

Insurance Guarantee Scheme Framework & Resolution Methods

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SHORTCOMING OF PREVIOUS LAW ON FINANCIAL SAFETY NET, 2016 (UU PPKSK): “IT COVERED MAINLY FAILURE OF BANKS, NOT INSURANCE COMPANIES”

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Law number 4 on Development and Empowerment of Financial Sector, 2023, (UU P2SK) introduces Insurance Guarantee Scheme (Program Penjaminan Polis)

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Basic Framework of Insurance Guarantee Scheme

3

Resolution Methods for Insurance Guarantee Scheme

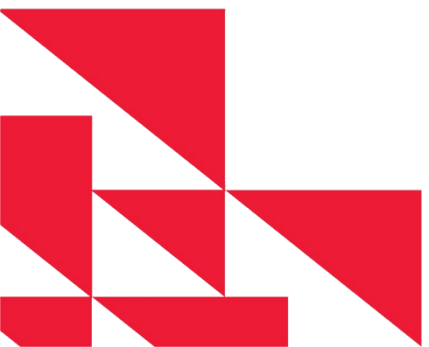
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Potential Framework & Resolution Methods For Indonesia

LAW NUMBER 4 ON DEVELOPMENT AND EMPOWERMENT OF FINANCIAL SECTOR, 2023: “THE BASICS OF INSURANCE GUARANTEE SCHEME (IGS)”

Resolution Authority	Indonesia Deposit Insurance Corporation – <i>Lembaga Penjamin Simpanan (LPS)</i>
Coverage beneficiaries	Insurance policy holders – of all insurance companies, including Sharia insurance companies
Scope of protection	<ol style="list-style-type: none"> 1. IGS only guarantees protection from certain lines of businesses 2. Social insurance and mandatory insurance are excluded 3. Insurance companies that are not qualified as IGS members must establish their own Guarantee Funds
LPS resolution authority	<ol style="list-style-type: none"> 1. Sets and collects premium contributions from insurance companies 2. Access insurance company's data base, including financial information and investigation reports 3. Sets requirements for guaranteed claim payments 4. Conducts inspection and due-diligence of insurance companies 5. Upon liquidation of insurance company, executes insurance portfolio transfers, insurance claim payments and returns of un-earned premiums or contributions 6. Transfers insurance policies without policyholder's consent
OJK: revoking license of failing insurance company	<ol style="list-style-type: none"> 1. OJK decides supervisory status (“intensive” or “special”) of a troubled insurance company and notifies LPS 2. LPS conducts due-diligence of the troubled insurance company 3. LPS and OJK decide whether the insurance company is insolvent before OJK revokes its license
LPS: Liquidating failing insurance company	<ol style="list-style-type: none"> 1. Takes over all rights and authority of shareholders 2. Conducts sales and/or transfers of assets and/or liabilities of failing insurance company to third party 3. Establishes liquidation team and liquidates failing insurance company
Pending issues	<ol style="list-style-type: none"> 1. IGS to be operational in January 2028 – five years after P2SK Law was introduced 2. Levels of insurance premium and guarantee limit to be determined by Government Regulation (PP)

BASIC FRAMEWORK



COMPARING IGS UNDER DIFFERENT SYSTEMS: “INDONESIA’S IGS TO BE COMPATIBLE WITH LPS SYSTEM”

1. IGS Coverage

Scope Coverage of IGS:

- Life Insurance
- Non-Life Insurance

IGS exclusions of product or policy:

- Aviation
- Maritime
- Credit / Guarantee products
- Reinsurance Contracts

IGS coverage ratio and limit:

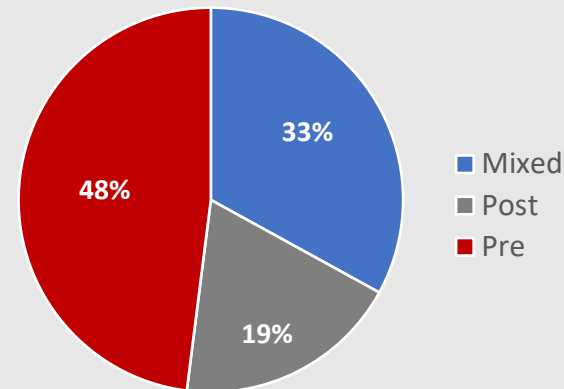
- Maximum benefits that IGS will provide to policyholders in the event of insurance company’s failure
- It will differ among different line of business or products or across countries that have implemented IGS

2. Basic Funding

Funding of IGS:

1. **Ex Ante (*Pre-Event*)**, IGS funding by collecting contributions to build up a reserve in anticipation of future liabilities
2. **Ex Post (*Post-Event*)**, IGS funding by levying contributions when required to cover the costs of failures that have occurred
3. **Mixed (*Pre and Post Event*)**

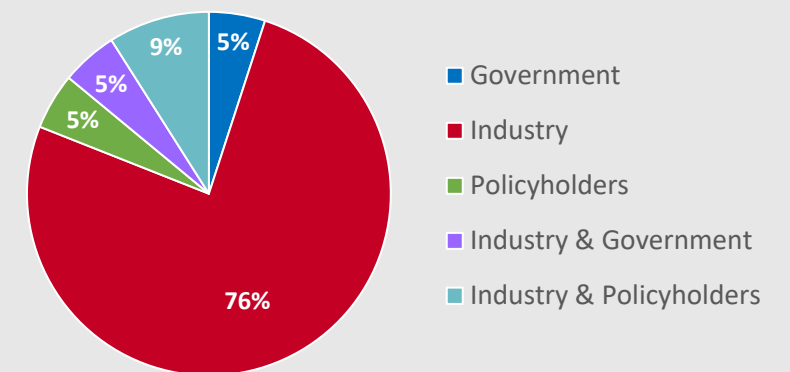
Funding Method of IGS



Funding Source of IGS:

1. **Industry**, majority of IGS funding source are funded directly by the industry
2. **Policyholders**, IGS funding source from direct charge to policyholder in a form of premium tax
3. **Government**
4. **Mixed (Industry & Government)**
5. **Mixed (Industry & Policyholders)**

Funding Source of IGS



Source: Principal Funding for an Insurance Guarantee Scheme, IFIGS (2015)

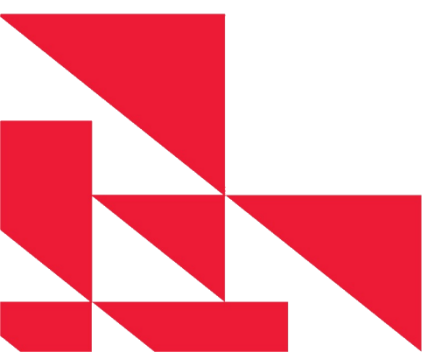
IGS OF SOUTH KOREA AND MALAYSIA: “LPS CAN PARTIALLY “COPY AND PASTE” THEIR SYSTEMS”

Country	Established	IGS Coverage	Fund Management Investment Policies	Basic Funding	Back-up Funding	Legal
Korea (KIDC)	1996	<p>Coverage Ratio (%): By value Life: 76.1% Non-life: 88.2%</p> <p>Excluded: Surety, Reinsurance, Variable Benefit Contract</p>	<p>Government/Public Bonds and MMFs beneficiary certificates in accordance with the related laws and regulations</p> <p>Investment Objective: Low Risk</p>	<p>1. Funding Type: Ex-Ante Life and nonlife insurance companies - 0.15% * This is standard premium rate to which a discount (up to minus 10%) or premium (up to 10%) will be applied according to each institution's risk assessment</p>	<p>1. Government 2. Private Market 3. Bank Loans, including Loans from Central Bank</p>	<p>Legal Structure: Government legislated and administered</p> <p>Legal Framework: Independent</p>
Malaysia (PIDM)	2005	<p>Coverage Ratio Asuransi Jiwa : 99% Asuransi umum : 96%</p> <p>Maximum Coverage RM500,000 (USD122,000) for each protected insurance benefit, other than 100% for healthcare benefits and certain refundable prepaid premium.</p> <p>Excluded maturity benefits, surrender benefits and income benefits that are payable from the unit portion of investment-linked certificates or policies</p>	<p>1. Low risk investment such as Government Bonds 2. Investment in corporate bonds with a high investment grade (minimum rating AAA) 3. Short-term and medium-term Ringgit Malaysia denominated Malaysia Government and Bank Negara Malaysia investment securities</p> <p>Investment Objective: Capital Preservation, Liquidity and Low Risk</p>	<p>1. Funding Type: Ex-Ante 2. Contribution Base: • Life Insurance & family takaful: Actuarial valuation liabilities • Non-life Insurance & general takaful: Net premium 3. Premium Rate: - Life & non-life: 0.025% - 0.2%; - Family takaful: 0.025% - 0.2%; - General takaful: 0.1% - 0.8% 4. Premium collection period: Annually</p>	<p>1. Government 2. Capital Market</p>	<p>Legal Structure: Government legislated and administered</p> <p>Legal Framework: Independent</p>

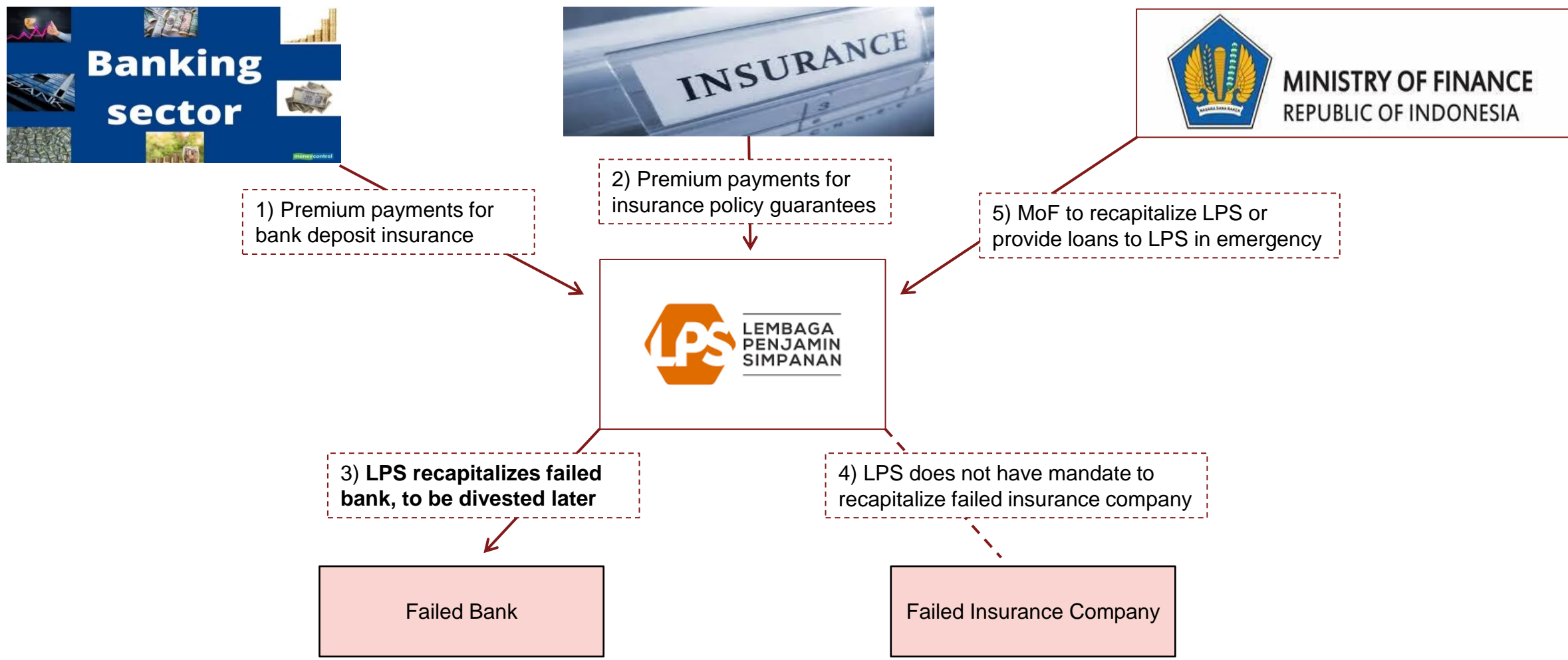




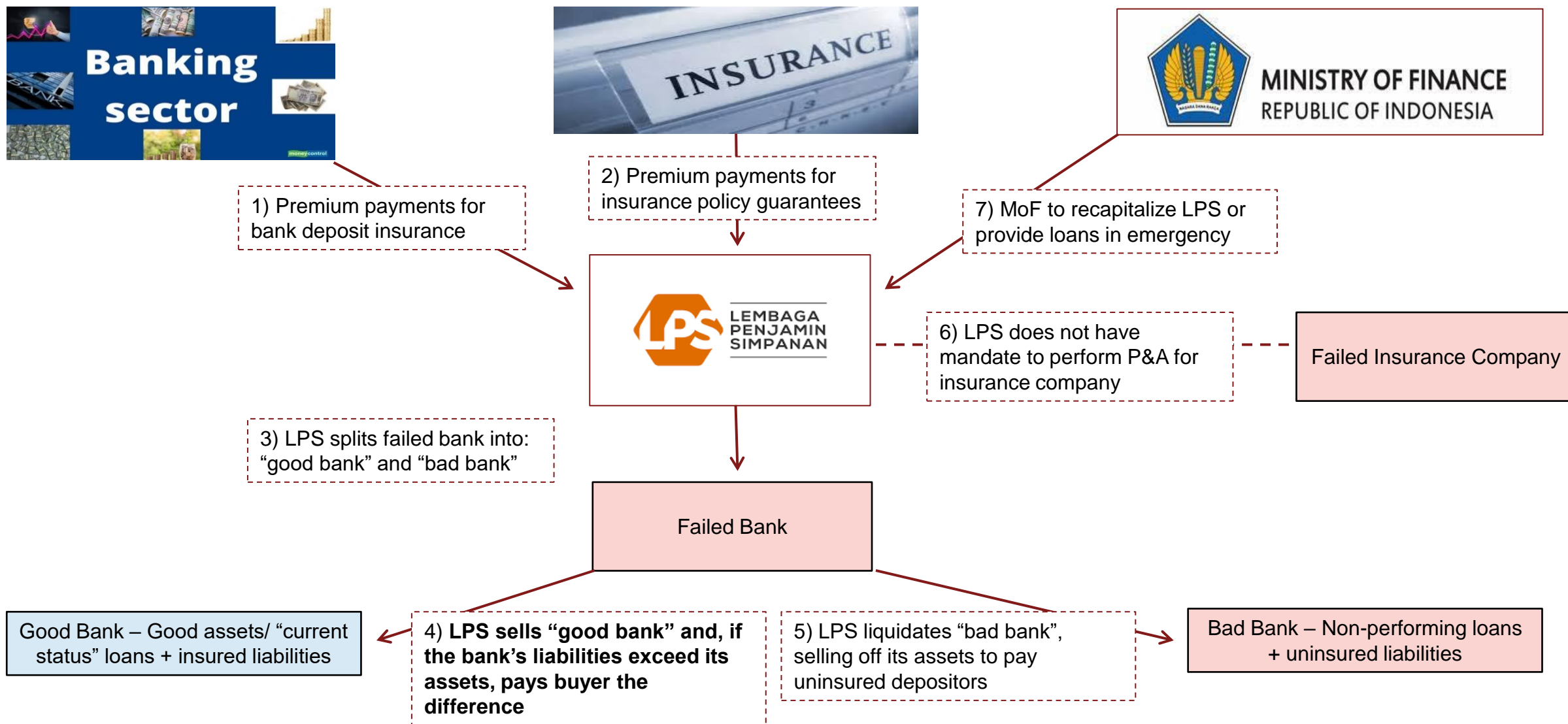
RESOLUTION METHODS



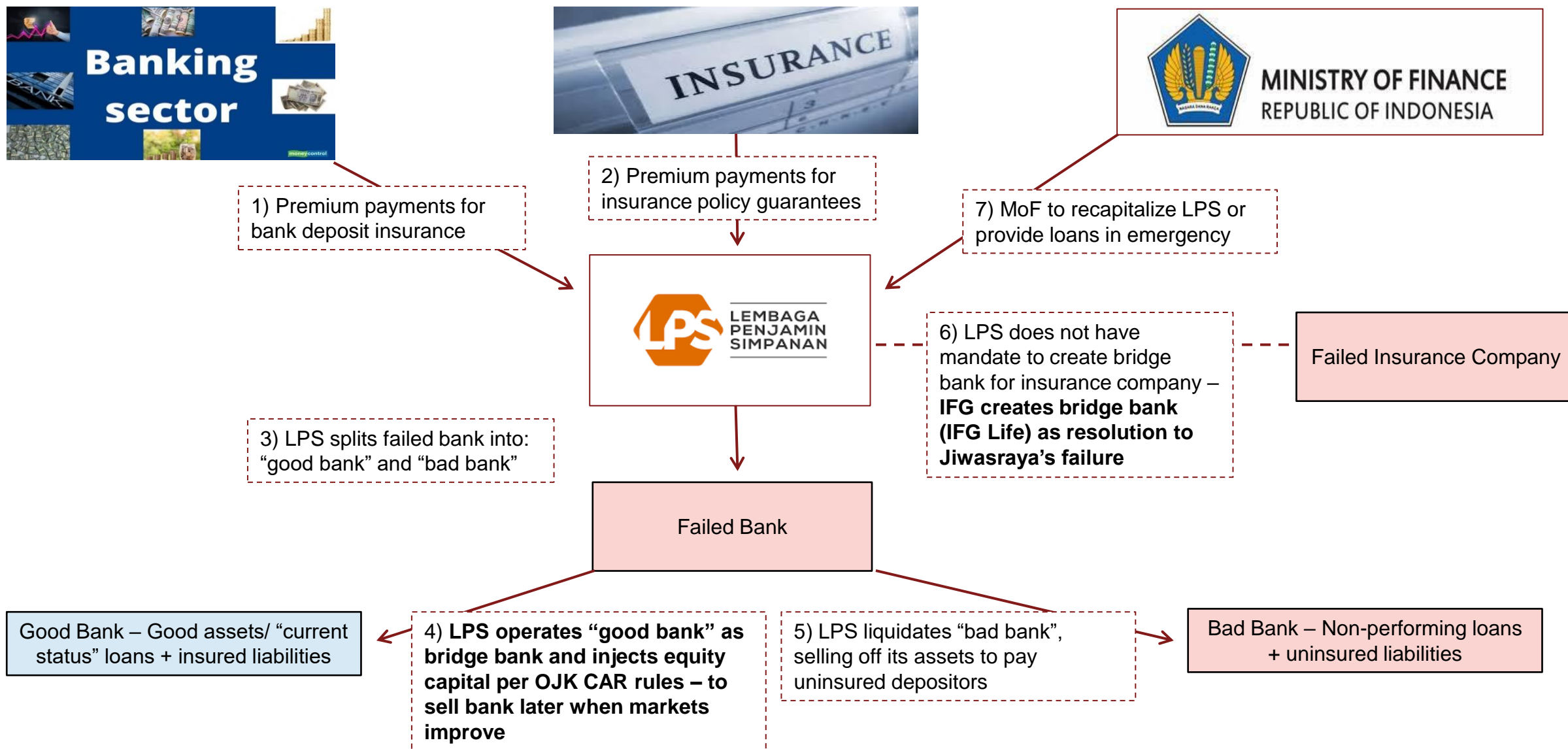
FUTURE LPS RESOLUTION OPTION 1 – DIRECT INJECTION OF EQUITY CAPITAL: “TOO COSTLY, LARGELY ABANDONED BY RESOLUTION AUTHORITIES GLOBALLY”



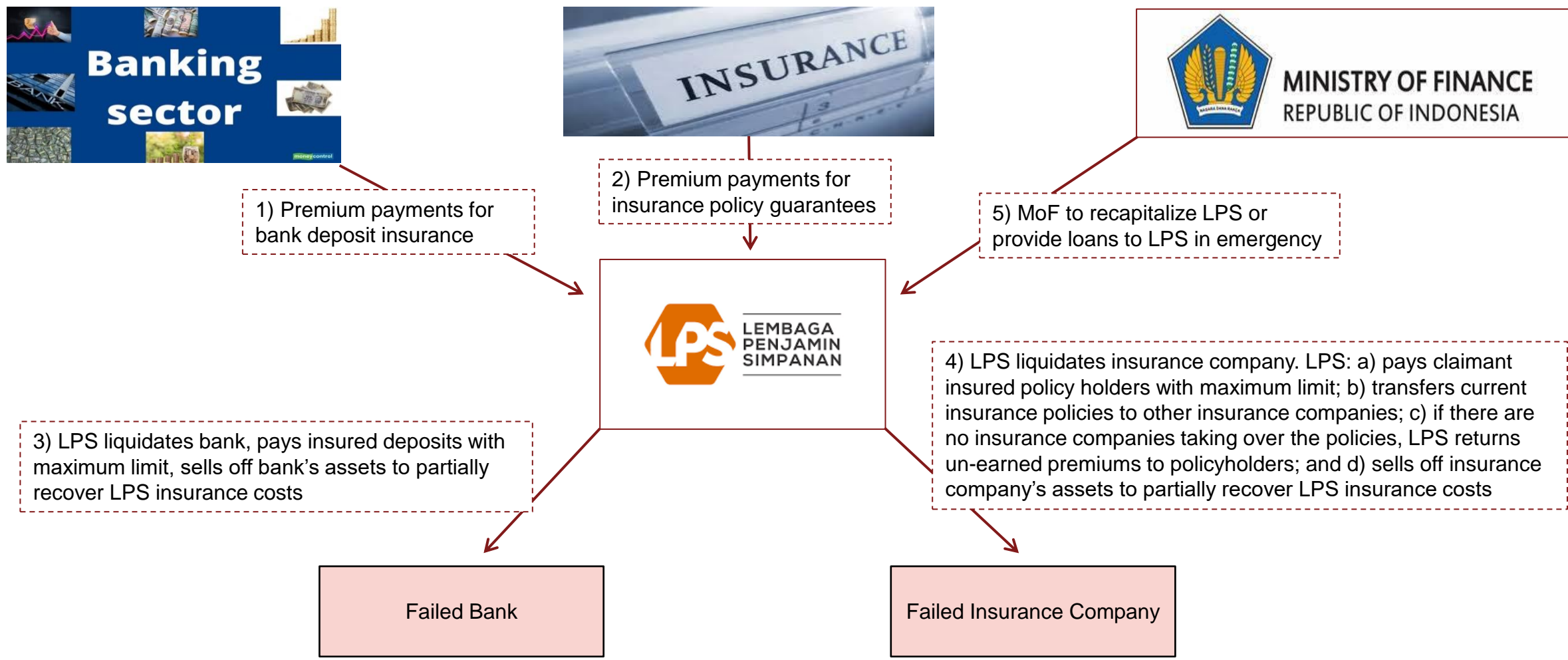
FUTURE LPS RESOLUTION OPTION 2 – PURCHASE AND ASSUMPTION (P&A): “PIONEERED BY FDIC IN 1980S, NOW LARGELY PREFERRED SOLUTION GLOBALLY”



FUTURE LPS RESOLUTION OPTION 3 – ESTABLISHING “BRIDGE BANK”: “IF MARKET CONDITIONS ARE BAD OR FAILED INSTITUTION TOO COMPLEX TO PERFORM P&A”



FUTURE LPS RESOLUTION OPTION 4 – LIQUIDATION: “LIKELY THE LEAST COSTLY OPTION FINANCIALLY”



LPS/IDIC RESOLUTION OPTIONS:

“MORE RESOLUTION METHODS FOR FAILING BANK THAN FOR INSURANCE COMPANY”

Resolution Method	Systemic Bank’s Failure	Non-Systemic Bank’s Failure	Insurance Company’s failure
Open Bank Assistance*	Yes	Yes	No
Purchase and Assumption (P&A)**	Yes	Yes	No
Bridge Bank Creation***	Yes	Yes	No
Liquidation****	No	Yes	Yes

***Open bank assistance:** LPS injects equity capital into failing bank and sells it within six years – e.g. Bank Century, 2008

****Purchase and assumption (P&A):** LPS breaks bank into “good bank” (good loans + mostly insured deposits) and “bad bank” (non-performing loans + uninsured deposits/liabilities). LPS sells “good bank” to chosen investor, and if the liabilities exceed the assets, LPS pays the difference to the investor. LPS liquidates “bad bank”, selling its bad loans and assets to help meet liabilities left in bad bank.

*****Bridge bank creation:** Same steps as in P&A transaction, but in the absence of interested investors (due to negative market conditions), LPS manages the “good bank” as a “bridge bank” and injects fresh equity capital, before selling the bank in future.

******Liquidation:** LPS liquidates troubled bank/insurance company, paying claims on guaranteed deposits/insurance liabilities. LPS insurance cost to be partially covered by sales of assets of the bank/insurance company.

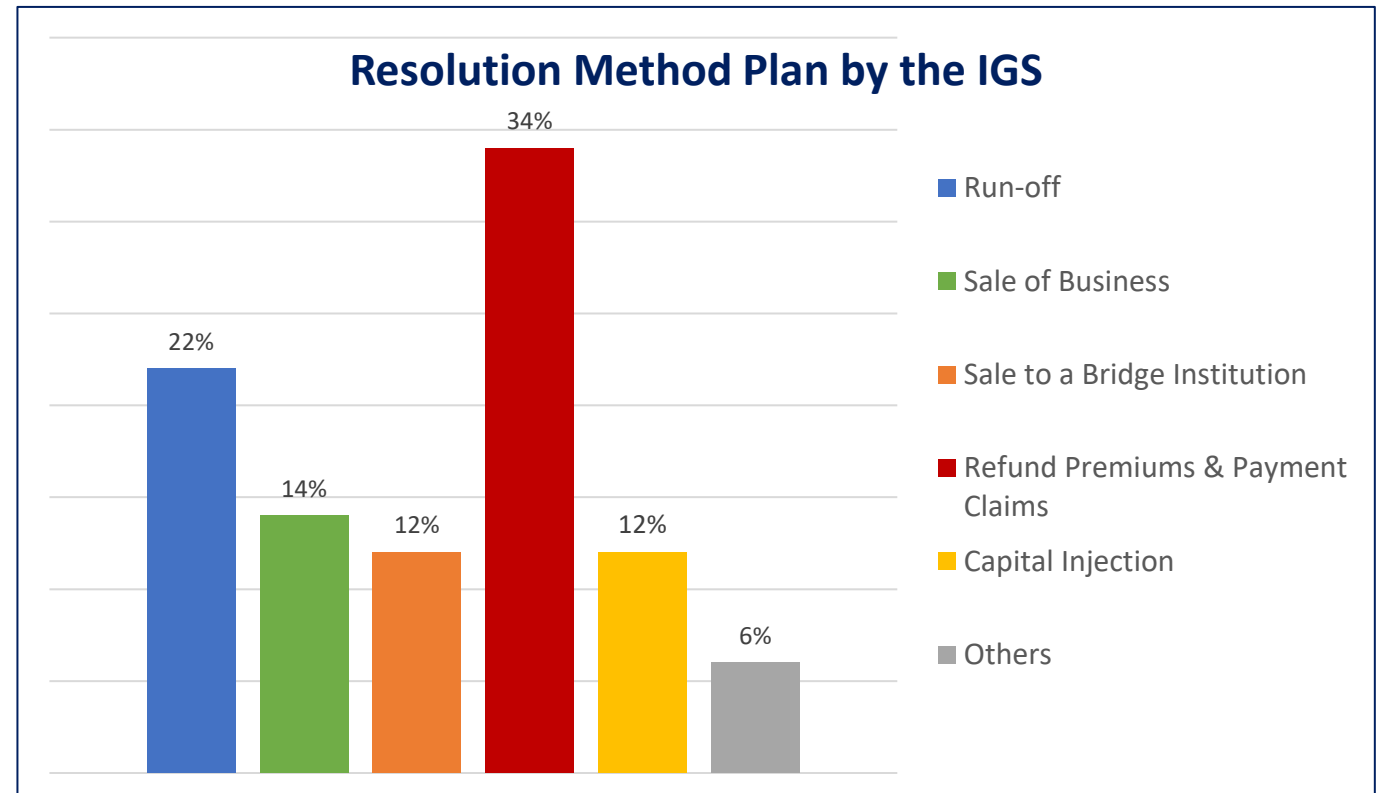
Before resolution of failed bank, LPS (or most Resolution Authorities) typically conducts “Least-Cost-Test” to determine the cheapest resolution option.



RESOLUTION OF FAILING INSURANCE COMPANIES GLOBALLY: “MORE THAN WHAT LPS WILL BE ABLE TO DO”

IGS-linked resolutions can also include:

1. **Sale of the shares of the company** – Transferring the whole business or single line of business to a third party
2. **Transfer portfolios to a Bridge Institution**
3. **Run-off the business** – Paying the claims or benefits as they come due and collecting premium until the renewal date
4. **Refund of premium on some policies** – Particular in non-life business
5. **Termination of policies and payout of assessed policy value**
6. **Capital Injection**



Source: *Principal Funding for an Insurance Guarantee Scheme, IFIGS (2015)*

Each resolution method has different cashflow pattern. For instance, the immediate transfer of the business or immediate refund of premiums of the failed company will require immediate funding than a run-off the business.

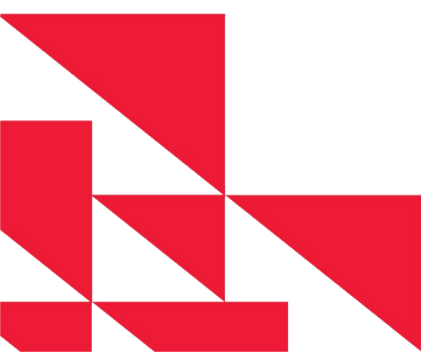
RESOLUTION OF FAILED INSURANCE COMPANIES IN SOUTH KOREA: “THE FULL ARMOURY OF KOREA DEPOSIT INSURANCE CORPORATION”

Liquidation & Deposit Payouts	Purchase & Assumption (P&A)	Establishment of Bridge Bank	Open Bank Assistance (OBA)
<ul style="list-style-type: none"> The resolution option chosen when liquidation of the failed institution is the cheapest option or when no assuming institution can be found. 	<ul style="list-style-type: none"> A healthy financial investor purchases some or all of the assets and assumes deposit liabilities of the failed financial institution. 	<ul style="list-style-type: none"> A temporary financial institution is established and operated by the KDIC on temporary basis to acquire the assets and assume the liabilities of the failed institution until the final resolution is accomplished. 	<ul style="list-style-type: none"> KDIC rescues failing insured financial institution through equity participation, contribution or purchase of assets, and acquires its shares in return.

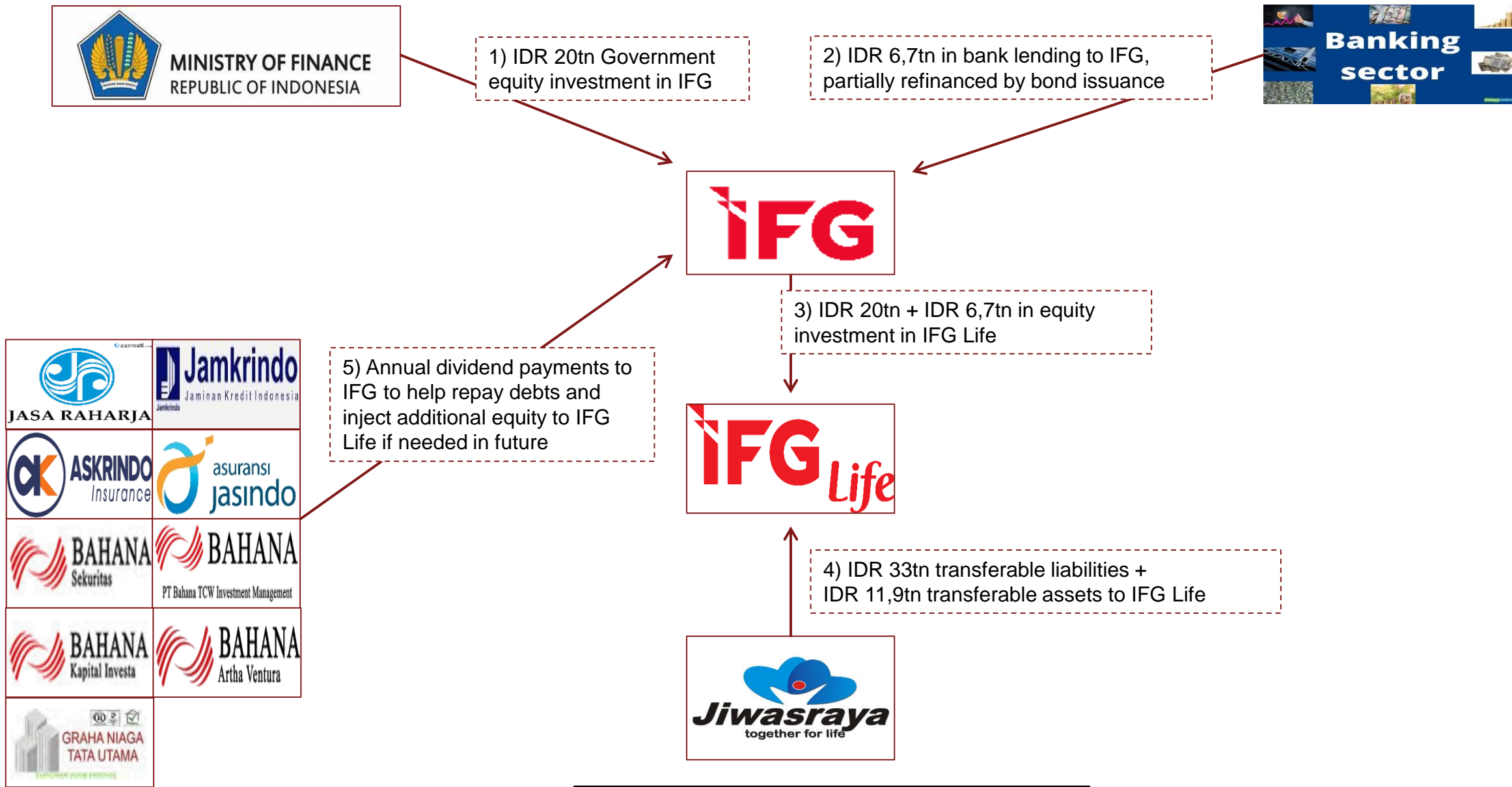
Cases	Causes	Resolution Method
Green Fire and Marine Insurance - 2012 (Non-life insurance with total assets of USD1.2 billion)	<ul style="list-style-type: none"> Loss in the valuation of securities due to the global recession Operational losses resulting from an increasing loss ratio, leading to a drop in RBC to 52.2% 	Purchase & Assumption KDIC gave injection around USD20,5 million.
Korea Life Insurance - 1999 (The 2 nd largest Life Insurance in South Korea with total asset of USD110,5 billion)	<ul style="list-style-type: none"> Excessive financial assistance to subsidiaries. Embezzlement of company funds (deficit of USD2.7 billion) 	Financial Support / P&A KDIC injected capital of +/- 60% of net shortfall (USD1,6 billion).
Seoul Guarantee Insurance – 1999 Non-life insurance resulting from the merger of Daehan and Hankuk (both insolvent then)	<ul style="list-style-type: none"> The Asian financial crisis and the bankruptcy of conglomerates Inappropriate lending management by lenders 	Financial Support and restructuring by injection public funds of USD 9,2 billion.



***POTENTIAL FRAMEWORK & RESOLUTION
METHODS FOR INDONESIA***



ASURANSI JIWasRAYA, A RESOLUTION CASE STUDY: “INDONESIA’S FIRST “BRIDGE BANK” EXPERIENCE”



INFORMATION AS OF DECEMBER-2022

CONCLUSION:

“MUCH PREPARATION NEEDED BY LPS, FOR MORE CERTAINTY AFTER 2028”

- Law No. 4, 2023, on Development and Empowerment of Financial sector mandates LPS to provide IGS by 2028
- MoF and LPS must decide on:
 - Premium contributions to LPS from the insurance industry – whether flat rate (like that for banks) or risk-based;
 - Limit to insurance claims by insurance policyholders paid by LPS – including qualifying conditions;
 - Insurance sub-industries covered (life and non-life), as well as sectors excluded (aviation, loan guarantees, re-insurance contracts, investment-linked products, etc.)
 - Whether to have separate internal insurance sector balance sheet from banking sector balance sheet – where inter-balance sheet borrowing (possibly from banking BS to insurance BS) is possible
- The Law limits LPS resolution of failing insurance company to liquidation – will other options be developed in future?
- Until 2028, resolution of failing insurance companies likely to be partially conducted by Government, via MoF, MoSE, as in the case of Jiwasraya, via IFG

THANK YOU

