Policyholder protection schemes in situations of insolvency. Comparative study between states and jurisdictions. New perspectives.

Far from the existence of a universal solution, the countries with policyholder protection schemes in situations of insurer insolvency –and not all countries have them, not even in the European context– address this issue with a heterogeneous range of solutions. This article describes the principal characteristics of these solutions and classifies them according to their public or private nature, whether membership is compulsory or voluntary, their scope within the financial sector and the extension of their cover, as well as in terms of their funding mechanisms and whether they play a role in the winding-up of insurers or not.

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1. Policyholder protection in winding-up processes. Special privilege

Policyholder protection in Spain in winding-up processes, whether entrusted to the *Consorcio de Compensación de Seguros* (CCS) or not, is addressed by a specific legal provision: the current article 179 of Act 20/2015, of 14 July, *on the Regulation, Supervision and Solvency of Insurance and Reinsurance Companies* (hereinafter, LOSSEAR). This article replaces article 59 of the revoked Royal Legislative Decree 6/2004, of 29 October, approving the *revised text of the Private Insurance Regulation and Supervision Act* (hereinafter, TRLOSSP) which, in the context of the more extensive scope of *protection of the insured*, regulated the *priority of credits*.

Following the identification of the policyholder credits in paragraph 1 of the aforementioned article 179[1] and the recognition of their nature as credits with special privilege in the context of winding-up procedures, these are related below to a number of the mechanisms created by Legislators for guaranteeing and duly protecting them. Consequently, in the event of the winding-up of an insurance company, policyholders enjoy a special privilege with respect to the assets and rights allocated to the coverage of technical provisions and to the mandatory capital requirements, as well

(1) Legislators have introduced a broad concept of the policyholder in winding-up processes, which extends to the policyholders, insureds and beneficiaries of policies, as well as to injured third parties of civil liability insurance, including credits derived from the provision of repair services or replacement of the damaged property and the assistance or the provision in kind under the cover of the policy. The protection also extends to transactions carried out without administrative authorisation, contrary to special control measures or to the prohibition of entering into contracts and, also, to the claims paid by the CCS as the Guarantee Fund of the compulsory third-party automobile insurance of companies in bankruptcy or in the process of being wound-up by the CCS itself.

as those subject to the special control measure of the prohibition of disposition of assets applied by the Supervisory Authority, even when this measure has not been formally recorded in an official registry[2].

2. The purchase of credits charged against the resources allocated to the winding-up activity of the Consorcio de Compensación de Seguros: Spanish policyholder protection scheme for insolvent insurance companies

For the special scheme of the winding-up processes entrusted to the CCS, policyholder protection is reinforced, as a power available to the CCS, through the *purchase of credits charged against the resources allocated to its winding-up activity*, for the purpose of improving and achieving quicker satisfaction of the rights of these creditors, provided for in article 186 of the LOSSEAR. The revoked TRLOSSP, article 33, regulated this protection mechanism under the heading of *winding-up proceeds*[3].

(3) In the context of policyholder protection schemes, in the framework of prudential supervision and in the sphere of the protection schemes tied to scenarios of the winding-up of insolvent insurers, in my opinion, the outline provided by the International Association of Insurance Supervisors, IAIS, in the *Issue Paper on Policyholder Protection Schemes* (October 2013), is very helpful and is shown below. The policyholder protection scheme in Spain acts in both spheres, as indicated.

Policyholder Protection Mechanisms

Within the supervisory framework		
Tied Assets (claims payment, bridge institution function)	**Preferred Claims** (claims payment function)	**Others** (e.g. segregated funds, collateral - function depending on instrument)

Outside the supervisory framework	
Policyholder Protection Schemes (PPS) (claims payment + bridge institution + sometimes financial support function)	
General PPSs covering: life, non-life, health insurance (the subject of this paper) Ex ante / ex post funding Different levels of coverage (limits)	**Third party liability insurance** (specific schemes for compulsory insurance (e.g. motor) or with a social element (e.g. workers' compensation))

(2) This special protection of policyholders in winding-up processes, through which they are granted a special privilege with respect to the assets of the failed company, exists in Germany and Italy in terms similar to those of Spain. In other countries, such as Canada, Estonia, France, Norway and the United Kingdom, policyholders lack a special privilege but do have a general privilege over the rest of creditors in relation to the assets not specifically allocated which, by applying bankruptcy legislation, is in effect recognised for certain labour-related and tax-related credits, among others.

The purchase of credits charged against the resources allocated to the winding-up activity of the CCS constitutes in Spain what the Organisation for Economic Cooperation and Development (OECD)[4] refers to as a Policyholder Protection Scheme (PPS) or, in the terms of the European Insurance and Occupational Pensions Authority (EIOPA), an Insurance Guarantee Scheme (IGS). That is, these are policyholder protection schemes for cases of insurer insolvency, even when this mechanism, in Spain, is also available to the *Consorcio* for winding-up processes in situations of solvency.

3. Comparative analysis of protection schemes. Differentiating elements and principal exponents

Nevertheless, within and outside of the OECD countries, the policyholder protection schemes (referred to hereinafter generically as PPSs and IGSs), where they exist, adopt a variety of formulas, with different scopes, coverage, sources of financing and lines of protection. These schemes, depending on the Jurisdictions, may or may not play a differentiated role in the stages of recovery and resolution of the companies. Thus, on some occasions, they participate in these processes directly while, on others, they are mechanisms external to the resolution.

The comparison between States and Jurisdictions of the policyholder protection schemes in situations of insolvency calls for an examination of aspects associated with their governance and organisation, such as:

- the voluntary or mandatory accession to the schemes by their members;
- the system of coverage and contribution to the scheme under the country of origin or host country principle;
- the scope of the protection in view of the place where the risk or the commitment is located or where the policy is formalised;
- the contribution to the mechanism at a fixed rate or depending on the risk exposed;
- the kinds of insurance or products covered and excluded;
- the existence or not of special treatment for compulsory insurance;
- the nature of the creditors covered;
- the possible exclusions;
- the protection for continuity of coverage, for compensation of losses, or both;
- the existence of risk ranges or deductibles accepted by the creditor;
- the mechanisms of handling claims and of settling controversies;
- the level of collaboration between the schemes and the supervisory authorities, with or without an exchange of information and early warning systems;
- the circumstances in which the scheme has powers of intervention;
- the system of communication of the scheme with its members as well as of advertising; and
- the relations and priorities of the scheme in the winding-up procedure and the mechanisms of partial or full recovery of the disposition of funds, with special preference or guarantee or in the absence thereof.

In 2013, the OECD published a document based on data obtained in 2007 entitled *Policyholder Protection Schemes: Selected Considerations*[5], which constitutes a reference in the identification of the elements to be considered for classifying each of the modalities of mechanisms for the protection of policyholders in situations of insurer insolvency.

(4) Or by the International Association of Insurance Supervisors (IAIS)

(5) OECD (2013), *Policyholder Protection Schemes: Selected Considerations*, OECD Working Paper on Finance, Insurance and Private Pensions, no. 31, OECD Publishing, Paris.

3.1. To have or not to have

Not all States or all Jurisdictions have policyholder protection schemes for cases of the insolvency of insurance companies. The existence or nonexistence of these mechanisms, independently of the scope and kind of protection granted, is, in itself, a differentiating element between States and Jurisdictions.

The International Forum of Insurance Guarantee Schemes (IFIGS), of which the CCS has been a full member since its creation in 2013, promoted a worldwide survey on this issue (Worldwide Survey on Insurance Guarantee Schemes). The survey targeted over one hundred countries under the premise of not belonging to the IFIGS but of being included, nevertheless, in the IAIS world directory. Sixty-four jurisdictions responded, and the principal conclusion was that there were only a handful of insurance guarantee schemes (IGSs) in the world, but that many governments had on their agendas the intention of establishing or developing policyholder protection schemes (PPSs) in their States.

Among those who moved from not having policyholder protection mechanisms for situations of insurance company insolvency, according to the document prepared by the OECD in 2013 based on data collected in 2007, to being in a position to join the IFIGS as full members on having operational PPSs, was China. Its mechanism, founded in 2008, relies on the China Insurance Security Fund Co., Ltd. This is a guarantee fund for property insurance policies (64.69% of the total) and for life (the rest), under public ownership, with a start-up capital of 100 million yuan and which, by the end of 2016, had accumulated a total fund of 94.2 billion yuan (13.7 billion USD).

In the framework of the European Union, not all Member States have IGSs. Among those who do have protection mechanisms, many do so for the compulsory third-party liability automobile insurance in formulas similar to the Compulsory Third-Party Automobile Insurance Guarantee Fund in Spain. In this context, Portugal has its *Fundo de Garantia Automóvel*, for the compulsory third-party automobile insurance, and its occupational accident *Fundo de Acidentes de Trabalho*, with no general protection schemes for cases of insurance company insolvency.

To fuel the document surveying States on possible European harmonisation in terms of the recovery and resolution of insurance entities, during the first half of fiscal year 2016, a questionnaire[6] was sent to the National Supervisory Authorities of the European Union and of the European Economic Area, receiving a reply from around thirty of those surveyed.

In regard to policyholder protection schemes for cases of insurance company insolvency, the results not only revealed the great diversity existing among PPSs in terms of funding, membership and coverage, but also the fact that seven of the thirty States did not have a protection scheme at all. In addition, only eighteen of the existing twenty-three schemes consisted of formulas that compensate policyholders for the losses caused by the winding-up processes of such entities.

The States lacking protection mechanisms included Luxembourg and Holland. Neither the *Fonds de garantie des dépôts Luxembourg*, nor the Dutch Deposit Guarantee Scheme cover insurance products, as these are guarantee formulas for bank deposits.

3.2. Public or private

The public or private nature of the policyholder protection mechanisms and their submission to –or their management by– the Supervisory Authority of the State or another public or private entity, differentiates the existing protection schemes.

(6) *"Discussion Paper on Potential Harmonisation of Recovery and Resolution Frameworks for Insurers", EIOPA-CP-16/009, 2 December 2016.*

As stipulated in the Articles of Association of the CCS –article 1–, the Consorcio is incorporated as a public business entity, attached to the Ministry of Economy, Industry and Competitiveness, whose private functions, in the insurance sphere, include –article 14– that of acting in the capacity of the administrative liquidator or receiver of Spanish insurance and reinsurance entities, provided that it has been entrusted with this task by the competent body. And it is in the framework of the winding-up process and, therefore, within a resolution process involving the winding-up of the insurer, where the policyholder guarantee mechanism for situations of insolvency can be activated. Specifically, it involves the *purchase of credits charged against the resources of the Consorcio tied to its winding-up activity* by using the proceeds from the winding-up procedures, and this is what constitutes the Spanish PPS.

The Chinese guarantee fund is also a public scheme, the China Insurance Security Fund Co., Ltd., as is also the case in Portugal, with the limitations mentioned previously, that is, the *Fundo de Garantia Automóvel* and the *Fundo de Acidentes de Trabalho*. Both are public autonomous funds: the first, managed by the *Autoridade de Supervisão de Seguros e Fundos de Pensões* and, the second, which has its own legal personality and administrative and financial autonomy, is managed technically and financially by the Supervisory Authority.

In Ireland, the Insurance Compensation Fund was created in 1964. Publicly owned and managed, the Fund lacks personnel seconded to it. It is managed and administered under the control of the Chief Justice of the Supreme Court, through its Accountant, with the Irish Central Bank being responsible for the annual valuation of the fund, as well as the determination of the yearly contribution of the insurance entities belonging to it.

Australia's Financial Claims Scheme (FCS) is also a public scheme. It is dependent on the Government whose administration, once the scheme is activated, is the responsibility of the Australian Prudential Regulation Authority (APRA), the prudential regulator of the Australian financial services industry.

In the United Kingdom, the Financial Services Compensation Scheme (FSCS) is the compensation fund of last resort for the clients of authorised financial services companies. The Scheme is an institution independent of the government and of the financial sector, without cost for consumers, created under the Financial Services and Markets Act[7] and active since 1 December 2001.

The PPSs for life and non-life insurance in France have a private legal personality. The *Fonds de Garantie des Assurances de Personnes* was created by law on 25 July 1999, to protect policyholders against the risk of insolvency of insurance companies in France in the life insurance branches. It is a legal entity under private law, subject to supervision, whose members are the authorised life insurance companies for which membership is mandatory. *The Fonds de Garantie* was incorporated in 1951 as a guarantee fund for the automobile insurance branch, including coverage in the event of insolvency. In 1966, its coverage was extended to hunter civil liability and, in 2003, to the compulsory construction insurance and to professional civil liability, among others. The Fund is a private initiative, subject to the control of the Ministry of Economy and is managed by a General Committee of 18 members representing the insurance companies of the lines covered and the Government Commissioner appointed by the Fund.

In Germany, section 124 (1) of the Insurance Supervision Act regulates the life insurance guarantee fund for policyholder protection in branches 19 to 23, as well as the health insurance guarantee fund, excluding the covers of hospitalisation, long-term healthcare and travel medical insurance. In both cases, the entities designated for providing the two policyholder protection schemes, *Protektor Lebensversicherungs-AG*, for the life insurance business, and *Medicator AG*, for health, are private legal entities.

(7) *Financial Services and Markets Act, 2000.*

Particularly unique, at least up to 2015, was the Austrian scheme, whose resolution mechanism was described by the OECD as having a *sui generis focus*[8]. Regulated at the present time in article 249 of the Insurance Supervision Act of 2016, the legal system put into place is now the protection scheme. It consists of the identification and declaration of the assets allocated to the *Deckungsstock* (the guarantee of the insureds in the event of winding-up), which are presented to the Austrian Financial Market Authority (FMA) in the first six weeks following the end of the fiscal year. The use and reinvestment of the assets of the *Deckungsstock* is legally regulated and controlled[9].

3.3. Compulsory or voluntary membership

Membership in the policyholder protection schemes, either by a legal requirement or voluntary, marks the difference between the Jurisdictions with IGSs.

The OECD stated in 2013 that in the majority of the Member States of that Organisation, participation in the PPSs by insurance companies, whose business is protected by the scheme, is compulsory.

Nevertheless, there are voluntary schemes, such as the Canadian scheme for life and health insurance. ASSURIS is the PPS for these branches. Membership in the association is voluntary for the life insurance companies, with the dual component of an institution of rehabilitation and of guarantee. PACICC, on the other hand, has been set up as a protection plan for general insurance[10]. Membership in PACICC by the authorised insurance companies in the branches protected constitutes a necessary requirement for being able to operate, unless the coverage is obtained through another approved plan.

An example of compulsory scheme membership can be found in the United States, in the Guarantee Fund formula for each State, associated through two supra-State organisations: specifically for life and health, the National Association of Life and Health Guaranty Associations (NOLHGA) and, for general insurance, the National Conference of Insurance Guaranty Funds (NCIGF). NOLHGA groups together the associations established in the 50 States, Puerto Rico and the District of Columbia, set up for policyholder protection in cases of insolvency. With limited exceptions, all of the insurance companies authorised in life and health in a State must be members of the association of that State. For the general insurance guarantee funds, NCIGF is a not-for-profit association created in 1989, which groups together the guarantee funds of the 50 States of North America and of the District of Columbia. Membership in the funds by the industry is compulsory, as it is a requirement for access to the insurance business.

Membership in *Protektor Lebensversicherungs-AG* is mandatory for all companies and branches operating in life insurance in the Federal Republic of Germany, with the sole exception of the branch offices of companies authorised in another Member State of the European Union or of the European Economic Area, as well as of the compensation pension funds. A private initiative, the scheme was founded in 2002 as a recovery pool entity, whose shareholders are the life insurance companies, and is subject to the legal and financial supervision of the German Insurance Association,

(8) Nevertheless, the Deposit Guarantee and Investment Compensation Mechanisms Act (2015) has provided the regulatory framework for the establishment of protection schemes for financial transactions, including insurance. The Act establishes the required and regulatory scheme of the protection institutions set up for this purpose, including among the deposits and investments to be guaranteed, the insurance transactions (article 10) conducted by the companies referred to in article 13 of the Directive 2009/138EC, paragraphs 1 to 6 (insurance undertakings, direct life or non-life; captive insurance undertakings; third-country insurance undertakings; reinsurance undertakings; captive reinsurance undertakings; and third-country reinsurance undertakings), those of collective insurance and pension and retirement funds.

(9) Article 179.3 of the LOSSEAR incorporates the philosophy of the *Deckungsstock* into the Spanish legal system, whereby, for the purposes of winding-up, the companies must keep an updated special register of the assets representing the technical provisions calculated and invested in accordance with the relevant legislation. In the regulations pursuant to the Law, this special register is integrated (article 96 ROSSEAR) into the investments register which, in addition to identifying the data to be captured per investment allocated, regulates the regime for its maintenance, modification and updating.

(10) PACCIC, in Canada, is the PPS for general insurance in the branches of accident and health, automobile, machinery and boilers, credit, liability and home insurance.

to which the portfolio of policies from failed companies was transferred for the purpose of rehabilitating them, of managing their insurance operations and of transferring them afterwards, completely or partially, to another company[11].

The element of membership in the scheme, in the case of the Spanish PPS, calls for special consideration. Since the *Consorcio* is a public business entity, the resources tied to the winding-up activity lack the consideration either of capital or of a social fund and, therefore, there is no scope for referring to members attached or belonging to the scheme.

Nevertheless, the entire Spanish insurance market benefits from this guarantee scheme and, pursuant to article 23.4 of the *Consorcio's* Articles of Association, contributes to its support in the form of a specific surcharge on all of the policies taken out on risks located in Spain, other than the life insurance and export credit insurance issued by or with the support of the State. With the nature of a tax applied to insurance transactions, the surcharge is paid by the insurance companies, as taxpayers, although the companies pass these amounts on to the policyholders, as legally required.

3.4. Scope of the schemes in the financial sector

In the group of States and Jurisdictions with protection schemes for the policyholders of insolvent companies, a distinction can also be made between those with specific mechanisms for the insurance market and those which have global formulas in place for the protection of the clients of financial products.

The *purchase of credits with winding-up proceeds* of the Spanish system is a special scheme specific to the insurance sector, regardless of the branch or line of insurance concerned. Supplementary social benefit schemes in the form of pension plans and funds are excluded, while the Deposit Guarantee Fund of Credit Institutions exists for the banking sector[12].

As a general rule, States have specific formulas for the insurance sector. This is what occurs with *Protektor Lebensversicherungs-AG*, for the German life insurance business, and with *Medicator AG*, for health; with ASSURIS, for the Canadian life branch and PACCIC, in certain categories of non-life insurance, and with the associated guarantee funds in NOLHGA and in NCIGF in the United States. All of these are circumscribed, including by business line, to the insurance sector and, therefore, respond to a principle of speciality in attention to the market.

In the context of the global coverage of financial clients, the FSCS in the United Kingdom, covers the commercial activities carried out by companies authorised by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) and is able to provide cover to companies authorised in another Member State but with commercial operations in the country. The scheme protects the deposits, insurance policies, insurance brokerage, investment transactions and household financing transactions.

In the same way, the Australian Financial Claims Scheme (FCS) extends to the global financial sector and protects the depositors of banks, building societies and credit unions, as well as the policyholders of general insurance companies.

(11) In 2006, the guarantee fund function, created by Law in 2004, was added to the recovery component, and it is this responsibility, received earlier from *Manheimer Lebensversicherung AG*, which will continue starting in 2017, when the transfer process of the portfolio it manages for recovery finalises.

(12) The Deposit Guarantee Fund of Credit Institutions was created by Royal Decree-Law 16/2011, of 14 October. It has a legal personality of its own and full capacity for the performance of its activity under private law. The purpose of the Fund is to guarantee the deposits in cash and in securities or other financial instruments made in credit institutions, up to the limit of 100,000 euro for deposits in cash or, in the case of deposits denominated in another currency, their equivalent at the relevant exchange rates, and 100,000 euro for securities or other financial instruments, these two guarantees being separate and compatible.

3.5. Extension of the cover provided to policyholders

The extension of the coverage provided to policyholders, in terms of protected business lines, or of compulsory membership in the PPS, or of the scope of the protection given, also constitutes a differentiating element between the IGSs.

The mechanism of the purchase of credits by the CCS with the proceeds from the winding-up process, constituting the Spanish PPS, can be described as of *maximum scope* in terms of its extension. Available, even for the winding-up processes in situations of solvency entrusted to the Consorcio[13], its cover extends to all of the branches and business lines[14], including life transactions, insured pension plans and the export credit insurance issued by or with the support of the State, regardless of the nature and public or private legal personality of the policyholder. And this extends even to credits of a different nature, according to the scheme described in article 186 of the LOSSEAR.

Thus, beyond the protection given to insureds, policyholders, beneficiaries and injured third parties, its guarantee extends also to the credits of workers derived from salaries and severance pay and to the rest of creditors, as provision has been made for the possibility of the purchase by the *Consorcio* –charged to its resources and taking over the position of the creditors by subrogation, and at real value– of all kinds of credits against the entities involved in the winding-up procedures. Including, indirectly, a special scheme that has been designed for the expenses necessary for the winding-up process in cases of insolvency –article 188.9 of the LOSSEAR–, which are advanced by the *Consorcio*, while their recovery is conditioned to the payment in full of the rest of the creditors and, consequently, such expenses lose the status of credits against the estate.

The offer to policyholders of the acquisition of their credits by assignment, for the purpose of improving and facilitating a speedy settlement of their claims, is made at the amount to which they would be entitled in proportion to the foreseeable assets remaining after the conclusion of the winding-up process. Nevertheless, this offer is made by

(13) The activation of the mechanism of the purchase of credits with winding-up proceeds by the *Consorcio*, established for winding-up procedures in cases of insolvency, can be extended to winding-up in situations of solvency for reasons of lack of liquidity of a company or other circumstances rendering such action advisable, as provided for in article 249, paragraph 2, of Royal Decree 1060/2015, of 20 November, on the Regulation, Supervision and Solvency of Insurance and Reinsurance Companies, hereinafter, ROSSEAR.

(14) Through the application of letter b) of article 179.7 of the LOSSEAR, even the insurance policy credits derived from transactions without an administrative authorisation or failing to comply with the measures of special control suspending the contracting of new insurance policies or acceptance of reinsurance and prohibition of the renewal of existing insurance policies are covered by the Spanish PPS.

applying *modified* asset valuation standards and priority of credits which, although they do not guarantee a percentage of recovery or a minimum amount (or a maximum), in practice they do enable the payment, in average percentages, of one hundred percent of their value.

In the United Kingdom, as a fund of last resort, there are limits with respect to the powers of the FSCS and to the amounts which this scheme can pay, in addition to differences in relation to the date of the declaration of the insolvency of the insurers.

Therefore, the exact level of the compensation to be received depends on the basis of the claim, since the FSCS only pays compensation for financial losses. Apart from the limits in bank or investment products, as a general rule the credits are protected to the extent of 90 % of the claim, without a ceiling, although the credits in compulsory insurance are protected in their entirety[15].

The British scheme is particularly interesting and innovative in the insurance market due to the protection it offers with respect to the activity of the insurance intermediaries. In this regard, claims can be filed against the scheme if the company underwriting the policy rejects the claims of coverage on account of the fraudulent action of the intermediary or the intermediary's inappropriate commercial practices, among other circumstances.

In the United States, for life and health, in the scope of NOLHGA, although the state laws set the maximum limits of coverage and the kinds of policies covered, the majority of the member funds are consistent with the Model National Association of Insurance Commissioners Act. In this way, they provide cover of at least 300,000 USD in life insurance death benefits; 100,000 USD in cash surrender or withdrawal values for life insurance; 250,000 USD in present value of annuity benefits; 500,000 USD in medical or hospital expenses; 300,000 USD in long-term care cover; 300,000 USD for disability and 100,000 USD for other health benefits. In addition, in most states the level of aggregate cover per individual is 300,000 USD (except for the medical expenses coverage), applied separately per each insolvent insurer.

In Poland, the scope of the coverage provided by the *Ubezpieczeniowy Funduz Gwarancyjny* (UFG) differs with respect to insurance company insolvencies depending on the covers affected. Coverage is as much as one hundred percent for injured third parties under automobile insurance, crop insurance and compulsory construction insurance, and provides indemnification of up to 50 % with a ceiling of 30,000 € for injured third parties of other policies and life insurance policies.

In Germany, the guarantee funds (*Protektor Lebensversicherungs-AG* for the German life insurance business and *Medicator AG* for health) are recovery entities (section 125) which maintain all of the policies and restructure the portfolio, with the possibility of transferring the portfolio to another German insurer, with the necessary approval of the *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin), which oversees the interests of the insureds.

ASSURIS, in Canada, for life and health, guarantees the credits transferred to the extent of at least 85 % of their value, and 100 % when these do not exceed 200,000 USD in death benefits; 60,000 USD in medical care; 2,000 USD in monthly income; 60,000 USD in cash values and 100,000 USD in accumulated values. PACCIC, as a protection plan for general insurance, restricts its coverage in terms of losses in auto and commercial insurance to 250,000 USD; in home insurance, to 300,000 USD per policy and, with respect to the premiums not consumed, to seventy percent, with a ceiling of 700 USD per policy.

(15) The limits of the British scheme of last resort, in the insurance sector, depend on the date of declaration of insolvency of the company (there are four periods) and, in turn, on the nature of the claim. In the case of entities declared insolvent from 3 July 2015 onwards, the protection extends to one hundred percent in the claims in respect of compulsory third-party automobile insurance, professional civil liability, and death and disability benefits derived from accidents, illness and illness associated with senescence, and to ninety percent in the claims derived from other kinds of policies without a ceiling. However, the scheme does not grant protection to goods in transit, marine insurance, aviation, credit insurance or to reinsurance policies.

In Ireland, when the coverage of the Insurance Compensation Fund is activated for non-life insurance companies in winding-up procedures, the total amount which the fund can pay with respect to an individual cannot exceed the lesser amount between 65 % of the credit or 825,000 €. For situations where, pursuant to the 1983 Insurance Act, a receiver is appointed, in view of each case, the Supreme Court may authorise the fund to pay for the expenses of the receivership.

3.6. Funding of the schemes

The sources of funding of the PPSs are considered to be another essential element in their configuration and, as noted in the OECD study, *can affect the moral hazard of the insurers*.

In the framework of the European Union and of the European Economic Area, the figures published through the *"Discussion Paper on Potential Harmonisation of Recovery and Resolution Frameworks for Insurers, EIOPA-CP-16/009, 2 December 2016"*, show that, of the twenty-three States with PPSs, thirteen describe the source of funding of their schemes as *ex ante*; four, as *ex post*, and the rest are classified as mixed formulas or others. The predominance of the systems of funding prior to the disposition of the funds or, mixed, is the general rule, not only in Europe but worldwide[16].

In terms of the assets regime of the *Consorcio*, pursuant to article 23 of its Articles of Association, its winding-up activity is funded, in practice, through the surcharge on premiums earmarked for this purpose, the proceeds and revenues from the assets accumulated and attached to the activity and, in accordance with current legislation, the amounts recovered in the exercise of the rights pertaining to the *Consorcio* in the subrogation of the credits acquired and the winding-up expenses advanced in the implementation of the Winding-Up Plan, according to article 186 of the LOSSEAR.

At 31 December 2016, the fund accumulated for the winding-up activity totalled 1.96 billion euro (2.07 billion USD). The surcharge created for funding the winding-up activity, as an *ex ante* source of funding[17], is –article 23.4 of the Articles of Association– a tax which accrues at the time of payment of the insurance premium, whereby the amount of the premium forms the tax base without including any other surcharges applicable to the insurance policy affected, with a fixed rate of 1.5 per thousand. The funding derived from the recovery through subrogation of the amounts advanced by the *Consorcio* for the purchase of credits and the taking over of the winding-up expenses constitute *ex post* sources of funding.

(16) In the context of the sources of financing, there are also other differentiating elements between the schemes. Some determine the contribution to the scheme based on the provisions or reserves protected for each member insurance company, thereby adopting a focus aligned with the risk that each member contributes to the scheme. This is what occurs in France and Germany for the life insurance funds. Other schemes, including the Spanish scheme, determine the participation of each contributor in relation to the gross or net premiums, making the PPS a participant in the annual turnover of the insurance market. This is also the case with systems such as the Italian or Polish schemes. There are even cases where participation in the fund is determined on the basis of the number of policies, such as in Denmark, for the non-life schemes.

Some systems establish a minimum annual contribution to the scheme. In France, the FGAP requires a minimum annual contribution per company of 15,000 €, except for newly created entities that have been in the market for less than three months.

In the configuration of the financing of the schemes, there are systems which establish a required minimum fund or capital. This is the case with ASSURIS in Canada and *Protektor* in Germany. There are also schemes that can have recourse to private credit or the issue of debt, with restrictions and for situations of asset imbalance or special circumstances. In fact, the Spanish system makes provision for this in article 23.1 e) of the *Consorcio's* Articles of Association. And *Protektor* in Germany also has a similar provision in place, if it were to become necessary to rehabilitate the life insurance portfolio of a company with difficulties. Although rarely explicitly stated in the schemes, formulas of public funding can even be found through direct government contributions, or interest-free loans, or at below-market interest rates, or by guaranteeing the long-term feasibility of the scheme.

The recovery of the funds of the scheme tends to be included as a secondary regime of their financing, either in the realisation of assets during the winding-up process of the company, or through the exercise of legal action against those responsible for causing the insolvency, or by demanding accountability for any damage caused.

And the schemes are likewise financed through the proceeds and revenues from the investment of the funds accumulated. Many schemes outsource the management of their investment portfolios and, in general, these are materialised as low-risk assets with high liquidity and a moderate return ratio.

(17) The assets allocated to the winding-up activity originating from the proceeds and revenues obtained from the funds accumulated in relation to that activity constitute another *ex ante* source of financing. For the 2016 financial year, the revenues from surcharges on premiums totalled 51.6 million euro and the revenues derived from the investments pertaining to the winding-up activity amounted to 35.6 million euro.

Protektor Lebensversicherungs-AG, in Germany, for life insurance policies, is funded by an ex ante system consisting of the collection of annual quotas from its members. In the majority of cases, these are 0.2 per thousand of the net technical provisions of the German life insurance companies up to 1 per thousand. The funding system for the other German protection scheme, *Medicator AG,* in the scope of health insurance, operates *ex post* in the form of a percentage on the net reserves.

ASSURIS, in Canada, has a mixed funding system. By Law it must maintain a liquid fund *ex ante* of at least 100 million USD, totalling 114 million at the present time, even though the final cost of the winding-up is collected ex post among the members. In addition, all of the members are charged an estimate of the administrative expenses that are not associated with a specific insolvency, the distribution and participation of which require the approval of its Management Committee and are performed on the basis of the size of the company.

In France, the funding of the FGAO for insolvencies in compulsory non-life covers (auto, hunter civil liability, construction, professional, among others) is provided by the insurers through an *ex ante* mechanism (one percent of the costs of the guarantee funds in respect of insolvent entities) and additional contributions. For the life insurance business, the FGAP is also funded through an *ex ante* system consisting of 0.05 percent of the mathematical provisions of the participating life insurance companies, 50 % of which is transferred to the Fund with the other 50 % remaining in the Entity's balance.

In the United Kingdom, the FSCS is funded through ex post tax collection. The charge affects the companies authorised by the Prudential Regulation Authority (PAR) and the Financial Conduct Authority (FCA). For the funding of the compensation costs, the revenues collected by the FSCS are divided into eight major categories: deposits, life and pensions, general insurance, general insurance brokerage, life insurance and pension brokerage, investment brokerage, investments and household finance (consumption)[18]. With respect to management expenses, the amount is subject to annual limits, after consulting the industry.

Ireland's Insurance Compensation Fund is included among the *ex post* funding systems on the European level. The fund is financed through the contributions received from the non-life insurance companies with respect to the business underwritten on risks in Ireland up to a limit of 2 % of the gross premiums, with exclusion of the unprotected risks. These contributions are collected through the Revenue Commissioners, appointed for this purpose through an order issued on 7 October 2011, and must be sent to the Fund through the Accountant of the Supreme Court. The Irish Central Bank performs the annual valuation of the fund, the determination of the contribution to be made by the non-life insurers and establishes, together with the Department of Finance, the interest rates and the payments of the credits advanced by the Public Treasury to the Fund.

In the United States, both for the funds belonging to NOLGHA, as well as those associated with NCIGF, the sources of funding are ex post, through the subrogation of the policyholders' rights by the funds, to which a tax is added[19].

(18) The limits subject to the PAR include the life and pension provisions (690 million pounds) and the general insurance provisions (600 million pounds); and those subject to the FCA include general insurance brokerage (300 million pounds) and life and pension brokerage (100 million pounds). Any cost that exceeds these thresholds for the FCA brokerage categories can determine situation where the other categories, including life and general insurance, would make contributions of 70 and 35 million pounds, as a maximum, respectively.

(19) When an insurer is insolvent or presents a deficit in capital, the guarantee is activated. There are two sources of funding for covering the policyholders. The funds belonging to NOLGHA take over the position of the creditors by subrogation in proportion to the remaining assets of the bankrupt insurer. These assets are used for covering the claims. Moreover, there is a charge applied to the insurers in the market for sharing the amounts necessary until the guarantee not covered has been met. The share of each insurer in this charge is quantified in relation to the premiums collected.

3.7. Protection schemes and resolution processes

Schemes can also be characterised according to the role of the PPS in the resolution processes of insurers or the absence of their participation in them.

In this regard, EIOPA issued a document in 2012, *EIOPA-TFIGS-12/007 Report on the Role of Insurance Guarantee Schemes in the Winding-Up Procedures of Insolvent Insurance Undertakings in the EU/EAA*, which determined the role of the IGSs before and after the declaration of insurer insolvency. The document describes the interaction, communication and advance notices (in most cases on an informal basis) that exist prior to the declaration of insolvency between the scheme and the resolution or supervisory authority[20], as well as during the winding-up procedure.

In some jurisdictions the sole function of the schemes is that of payment or continuation of the insurance policies. This is the case with the FSCS in the United Kingdom, the Austrian scheme of assets tied to winding-up –*Deckungsstock*– and the Polish UFG, among others.

Many schemes are recovery mechanisms that address the transfer of the portfolio of a company in a winding-up process as a formula of protection for the purpose of giving continuity to the coverage. This is the case with ASSURIS in Canada for the life insurance portfolio, or *Protektor Lebensversicherungs-AG* and *Medicator AG* in Germany. In this context, *Protektor Lebensversicherungs-AG* has been guaranteeing the continuity of the policies of companies being wound up and is authorised for this purpose in the branch[21].

The participation of the policyholder protection schemes has greater relevance in resolution processes in the case of Ireland and, most especially, in the case of Spain.

In the case of the winding-up or receivership of a non-life insurer in Ireland, the Supreme Court has recourse to the Insurance Compensation Fund which can become operational only upon approval by its Chief Justice, acting through its Accountant.

The Spanish case in this sense is a prime example, to the extent that the *Consorcio* only has the policyholder protection mechanism available to it (the purchase of credits with winding-up proceeds), once the administrative winding-up of an insurance company has been entrusted to it or it has been appointed as the receiver. It is the resolution procedure itself which, through the winding-up of the entity, is what is entrusted to the *Consorcio* in the terms contained in Section 3, Chapter II of Title VII of the LOSSEAR and Section 2 of Chapter III of the Regulation.

3.8. Cross-border protection and harmonisation

The treatment accorded in the policyholder protection schemes to cases of risks underwritten by insurers operating in a Jurisdiction or a State, but domiciled in another Member State or Third Country, constitutes not only a differentiating element among the schemes, but also an argument in favour of the possible harmonisation of the IGSs in Europe.

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(20) Article 128 of the LOSSEAR regulates the exchange of confidential information between those who, in accordance with article 127, are subject to the duty of professional secrecy in the exercise of the activity of regulation and supervision, as well as the CCS in the exercise of its winding-up functions. A non-restrictive interpretation of this article makes it possible to establish the channel for complying with the EIOPA recommendation on the establishment of early alert systems by the supervision and resolution authorities to the policyholder protection schemes, prior to the declaration of insolvency, implicit in this document and in the so-called *EIOPA-TFIGS-11/007 Report on the cross-border cooperation mechanisms between Insurance Guarantee Schemes in the EU*.

(21) The scheme takes over the insurance portfolio and manages the policies up to their expiry or their transfer to another insurer. However, as from 2017, when the transfer process of the portfolio being managed at the present time for its recovery finalises, *Protektor Lebensversicherungs-AG* will have entrusted to it solely the guarantee fund function created by Law in 2004, and which it took over in 2006, succeeding *Manheimer Lebensversicherung AG*.

In June 2011, EIOPA published a document (*EIOPA-TFIGS-11/007 Report on the cross-border cooperation mechanisms between Insurance Guarantee Schemes in the EU*[22]) on the content of a future Directive on Policyholder Protection Schemes in cases of insolvency in cross-border relations. In that document it was stated that, of the seventeen States that had IGSs other than the guarantee fund for compulsory third-party automobile insurance, six operated under the country of origin principle, seven under the host country principle and four under both, host and origin.

The PPSs operating under the country of origin principle protect all of the policyholders, regardless of whether the insurance policy concerns risks located or commitments accepted in that country or in the host country, provided that the policies have been underwritten through a branch or the headquarters of the company domiciled in the country. In these cases, the PPS of the country of origin does not protect the policyholders of the host country with respect to commitments or risks accepted in it through branches or headquarters of companies whose domicile is in another State. They may possibly be protected in that other State, provided that a protection mechanism exists and operates likewise under the country of origin or a mixed principle.

The Spanish scheme operates under the country of origin principle with respect to the coverage of policyholders in the event of insolvency. The very nature of the scheme in its purchase of policyholder credits with proceeds from the winding-up procedure requires that the CCS must be previously entrusted with the winding-up of the company domiciled in Spain (article 14 of its Articles of Association and article 27.1 of the LOSSEAR).

The country of origin principle also operates in the protection schemes of France, Denmark and Germany.

In the schemes of Norway, Belgium, Estonia, Finland, Greece, Italy, Japan, Korea and Poland, the coverage of the PPSs, under the host country principle, is circumscribed to the risks located and the commitments accepted in that country.

In this context, the case of the British FSCS and of the Irish Insurance Compensation Fund, with their limitations and in the terms indicated, offer global protection, not only with respect to policies issued by companies established in their respective countries, but also with respect to the clients of companies established in other Member States.

In addition, the legislators in Spain have incorporated a number of the recommendations of the IAIS, the OECD and the Financial Stability Board (FSB)[23] on the treatment of protection and the performance of winding-up processes with a supranational or cross-border scope.

With the entry into force of the Transposition of the Solvency II Directive through the LOSSEAR, a catalogue of new competencies of the *Consorcio* was introduced for situations where the winding-up of insurance companies domiciled in another Member State of the European Union or of the European Economic Area takes place, although with the express exclusion of the exercise of winding-up functions over such entities and of the activation of the mechanism for

(22) The principal conclusions of the EIOPA Report, in the framework of a future harmonisation of the *PPSs*, with respect to cross-border transactions, were as follows:

1. The vital importance of the cooperation between the IGSs operating under the country of origin principle and those operating under the host country principle, on the one hand and, on the other, the cooperation of the IGSs with the supervisors to ensure effective policyholder protection in the event of insolvency.
2. The exchange of information as a prior requirement for effective policyholder protection. The IGSs must access information held by the supervisors, once insolvency has been declared and in the routine day-to-day activity of the company, including the incorporation of the information of other jurisdictions, when the entity has a cross-border dimension.
3. The legal certainty of confidentiality in the processing of the information received by the IGSs.
4. A sound legal infrastructure for the exchange of information provided by a framework of common understanding about the cooperation and collaboration expected between the schemes and the supervisors, both national and international.
5. The need to establish a mechanism for the settlement of controversies.

(23) The Financial Stability Fund published the *Key Attributes of Effective Resolution Regimes for Financial Institutions*, where, in the version of 15 October 2014, several chapters (6 to 9) are devoted to issues with cross-border implications.

the purchase of credits with winding-up proceeds, preventing alternative protection formulas, such as the making of payments on the basis of the policy, or advances of such payments.

Nevertheless, in the medium term, it appears that the debate on the establishment of a harmonised minimum guarantee fund which would solve, at least, the cross-border protection of policyholders in situations of insolvency, as well as the recovery and resolution regimes, will be on our agendas and, as a logical consequence, the catalogue of functions of CCS as an institution at the service of clients and the insurance industry will be expanded and improved to an even greater degree. All of which will contribute in turn to expanding and improving the policyholder protection scheme.