes severe negative effects.

For banking resolution, there is a public interest test that determines whether resolution tools should be applied to individual firms. A comparable approach is developed for the resolution of insurers. The public interest test determines which insurers cannot go into insolvency without severe negative consequences.

Public Interest test



This test is different from the public interest test in bank resolution. That is because the effects of a failed insurer are also different. Insurers that pass the public interest test, will be subject to resolution planning.

As you can see here, the starting point of the resolution decision is similar to the BRRD. Insurers can only be put into resolution when they are failing or likely to fail, when market solutions have been exhausted <u>and</u> when resolution is in the public interest. Now the important question is: **When *<u>is</u>* resolution in the public interest?**

There are **four criteria** that guide the public interest but the first one, the protection of policyholders, needs to be **combined** with at least one of the other three. These other three objectives are:
- avoiding severe disruption to society
- preventing significant severe impact on financial markets or the real economy
- and protecting public funds.

In practice, the impact on society and the economy will create the most discussion. To provide some guidance, the explanatory note to the new Act states that the public interest will depend on the size of the insurer, the number of policyholders, the type of product offered and the current economic situation. It adds two criteria for applying the test: technical provisions of at least one billion euros, or at least one million policyholders. Of course, this is **just general guidance** and the public interest needs to be determined case by case.

At first glance, it seems that between ten and twenty insurers in The Netherlands could be eligible for resolution and resolution planning. It also means that the scope of the resolution regime not only focuses on systemic insurers. But also on the insurers that can have an impact on the Dutch society, financial markets and economy.

Part III: Governance

Instruments, rules and tests are important. But they could become dead letters when it isn't clear who should do what at what moment. So, I'm glad the new resolution regime also introduces a specific **governance model**. This is the third feature that may be of interest to you. In this respect I will first discuss the decision-making process, and then proceed to the internal organization.

Governance

Within DNB	**Within Resolution**
• Collegial decision-making, but casting vote on resolution execution • Designated board member for resolution versus supervision & central bank function • Same board member for bank and insurer resolution	• Fifteen people designated for insurer resolution • Horizontal and vertical work • Future goal is further integration with bank resolution

As you may know, our governing board is a collegial body that takes decisions by consensus. When it comes to resolution planning, all board members have equal voting rights. However, in terms of decisions regarding resolution execution, the board member for resolution has a casting vote. Although I do of course hope and trust I will never have to use that casting vote…

The **board member for resolution** cannot also be the board member in charge of supervision. At DNB, we have decided to make one board member responsible for bank and insurer resolution, and for the deposit guarantee system. And that's me.

Below board level, we discussed whether insurance and banking resolution tasks should be two different departments. Or whether they could be combined. Because of the similarities in the resolution regime, and the experience that bank resolution has gained, we decided to combine the two resolution tasks into one directorate. The combination of bank and insurance expertise also benefits the resolution planning for bank-assurance institutions. This is because it brings together different perspectives at an early stage.

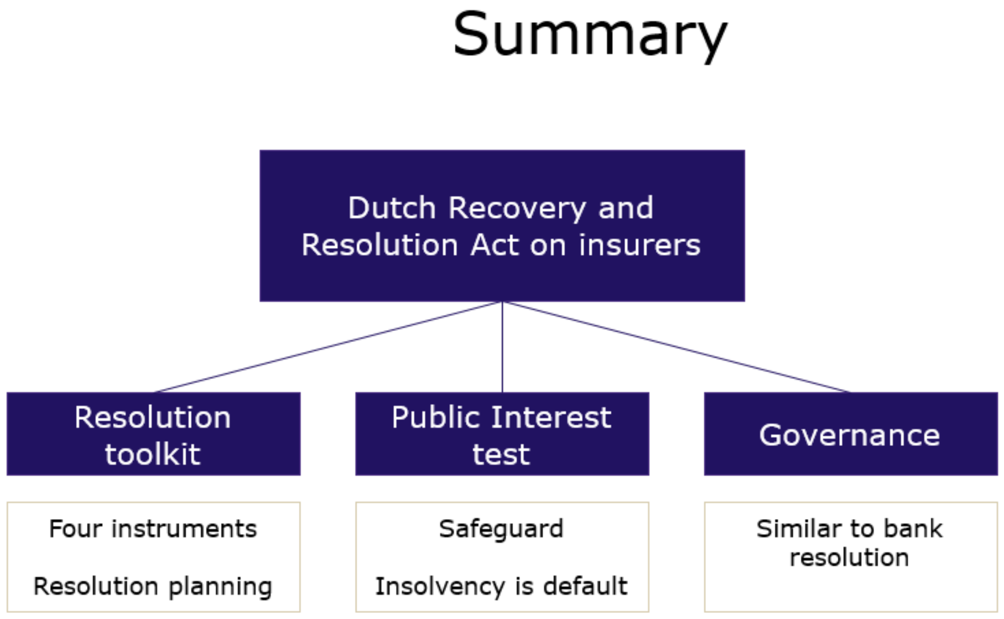
Within the **resolution division**, we have started setting up a designated unit for insurance resolution. The unit will ultimately consist of fifteen people. Some of them will focus more on horizontal topics, such as the resolution toolkit. Others will focus more on the verticals. Or in other words, the resolution planning of individual insurers. This is the same setup as for bank resolution, and has proven to be an effective approach.

After figuring out the basics for insurance resolution, we aim to **further integrate** the task with bank resolution. Bank resolution already works within a matrix organization with the DGS function. There is quite some overlap on certain topics. Good examples are crisis management, setting up a bridge institution, and the Sale of Business procedures. On other topics, such as valuation techniques, it is very likely we will team up the functions much earlier.

To conclude, the governance is similar to bank resolution. This is not surprising, given the features of the resolution Act, and the potential benefits from cooperation between the two resolution tasks.

Summary

To sum up, I have tried to give you a bird's eye view of the new resolution function. However, there is of course much more to explain.



With respect to the resolution toolkit, it has become clear that DNB will have four resolution tools. These can of course can be combined. Insurers will be subject to recovery and resolution planning, with the possibility to remove impediments to resolvability. But of course, there is a safeguard to this regime, which is the public interest test. Because insolvency should always remain the default option for an insurer. In addition, creditors can never be worse off in resolution than in insolvency. And governance is similar to bank resolution, in terms of decision-making and internal organization.

Closing remarks

Although this resolution regime is a big step forward, there is still a lot to gain from a **European perspective**. Different countries have shown an interest in a resolution regime. Some of them, such as the Netherlands, have started to build one.

This potentially creates differences between countries. At the same time, large insurers have cross-border activities and regulation. Solvency II aims to establish a level playing field within Europe. The challenge we face is ensuring European citizens are equally protected, despite different national approaches within the EU. Ultimately, I am very excited about the Dutch resolution regime. And I still hope we will make progress on a European level as well.

So let's discuss your ideas and experiences so far, and learn from each other. And keep building together, towards more equal and adequate protection within the EU.