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SUBJECT: The role of "Private Life Insurance Guarantee Fund" when an insurance undertaking becomes insolvent

I. Introductory remarks

1. The problem

The basic characteristics of insurance are two twin concepts: expectation and hope for the future that every insurance offers to the each member of the society of risks. These two concepts have a more profound meaning when long term life insurances of saving or investing character are involved, to which the consumers anticipate thanks to the credibility and solvency of the entities that offers them. Respectively, when an insurance undertaking becomes insolvent, it is an adverse situation that can shake down the institution of private insurance and create a systemic hazard if these consequences outspread in the financial system.

There is not an existing economy or society of risks that are faceless and with no legal obligations. All their operations originate from named entities and the community consists of certain groups of people. In this particular case, from one side there are the state with its supervisory role on insurance undertakings and the insurance entities themselves, that have to follow the rules of solvency that are enforced by the supervisory authority and from the other side there is the society of the insured persons, whose protection is covered by the state through Insurance Guarantee Schemes, that guarantee compensation for losses to the insured party when the insurance undertaking becomes insolvent.

2. EU status

Unlike the banking and investing sector, where there is a community legislation through which there have been established insurance deposit schemes and compensation of the investors respectively[1] in the sector of private insurance there is no community obligation for the establishment of a harmonized regulation for the Insurance Guarantee Schemes in E.U. This situation can prevent the effective and equitable protection of the consumers in the members states in E.U. since it can lead to the distortion of the cross-border competition between insurance undertakings that operate in countries that have such insurance mechanisms and insurance undertakings that are not covered by Insurance Guarantee Scheme[2].

After the financial crisis in 2008, the European Commission took more drastic measures to address the insurance undertaking that have become insolvent and protect the rights of the insured persons, and issued in 2010 the White Paper[3] which formulate fundamental principles that reflect the socio-economic policy of EU regarding the protection that must be offered by the Insurance Guarantee Schemes as an ultimate protection of consumers when the insurance undertakings of all the sectors become insolvent.

These initiatives by the Commission, are promoted by EIOPA, the European Insurance and Occupational Pensions Authority[4], while the Directive Solvency II (Recital 141. q.2) refers to harmonized and adequately funded

[1] Ar. Sinanioti-Maroudi, Private Life Insurance Guarantee Fund (unpubl.) Study in Legal Law Association of Private Security-2013 there isa reference to "Deposit Guarantee Fund and Investment" (T.E.K.E.) and "Guarantee Fund Capital" covering the risk of SA in the provision of investment services.

[2] European Commission, White Paper. About the Insurance Guarantee Schemes, Brussels 12/7/2010 (COM -2010 - 370 final), p.5

[3] European Commission, White Paper. About the Insurance Guarantee Schemes, Brussels 12/7/2010 (COM -2010 - 370 final).

[4] VELCRO, European Insurance and occupational pensions authority, Report on the role of Insurance Guarantee-Schemes in the Winding-up procedures of Insolvent Insurance undertakings in the EU / EEA 25 May 2012 and 20 July 2012 (p. 2). The VELCRO replaced CEIOPS, that with the respective authorities operating in the banking industry and business-investment (EBA-ESMA) establishes the "European System of Financial Supervision"• cf. N. Rocka / Gortsou, Elements of Banking Law (2012) p.37

insurance guarantee schemes[5]. But in the EU, the situation for the final configuration of a harmonized insurance guarantee scheme has not taken a final form and each Member State differentiates according to their aspirations[6].

3. Funding

A serious issue for discussion among the Member States is funding an insurance guarantee scheme. Who bears or who should bear the cost of operation in a time of intense economic fluctuations. I would say in principle the state itself through the direct funding of the guarantee mechanism, if the problem is mainly due to the improper exercise of its supervisory duty on insurance undertaking. Subsequently the operation cost should burden the insurance undertaking itself, with the (usually) prior contributions and possibly additional ex-post funding, depending on the volume of business and the balance of risks. The very participation of insurance undertaking in the financing of insurance guarantee mechanism is a positive sign because it constitutes a limiting factor in the issue of the so-called "moral hazard"[7]. The funding from insurance undertakings discourages them to take excessive risks, regardless of the adverse consequences. The limits on the amount of compensation to be paid to beneficiaries and supervisory authorities can limit the moral hazard[8].

In their effort to finance the guarantee systems, insurance undertaking usually pass on their costs to society of insured members through the payment of premiums. This is certainly contrary to the obligations of a welfare state, since the insured are the ones that are clearly not responsible for the insolvency of an insurance undertaking.

[5] Directive 2009/138/EC of the European Parliament and of the Council of 25/11/2009 relating to the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II)
[6] See Report of VELCRO, 20 July 2012
[7] See also A. Karagkounidi, Protection of the insured person from the insolvency of the insurance company (The institution of guarantee insurance in the light of EU law) visits. SS (C) 2013, pp. 523, European Commission, White Paper, page 9
[8] See also European Commission, White Paper 2010, pp. 12-13

On the other hand, perhaps it is unrealistic in the current economic environment, to expect the state to fund one or more guarantee funds in insurance industry. In any case, however, the inability of providing a state funding of an insurance guarantee scheme should be counterbalanced by the state with tighter controls on insurance undertaking in order to avoid creating adverse effects.

II. The Private Life Insurance Guarantee Fund

1. Purpose and institutional framework of operation.

In Greece, the only insurance guarantee system that operates in the context of the 'EU commitments' is the Auxiliary Fund that operates in accordance with Law 489/1976 on compulsory liability insurance of motor vehicle accidents. This obligation of Greece derives from: a) the ratification of the European Convention of Strasbourg from Greece by Law 4147/1961 (art.9), which is an International Convention and b) by Union law (art. 10 § 1) the codified Insurance Directive for 2009/103/EC obliging states to establish a Compensation Agency for victims of uninsured or unidentified vehicles[9].

In addition, the same recommendation regarding the insurance undertakings is included in the preamble of the Directive Solvency II (Recital 76 2009/138/EK) stating that they should participate in the funding of an Guarantee Fund that would operate in every state – member.

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[9] See, instead of many I. Rokas, Restrictions in benefits of the Auxiliary Fund of cl 489/1976 and in particular those introduced by Law 4092/2012 and the commitments of lawmakers from the international and EU law, E. Com.L. 2013 (t xD '), p.1 ff

Such obligation imposed by the EU law does not exist in Greece in any form of insurance, than the Auxiliary Fund. Relatively recently with Law 3867/2010 the Greek legislature established the "Private Life Insurance Guarantee Fund " as an institution to provide last resort protection to holders of life insurance policies[10]. This guarantee mechanism has been established after the trouble caused to the sector of life insurance by the withdraw of the authorization of "Aspis Pronoia". Although it has not been be imposed by EU law, it follows the basic principles of the 2010 White Paper on Insurance guarantee schemes mentioned above.

The directive proposes that both the Auxiliary Fund and the Life Guarantee Fund have guarantee operation if the debtor liable insurance undertaking becomes insolvent[11]. The liability of the Life Guaranty Fund is certainly not equivalent to the liability of the debtor insurance company, because there are ceilings to the amount of compensation.

The above mentioned «Life Guarantee Fund» established by Law 3867/2010 (art. 3-13 GG A128/3.8.2010) is a Private Legal Entity which is under the supervision of the Bank of Greece.

Its goal is to intervene after the withdrawal of the authorization of an life insurance undertaking which is during a winding – up procedure, in order to maintain and transfer this insurance undertaking to another contractor. If the search for a contractor and the transfer of the portfolio are unsuccessful then the Life Guarantee Fund initiates the process of compensation to policyholders and beneficiaries.

The role of Life Guarantee Fund is activated after the withdrawal of the authorization of insurance undertakings that have entered a winding – up procedure after Law 3867/2010 (3.8.2010). For ongoing proceedings

[10] See also A. Karagkounidis, ibid pp. 517 et seq VELCRO reports of 25/5/2012 p.1 ff
[11] See X. Contiades, Constitutional issues of the recent legislation regarding the Auxiliary Fund (Law 4092/2012) suggestion to Congress ENDIETA 2013 and Epi.Dik.I.A. 1/2013 pp. 137 et seq

concerning insurance undertaking whose authorization was withdrawn by the date of publication of this law, another process is applied, which is defined by Article 2 of the same Act, which was recently modified to address problems of compensation of the beneficiaries of the insurance undertaking "Aspis Pronoia". In this report we will not focus on this particular topic but on the operation of the guarantee fund as it stands today.

2. Operation of the " Life Guarantee Fund"

The establishment of guarantee fund in the area of life insurance was necessary because after the withdrawal of the authorization of an insurance undertaking, it is automatically terminated and enters a winding – up procedure. In addition the insurance contract for damage of the insured persons is terminated within 30 days after the withdrawal of authorization. This setting does not apply to life insurance contracts where the insured event has not occurred yet. These contracts due to their consuming characteristic as either saving or investment products are not terminated, if during the 30 day period of time another insurance undertaking takes the portfolio (art. 3 § 6.7-d.400/1970), and at the same time the rights and obligations of the insolvent company and continues the operation of these life insurances (art. 3 § 6-d.400/1970)[12].

However, in an environment of economic recession it is difficult to transfer a portfolio, especially when the scope of the obligations of the insolvent insurance undertaking is very large. In this case the Guarantee Fun decides on the fate of the insurance contracts and the settlement to persons entitled to compensation. In addition it is responsible for all the rights and obligations of the insolvent company, the insurance contracts are terminated and the pending trials are continued (Art. 5 § 3 N.3867/2010)[13].

[12] See, instead of many P-Chatzinikolaou Angelidou, Private Insurance Law, 2nd Edition (2012), pp. 90-91

[13]See R. Chatzinikolaou-Angelidou, Private Insurance Law, 2nd Edition (2012), pp. 108-109

3. Provided coverage –territorial validity

The protection that the Life Guarantee Fund offers involves the insurance coverage regarding insurance compensations from life insurance policies issued by a greek insurance undertaking in Greece or another state – member, as also life insurance policies issued by European companies in our country with the exception of the supplementary insurances for hospitalization (art. 5§3). Therefore in terms of territorial validity, the institution of Life Guarantee Fund provides coverage based on the laws of the country of origin, which is compatible to the Supervising Authority of the country of origin, whose supervisors are responsible for preventive supervision and solvency. According to the greek legislator, the country of origin steps aside in favor of the host country, when the Community company operating in our country through a branch is not covered by an insurance guarantee equivalent mechanism in the country of origin[14].

Members of the Private Life insurance Guarantee Fund (art. 6 N. 3867/2010) are, mandatory and automatically, all the insurance companies which are headquartered in Greece and practice in the insurance market, according to art.13 § 2-d 400/1970, as also the branches of insurance companies from a third country operating in Greece. Also branches of insurance undertakings established in a Member State of the EU and EEC and European enterprises operating in Greece under the freedom to provide services as long as they are not covered by guarantee funds respectively in the country of origin. In this way it is combined the geographical area of the country of origin to the host country, ensuring equal protection for policyholders of member states, providing harmonized coverage.

4. Administration of the Private Life Insurance Guarantee Fund

[14] See Ap Karagkounidi, op, pp. 518, European Commission, White Paper, op, p 5.11

(Administrative Act of BoG 2629/4.10.2010)

The highest Administrative Body of the Private Life Insurance Guarantee Fund is the assembly of members, that decides for every case with an absolute majority of its members, and its decisions are binding for members who disagree or that have not attended (art. 11), such as drawing up internal rules and reinsuring from the Private Life Insurance Guarantee Fund against the insolvency of its members to fulfill their obligations towards the Fund.

The Management Committee consists of five members, one of which is appointed by the Bank of Greece as the chairman and the other four members are elected by the Assembly. The Private Life Insurance Guarantee Fund is represented judicially and extrajudicially by the Chairman of the Administrative Committee

5. Funding of Private Life Insurance Guarantee Fund

The funding of the Private Life Insurance Guarantee Fund is based according to the Greek legislator to the system of the advanced funding of the insurance undertakings, as also the insured persons opposed to the ex post funding that is in force in the other member states of the E.U.

So, it was chosen the distribution of the annual contribution of the Private Life Insurance Guarantee Fund in half to the insurance companies and in half to the members according to the weighting of risk management. The contribution was defined by the act of the D. of the BoG No. 2636/24.11.2010 and was scaled from 1.5% of total production of gross registered premiums for life insurance industry ranging in lower levels of 0.8% to 0.3 % in life-management of group pension funds, which completely lacks the assumption of risk[15].

The insurance companies reimburse at the end of two months the contributions to the Private Life Insurance Guarantee Fund that attribute to the life insurance contracts concluded or renewed. The Private Life Insurance

[15] See Administrative Act of BoG 2636/24.11.2010 regarding the calculation of contribution.

Guarantee Fund has a right of action against members for collecting contributions and non – compliance of members to their obligations results in the withdrawal of the authorization for the life insurance industry.

The positive aspect in the advance funding is that it helps, as it has already been stated, in the minimization of the moral hazard, because insolvent companies have already contributed to the Private Life Insurance Guarantee Fund when their authorization is being withdrawn. At the same time it offers greater flexibility in contributions. A negative aspect is the shift of the cost of operation of the Private Life Insurance Guarantee Fund from the insurance companies to policyholders and in particular the charge of the insured persons with an equal percentage of the premium for the payment of the levy, as if there are two parts with the same economic power.

In this way the Greek legislator gave precedence to the debt of social solidarity that according to art. 25 § 4 of the Constitution, the State is entitled to require from the citizens, putting aside its constitutional obligation according to art. 25 1 para. 1 to take positive measures to guarantee the rights of citizens[16].

[16] See P. Mantzoufas, Constitutional protection of rights in the Risk Society (2006), pp. 93 ff, X. Contiades, op, pp. 3-4 C. Katrougalos, The constitutional framework of the operation of the Auxiliary Fund, proposal in conference ENDIETA 2013, pp. 5,7

6. The acting role of Private Life Insurance Guarantee Fund

Maintenance and transfer of life portfolio

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A. The Private Life Insurance Guarantee Fund takes action in two cases. Its role is dual and is activated by the withdrawal of the authorization as a result of an offense against the Law.

The Bank of Greece gives to the liquidator of the insolvent insurance company, all the data that has in its possession regarding the portfolio of life meaning all life insurance policies of the insurance company. He is also at the disposal of the Life Insurance Guarantee Fund that proceeds to the registration of the insured persons and the devaluation of the Life Portfolio[17].

In addition the Private Life Insurance Guarantee Fund starts the procedure for finding a contractor, examining the files of the insurance companies that have expressed their interest regarding all or part of the portfolio depending on the sectors and the type of coverage. The interested contractors, after having studied all the available information from the Private Life Insurance Guarantee Fund, submit their proposals within specific deadlines. The Private Life Insurance Guarantee Fund evaluates each offer according to the interest of the insured persons and submits its decision to the BoG. Within 10 days of the approval decision of the BoG, the liquidator and the contractor transfer a contract for the portfolio (art. 5 C. of BoG).

After the transfer of the life portfolio the contractor becomes involved in the rights and obligations of the life portfolio from the date of withdrawal of authorization, subject to the reform of the benefits agreed (art. 6§2).

It must be emphasized that during the withdrawal of the authorization of the insurance undertaking and the transfer of the life portfolio and its receipt by

[17] See Decision of the BoG regarding the transfer of life portfolios of the insurance undertaking that has entered a winding up procedure (GG 1050/30.5.2011)

the contractor, the collection of premiums, the payment of insurance and the right of redemption, existing and future, are suspended (art. 6§2).

After the transfer of the life portfolio, the contractor is the one that transacts the collection of premiums and the payment of insurance that come of the period of time between the withdrawal of authorization and the date of receipt of the life portfolio.

This solution is the most advantageous for the insured party, because it contributes to the continuation of long-term life insurance contracts in favour of the policyholders by ensuring the saving or investing nature of these eminently consuming contracts

B. If the process for find a contractor and transferring the life portfolio proves fruitless, all the life insurance policies are terminated automatically (art. 9§5 L. 3867/2010) and the Private Life Insurance Guarantee Fund activated its second role, meaning the compensation of the insured persons according to art. 7 L. 3867/2010.

Private Life Insurance Guarantee Fund activates the procedure for compensation of the insured persons, as soon as the liquidator hands the demand list from the life insurance policies[18] (art. 3 D. of the BoG).

The amount of the claim from life insurance is calculated in accordance with statutory and contractual terms of any contract in force at the time of the withdrawal of authorization (art. 7 § 2 Law 3867/2010) and Private Life Insurance Guarantee Fund proceeds to the payment of cash benefits by setting a ceiling for each type of requirement.

So for insurances for deaths or permanent total disability compensations shall be paid to a maximum amount of 60.000 € and for the other life insurances compensations shall be paid to a maximum of 30.000 € and for benefits of value redemption that the right has legally been exercised prior to

[18] See Decision of BoG for compensation to the beneficiaries of life insurance in an insurance company that has entered a winding – up procedure (GG 1862/22.8.2011)

the withdrawal of authorization compensations shall be paid also to a maximum of 30,000 € (art. 4 d 1.2 D. BoG and 7 § 1 Law 3867/2010).

The above mentioned coverage of the Private Life Insurance Guarantee Fund is extended to all the life insurance sectors e.g. life insurance and pensions, investment funds, other variables per insured person of insurance policy due to the long-term commitments that these insurances had, except claims arising from supplementary covers of hospital care.

Under the allocation mechanism of the operating costs of the Private Life Insurance Guarantee Fund and the balance of risks, the calculation of the contributions to the Guarantee Fund is matched to the maximum compensation to policyholders, in order to avoid moral hazard on the part of the insured persons from risky decisions and to achieve a balance between the guarantee of an equal minimum coverage and limits of liability[19].

Exceptions to the compensation are specified only for certain persons that are closely related to the insurance undertaking, e.g. board members or stakeholders with shares above 5% (art. 8 L. 3867).

After verifying the claims, the Private Life Insurance Guarantee Fund makes the payments to the persons entitled, by crediting the bank account and after the beneficiary has no claim against the Private Life Insurance Guarantee Fund. Compensation shall not be paid directly but within 3 years in installments.

7. The "Private Life Insurance Guarantee Fund" model to other types of insurance ?

Creating an insurance guarantee scheme as a mechanism of last resort, can definitely strengthen credibility and public trust in the institution of private insurance and therefore it can prevent regulatory moral hazard. Its role is

[19] See European Commission, White Paper, op p.14

justified as an attempt to prevent the insolvency of insurance firms, and if this cannot be avoided, as a mechanism to cushion the adverse effects.

Theoretically, an insurance guarantee mechanism may cover life insurance policies and insurance losses. However on the basis of the average amount of losses sustained by holders of life insurance policies and losses when the insurance undertaking becomes insolvent, insured persons with life insurance policies need greater protection through a support mechanism, due to the nature of long-term savings or investing programs, without of course ignoring the damage to the insured parties in the insurance for damage, ie financial risks[20].

Because of the cost involved in establishing a guarantee fund for all parties involved, it is more appropriate to limit the types of insurance that include greater risks, such as, besides life insurance and automobile liability insurance (Auxiliary Fund), professional indemnity insurance, e.g. medical liability.

For the establishment of a single mechanism insurance guarantee there should be a balance all the interests involved, the justice for all policyholders and effectiveness of all risk management bodies.

Only one situation should not be avoided, the insurance. According to Adam Smith, avoiding insurance is not a result of good calculation but a recklessness and an arrogant contempt of the risk.

[20] See European Commission, White Paper, op pp. 11-12, where it is argued that the TAC should cover both life insurance policies and insurance policies against losses