This conference is presented by the IBA Insolvency Section

29th Annual IBA Global Insolvency and Restructuring Conference

2–4 June 2024, Kunsthaus, Zurich

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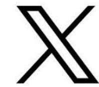

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Preventing insolvency in the financial sector: insurance companies

Brigitte Umbach-Spahn
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Alvarez & Marsal

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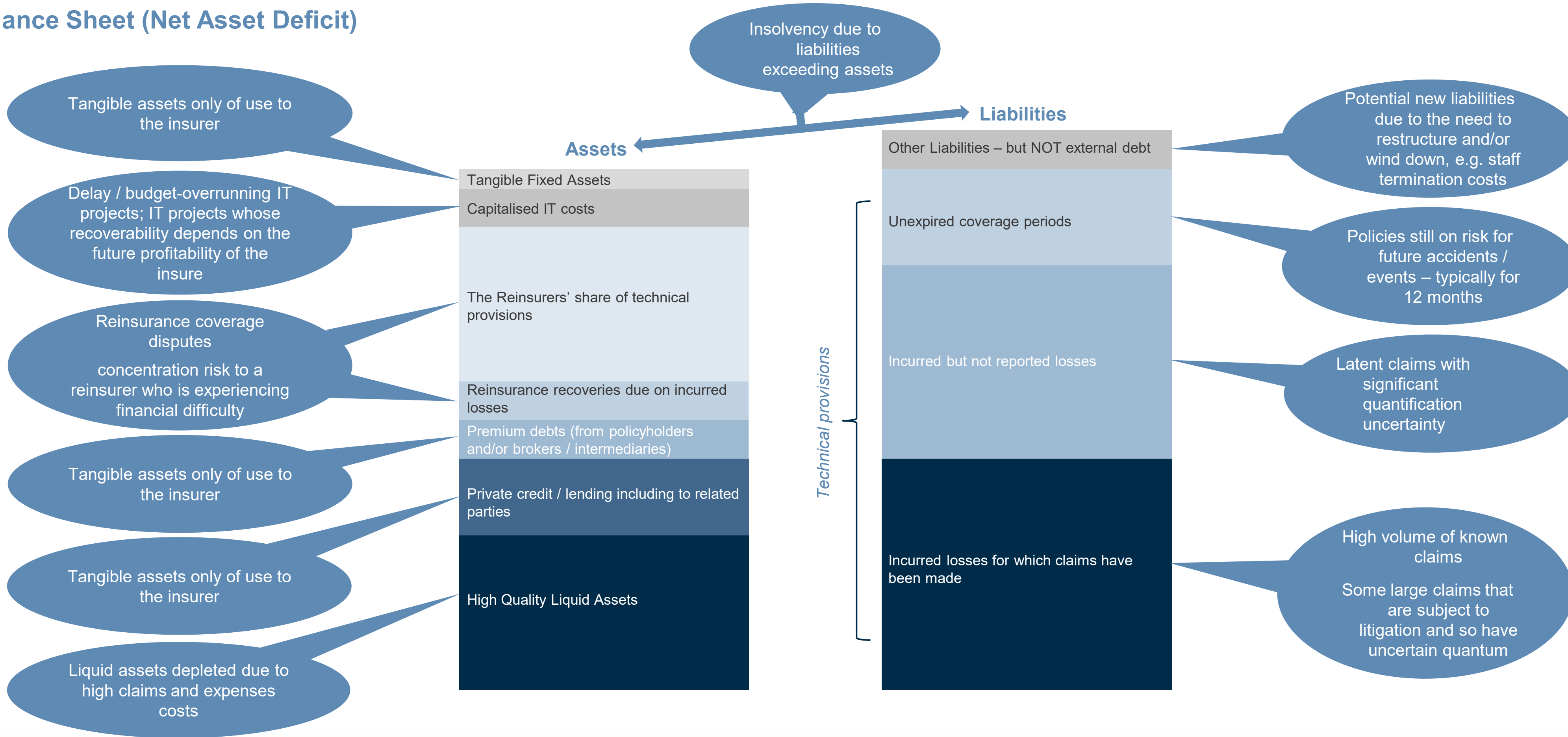
Insurance Insolvency Case Study

Simplified balance sheet and typical problems leading to an insolvency – non-life insurance company

Balance Sheet (Net Asset Deficit)



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Insurance Insolvency Case Study

How insurance companies are unique or unusual

Regulation & Supervision

- Regulation – In almost all jurisdictions, insurance companies are required to adhere to minimum regulatory standards both as to their financial strength (solvency, asset-liabilities matching, range of permitted activities etc.) and their conduct (fair / appropriate treatment of policyholders).
- Supervision – insurance companies are closely supervised both in respect of their adherence to the regulatory standard and as to any risks to policyholder and/or to financial stability. This is usually done by a public-sector body.

Solvency

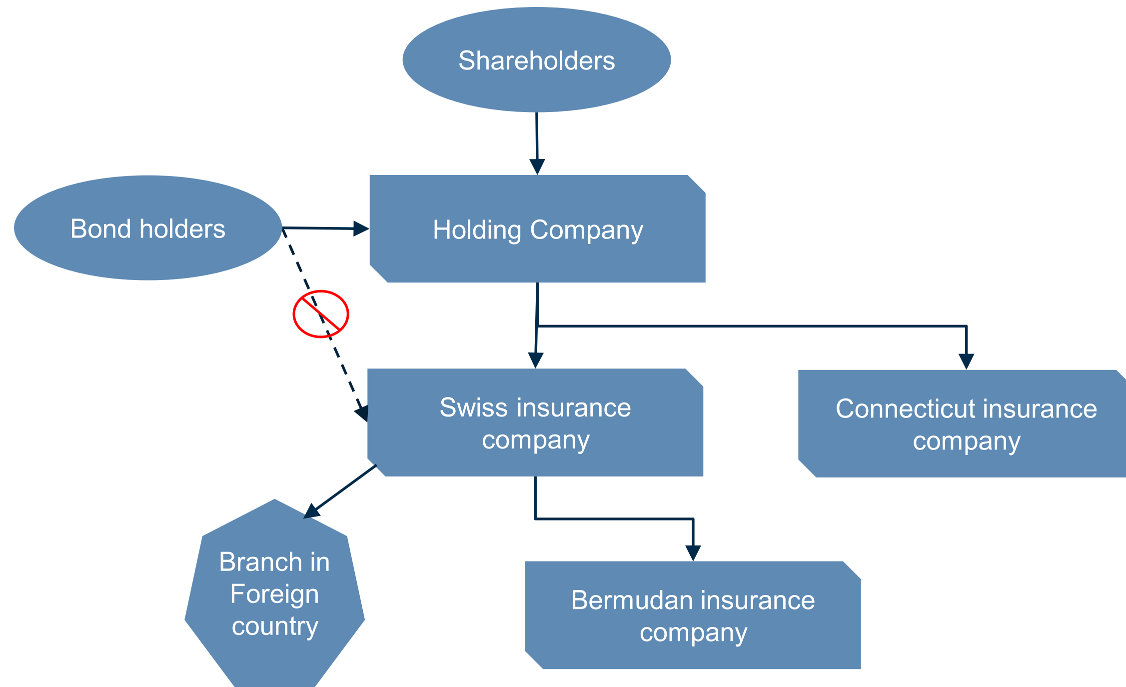
- Balance sheet – the main insolvency risk to a (non-life) insurance company is that claims significantly exceed expectations, e.g., as to claims numbers and/or the cost-per-claim.
- Technical provisions – insurance companies are required to quantified the expected claims – including for future claims (from existing insurance contracts). This quantum may be highly uncertain, including:
  - Following a major event that significantly increases claims volumes, e.g., natural (weather, seismological, or pandemic) or hostile (terrorism, war) or accidental (major industrial or transport accident).
  - Where there is a high latency, i.e., time gap between the insured accident / event and the policyholder making a claim. Historically, industrial diseases such as asbestosis are examples.
  - Where the quantum of large claims is subject to litigation.
- Asset-liability matching – a non-life insurance company typically – but not always – invests mostly in marketable investment-grade debt with good liquidity, low price-volatility (except when interest rates move) and matched duration, i.e., duration no longer than that of the liabilities (technical provisions) that it matches. Exceptions are often a contributing reasons for an insolvency.
- Reinsurance – a non-life insurance company typically purchases reinsurance. This reimburses it (at least in part) for claims paid and is often an important mitigant to the risk of high claims volumes / costs. Non-payment by a reinsurers (due either to it disputing liability or itself becoming insolvent) may put the insurance company at risk of insolvency.
- Liquidity – even in insolvency an insurance company typically has a significant stock of high-quality liquid assets.

Narrow focus

- Only insurance – many jurisdictions the non-insurance activities that an insurance company is permitted to conduct, e.g., to activities that directly arise from insurance and/or are closely related to it. This restriction applies to the insurance company but not to its subsidiaries or parent. It helps reduce – but does not fully eliminate – the risk of large / unexpected non-insurance liabilities occurring.
- No debt issuance – as a result insurance companies typically do not borrow money to invest.

Insurance Insolvency Case Study

Group and cross-border issues



Group v solo

Solo entity – an insurance company is typically wound up as a legal entity with its assets applied to its liabilities. The holding company does not have direct access to the assets of its subsidiary insurance company.

Policyholder preference – in some jurisdictions, claims from policyholders rank above other (unsecured) creditors, including above intra-group debt.

Non-policyholder liabilities – an insurance company typically does not issue bond securities, although it may issue hybrid debt in a form that counts for regulatory purposes as (tier 2) capital.

Cross-border

Location of policyholders – policyholders and/or risks insured may be located abroad resulting in the settlement of claims being subject to foreign law and regulation.

Foreign branches – in the example opposite, the foreign branch – although the same legal entity as the Swiss insurance company – might (or might not) be subject to local regulation with separate identifiable assets and liabilities. If it is, then it typically be would up separately in a local insolvency process.

Subsidiaries

Subsidiaries – in the example opposite, the Swiss insurance company would not have direct access to the assets of its Bermudan subsidiary.

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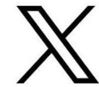

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