



THE  
GENEVA  
ASSOCIATION

# U.S. and Japan Life Insurers Insolvencies Case Studies

Lessons learned from resolutions

A GENEVA ASSOCIATION RESEARCH REPORT

*Edited by Etti Baranoff*

January 2015

## The Geneva Association

The Geneva Association is the leading international insurance think tank for strategically important insurance and risk management issues.

The Geneva Association identifies fundamental trends and strategic issues where insurance plays a substantial role or which influence the insurance sector. Through the development of research programmes, regular publications and the organisation of international meetings, The Geneva Association serves as a catalyst for progress in the understanding of risk and insurance matters and acts as an information creator and disseminator. It is the leading voice of the largest insurance groups worldwide in the dialogue with international institutions. In parallel, it advances—in economic and cultural terms—the development and application of risk management and the understanding of uncertainty in the modern economy.

The Geneva Association membership comprises a statutory maximum of 90 chief executive officers (CEOs) from the world's top insurance and reinsurance companies. It organises international expert networks and manages discussion platforms for senior insurance executives and specialists as well as policy-makers, regulators and multilateral organisations. The Geneva Association's annual General Assembly is the most prestigious gathering of leading insurance CEOs worldwide.

Established in 1973, The Geneva Association, officially the "International Association for the Study of Insurance Economics", has offices in Geneva and Basel, Switzerland and is a non-profit organisation funded by its members.

# U.S. and Japan Life Insurers Insolvencies Case Studies

Lessons learned from resolutions

A GENEVA ASSOCIATION RESEARCH REPORT

*edited by Etti Baranoff*

---

## The Geneva Association

Geneva | Route de Malagnou 53, CH-1208 Geneva | Tel: +41 22 707 66 00 | Fax: +41 22 736 75 36  
Basel | Sternengasse 17, CH-4051 Basel | Phone +41 61 201 35 20 | Fax +41 61 201 35 29

[secretariat@genevaassociation.org](mailto:secretariat@genevaassociation.org) [www.genevaassociation.org](http://www.genevaassociation.org)

---

Photo credits:

Cover Fotolia©Bluebay2014

---

January 2015

*U.S. and Japan Life Insurers Insolvencies Case Studies—Lessons learned from resolutions*

© The Geneva Association

Published by The Geneva Association (The International Association for the Study of Insurance Economics), Geneva/Basel.

The opinions expressed in The Geneva Association newsletters and publications are the responsibility of the authors. We therefore disclaim all liability and responsibility arising from such materials by any third parties.

Download the electronic version from [www.genevaassociation.org](http://www.genevaassociation.org)

# CONTENTS

<b>5</b>	<b>FOREWORD</b>
<b>7</b>	<b>EXECUTIVE SUMMARY AND KEY INSIGHTS</b>
<b>11</b>	<b>CHAPTER 1—OVERVIEW: INSURERS' DEFAULT RATES DURING 2008-2012 AND CASES IN U.S. AND JAPANESE LIFE INSURERS' RESOLUTIONS</b>
11	1. National and global default rates
13	2. The U.S. life insurance insolvencies cases
16	3. The Japanese life insurance insolvencies cases
17	4. Conclusions and main lessons learned
<b>19</b>	<b>CHAPTER 2—U.S. LIFE INSURERS INSOLVENCIES AND RESOLUTION CASE STUDIES, by Peter Gallanis</b>
19	1. Preliminary observations: modern U.S. life and annuity solvency experience
20	2. Insurer liquidation case studies
21	3. The three largest U.S. life and annuity liquidations
22	<i>Case 1: Executive Life Insurance Company (ELIC), California, 1991</i>
25	<i>Case 2: Mutual Benefit Life Insurance Company (MBL), New Jersey, 1991</i>
27	<i>Case 3: Confederation Life Insurance Company (Confed), Canada, Michigan and Georgia, 1994</i>
30	4. Summary and lessons from U.S. insolvent life insurer experience
<b>33</b>	<b>CHAPTER 3—JAPAN LIFE INSURERS INSOLVENCIES AND RESOLUTION CASE STUDIES, by Makoto Okubo</b>
34	The policyholder protection and resolution regime in Japan
38	Improvement of the resolution system
<b>41</b>	<b>CHAPTER 4—CONCLUSION AND LESSONS LEARNED: THE DEFAULT RATE OF INSURANCE INSOLVENCIES AND THE U.S. AND JAPAN LIFE INSURANCE INSOLVENCY CASE STUDIES</b>
<b>43</b>	<b>REFERENCES</b>
<b>45</b>	<b>APPENDIX</b>
<b>49</b>	<b>ABOUT THE AUTHORS</b>

---

---

## FOREWORD

Since the beginning of the global financial crisis in 2008, the world's leaders have been working on improving financial markets oversight in order to increase global financial stability. The Group of Twenty (G20) mandated the Financial Stability Board (FSB) in conjunction with the Basel Committee on Banking Supervision (BCBS) and the International Association of Insurance Supervisors (IAIS) with designing the framework for new rules to ensure global financial stability.

While the FSB and the IAIS made continuous progress in developing new policies and measures to help contain systemic risks, The Geneva Association has pursued an intensive dialogue with regulators, supervisors, central bankers and the insurance industry to develop research addressing the issues that have emerged during the process.

This report—the first in a series of studies of insolvency cases and troubled insurers<sup>1</sup> receiving governmental help—is a study of life insurance company insolvencies in the United States and Japan, and their implications for policyholder protection and financial stability.

Our key purpose with this study and the forthcoming reports is to inform the resolution debate regarding the lessons learned and best practices extracted from the case studies.

We hope that this report will contribute to a better understanding of prevalent resolution methods and tools, as well as help inform the current resolution debate.

We express our deepest gratitude to the Members' companies and experts in the field of resolution who contributed to this report.

Anna Maria D'Hulster

Etti G. Baranoff

<sup>1</sup> The second report will include the HIH Insurance Insolvency and Lumbermen. The rest of the reports will include AIG and European insurance insolvencies and troubled companies cases including Equitable, U.K., and Ethias.

---

---



## EXECUTIVE SUMMARY AND KEY INSIGHTS

This report presents some of The Geneva Association's research over the past few years into insurance insolvency cases from around the world and the most important lessons learned for improving resolution regimes. We begin with an examination of the size of insurance insolvencies globally between the beginning of the financial crisis in 2008 and 2012. Once the magnitude of the insolvencies—less than 0.04 per cent of total outstanding liabilities in any one year—is established, we go on to explore cases of insolvencies in the past 2–3 decades.

In this first report, the case studies include three U.S. and eight Japanese life insurance insolvencies. The main objective in examining these cases is to identify the best practices for ensuring smooth, non-disruptive resolutions, with a focus on policyholder protection and the overall stability of financial markets and economies. Further, it is aimed at informing the current resolution debate, thereby contributing to FSB and IAIS efforts to create effective and efficient insurance resolution systems.

The main conclusions of this report are:

1. The regulatory systems in the U.S. and Japan were able to mitigate the impact on policyholders by:
  - imposing an immediate suspension of surrenders;
  - changing contract provisions after insolvencies;
  - avoiding fire sales of assets;
  - finding healthy carriers to take over the assets and liabilities;
  - allowing for changes to insurance contracts before insolvencies.
2. The regulatory systems in the U.S. and Japan were able to sustain the financial stability of their markets because :
  - in the U.S., the insolvencies were unique to each player and resolved accordingly, with no impact on the markets, since the removal of the very aggressive and risky players allowed the healthy insurers to sell their products for the right provisions and pricing;
  - the insolvencies in Japan were the result of a 'perfect storm' of external market conditions (low interest rates and falling asset values), and regulators stabilised the insurance markets with no contagion occurring.

This report comprises four chapters:

Chapter 1 presents an overview and lessons learned. As a foundation for understanding the issues of insurance insolvencies in the larger context, we begin with the study of global default rates in insurance; that is, we look at the liabilities of global insurance insolvencies as a percentage of the total liabilities of the global

industry during 2008–2012, the period of the financial crisis and its aftermath. The percentages given represent the 'default rate' for each year and the weighted average for the five-year period. This study concurs with the conclusions of an IAIS paper (2013) and prior studies by The Geneva Association that noted that the insurance industry did not suffer a high rate of insolvencies. The global default rate derived in this study shows a minimum of 0.002 per cent in 2009 and a maximum of 0.038 per cent in 2008, with an average of 0.0139 per cent for the 2008–2012 period. In comparison to the default rate of bonds, it is as low as the top-rated bonds with ratings of AAA or AA.

Chapter 1 also summarises the main life insolvency cases in this report. Concerning the U.S. insolvencies, the main findings and conclusions are (i) insurers get into trouble when they compete aggressively with products that demand aggressive investment strategies and (ii) when these investments fall in value, that may cause pressures both on solvency and liquidity for the company. In the case of the Japanese insolvencies, the market conditions of low interest rates and falling values of assets collided to create a 'perfect storm' for seven life insurers that provided high levels of interest rate guarantees.

Chapter 2, written by Peter Gallanis, is dedicated to the three main U.S. life insurance insolvencies, namely, Executive Life Insurance Company (ELIC), a California-domiciled insurer that failed in 1991; Mutual Benefit Life Insurance Company (MBL), a New Jersey-domiciled company that also failed in 1991; and Confederation Life Insurance Company (Confed), a Canadian-based insurer with significant U.S. business, which operated in the U.S. through a Michigan 'port of entry' statute and through a subsidiary in Georgia.

Chapter 3, authored by Makoto Okubo, analyses eight Japanese life insurance insolvencies. They are presented in one comprehensive study, since their causes and resolution were very similar.

Chapter 4 summarises the study and the lessons to be learned in relation to the current resolution debate.<sup>2</sup> The main findings are that (i) insurance policyholders are protected under the current resolution regimes of the U.S. and Japan and (ii) while 'a perfect storm' of market conditions can hit a few insurers simultaneously, the implications of such a hit does not spill over into other financial markets, nor to the economy as the case of Japan in the early 2000s demonstrates.

---

<sup>2</sup> The details of the cases are very instructive for the current resolution debate. See also IAIS (2013) and Haefeli and Liedtke (2012). The majority of case studies analysed pre-date both the financial crisis that began in 2008 and, in the U.S., extensive improvements in regulatory oversight of insurer solvency that took place beginning in the mid-1990s.

A summary of the report is shown in the following Table 1.

**Table 1: Overall findings for the U.S. and Japanese life insurers' insolvencies cases**

	Products' characteristics	Investments characteristics	Regulatory actions	Lessons learned for resolution
U.S. life insurance insolvencies	<ol style="list-style-type: none"> <li>1. Aggressive contract promises relative to peers</li> <li>2. Light surrender charges</li> </ol>	<ol style="list-style-type: none"> <li>1. To fund high contract promises, excessive investment concentration in high-yield bonds</li> <li>2. Real estate investments—too much concentration and inability to liquidate during economic downturn</li> </ol>	<ol style="list-style-type: none"> <li>1. Freezes on surrenders</li> <li>2. Seeking buyers with success or partial success—avoiding fire sell of investments</li> <li>3. Changes in contracts</li> </ol>	<ol style="list-style-type: none"> <li>1. Post insolvency: <i>ex post</i> changes in contracts by laws and regulation</li> <li>2. Creating incentives by policyholders to buy prudently (market conduct regulation as well as education)</li> <li>3. Pre insolvency: <i>ex ante</i> changes in contracts with approval by policyholders to avoid insolvency</li> <li>4. After insolvency: retrospective policy and reserves modifications</li> <li>5. Pre insolvency: oversight over diversification of investments (national regulation and education)</li> </ol>
Japanese life insurance insolvencies	Interest rate guarantees in an era of low interest rates in Japan	Falling values of assets and aggressive pursuit of foreign investments to 'feed' the guarantees on the products		



## CHAPTER 1

# OVERVIEW: INSURERS' DEFAULT RATES DURING 2008–2012 AND CASES IN U.S. AND JAPANESE LIFE INSURERS' RESOLUTIONS

This report examines a selection of life insurance insolvencies that can shed light on an efficient and smooth resolution process without negative implications for the financial markets and economies. This specific study is limited to three U.S. life insurance and eight Japanese life insurance insolvency cases.

As an introduction to the overall study of insurers' insolvencies, it is vital to show the global magnitude of such insolvencies, especially during the 2008 financial crisis and in the aftermath. Therefore, this part of the study begins with the examination of national and global default rates; it is followed by brief summaries of the next two chapters describing the insolvencies and their resolution process. Chapter 1 concludes with lessons learned.

## 1. NATIONAL AND GLOBAL DEFAULT RATES

We define the default rate as the ratio of the total liabilities of the insolvent insurers in the market per year divided by the total insurance liabilities of that market.

To assess the level of default in the insurance industry, we did the following:

- Ninety-four per cent of the global insurance markets were selected for inclusion in this study. For these markets, the total insurance liabilities were extracted.<sup>3</sup>
- In the selected markets, insurers' insolvencies were identified and their liabilities before the failure extracted. It is important to note that this number is the best estimate that was available.

We computed the default rates by country by year for 2008–2012.<sup>4</sup>

As shown in Table 2, the default rates range from 0.00 to 0.87 per cent (Ireland in 2010 due to the Quinn failure). These results incorporate both life and non-life insurance insolvencies.<sup>5</sup>

In Table 2, the top 10 default rates for a country in a particular year have been highlighted. The column 2008–2012 shows the weighted average (for details, see the Appendix).

<sup>3</sup> OECD Online Insurance Database <http://www.oecd.org/finance/insurance/insurancestatistics-oecdonline-database.htm>

<sup>4</sup> It should be recognised that this approach has its limitations, specifically as companies in default may, at the time of default, have inadequate reserving and subsequently understated reserves. Non-defaulting, viable companies may have better reserving levels to ensure their solvency and viability.

<sup>5</sup> See the Appendix for the list of insolvencies in each market with liabilities.

**Table 2: Fraction of total insurance sector's liabilities in default (Default rate of insurance companies that went into resolution) 2008–2012<sup>6</sup>**

Percentage of assets		2008	2009	2010	2011	2012	2008–2012
27%	United States	0.042%	0.006%	0.012%	0.013%	0.004%	0.0151%
24%	Japan	0.078%	0.000%	0.000%	0.000%	0.000%	0.0147%
12%	United Kingdom	0.000%	0.001%	0.000%	0.000%	0.001%	0.0002%
9%	Germany	0.000%	0.000%	0.000%	0.000%	0.333%	0.0075%
5%	France	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%
3%	Netherlands	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%
3%	Switzerland	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%
3%	Sweden	0.355%	0.002%	0.034%	0.056%	0.004%	0.0820%
2%	Denmark	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%
1%	Ireland	0.000%	0.000%	0.867%	0.000%	0.000%	0.1613%
1%	Italy	0.058%	0.012%	0.078%	0.017%	0.000%	0.0326%
1%	Spain	0.000%	0.005%	0.056%	0.000%	0.009%	0.0155%
0%	Belgium	0.000%	0.000%	0.000%	0.052%	0.000%	0.0102%
<b>94%</b>							
	<b>Global default rate</b>	0.038%	0.002%	0.020%	0.006%	0.005%	0.0139%

Source: The Geneva Association.

A checkpoint is to compare insurance company default rates against the probability-of-default rate by rating classes, i.e. a prospective estimation of default as shown in Table 3. A study by Moody's (Hamilton, 2007) claimed that over a '5-year time horizon' bonds that received Moody's highest rating (AAA) had a 'cumulative default rate' of just 0.18 per cent, the next highest (Aa2) 0.28 per cent, the next (Baa2) 2.11 per cent, 8.82 per cent for the next (Ba2), and 31.24 per cent for the lowest it studied (B2).

6 The table does not include any bailout or governmental support to rescue insurers during that period. Since the insurers were kept functioning as ongoing operations, we did not attempt to speculate as to their liabilities at the time. However, the level of rescue of troubled insurers was as follows: in 2008: AIG (US)—\$182 billion; Lincoln National Corp (US)—accepted \$950 million in TARP money and The Hartford (US) accepted USD \$3.4 billion in TARP money. Neither of these insurers were ever anywhere close to insolvency and accepted the TARP money as a precaution from deteriorating market conditions). ING (Netherlands)—€10 billion; Ethias (Belgium)—€1.5 billion; Fortis Life—€11.2 billion (Netherlands, Belgium, Luxembourg). 2011: AMI Insurance Property and Casualty (New Zealand)—NZD 500 million. 2013: SNS Reaal Life (Netherlands)—€750 million (November 2012); Daehan Life (South Korea)—3.55 tn Won (August 1999–April 2001). The difficulty in creating hypothetical liabilities for bailed out insurers is illustrated in the following quote: 'The AIG corporate empire held more than \$1 trillion in assets, but most of the liquid assets, including cash, were held by regulated insurance subsidiaries whose regulators did not allow the cash to flow freely up to the holding company, much less out to troubled subsidiaries such as AIG Financial Products.' (Financial Crisis Inquiry Commission, 2011, p. 344). See also Baranoff (2011).

**Table 3: Default percentage estimated by rating grade over a 5-year time horizon**

Rating	Description	Five-year cumulative default rate
AAA/Aaa	Prime	0.18%
AA/Aa2	High Grade	0.28%
A	Upper Medium	n/a
BBB/Baa2	Lower Medium Grade	2.11%
BB/Ba2	Non-Investment Grade	8.82%
B/B2	Highly speculative	31.24%
CCC	Extremely speculative	N/A

Source: Hamilton (2007, p. 24).

Over the 2008–2012 five-year period, the weighted average of the default rate for the insurance industry was 0.0139 per cent, which is lower than the five-year estimated cumulative default rates of the highest quality rating, AAA, bond (Langohr and Langohr, 2008, p. 48).<sup>7</sup>

## 2. THE U.S. LIFE INSURANCE INSOLVENCIES CASES

While it is evident that insurers' insolvencies are not of large magnitude, they do occur. In this report we focus on life insurance insolvencies in two markets. The three U.S. cases detailed in Chapter 2, are briefly summarised here.

### Case 1: Executive Life Insurance Company (ELIC), a California-domiciled insurer that failed in 1991

**Main products that led to failure:** The products sold by ELIC included competitive guaranteed investment contracts (GICs) that had been issued as a credit enhancement for municipal bond offerings and as bond-alternative investments for pension plans, as well as large-face-amount annuities issued to fund structured settlements of litigated matters.

**Main assets:** ELIC's assets included a significant portfolio of investments in corporate high-yield bonds (sometimes called 'junk bonds'), which were intended to help finance above-market promises made to purchasers of certain ELIC contracts. The collapse of the junk bond market was a significant factor leading to the company's failure.

**Regulatory actions:** The Commissioner's response involved two principal

<sup>7</sup> A caveat should be made here that the corporate bond default rate is a frequency measure, not a value weighted rate of default computed using liabilities.

thrusts—preventing further deterioration of the company’s financial condition, and pursuit of a durable resolution strategy. The Commissioner imposed a moratorium on contract payments except for some death and medical payments. To arrive at a durable resolution plan, bids were taken. The final resolution plan involved the acquisition of the bond portfolio by one entity and the assumption of ELIC’s liabilities by another entity. Also, guaranty associations were activated to satisfy their obligations to consumers.

**Policyholders’ protection:** (i) contract values were completely protected up to the amounts covered by the various affected guaranty associations; (ii) contract claims in excess of guaranty association coverage were guaranteed to receive at least 77.7 cents on the dollar and (iii) contract owners were permitted to surrender their contracts, subject to a new schedule of surrender charges. Roughly 92 per cent of ELIC contract owners who opted into the plan were made whole, while average recoveries were approximately 91.5 cents on the dollar.<sup>8</sup> The ELIC resolution plan essentially established a programme for the ‘run-off’ of ELIC’s insurance business, and that run-off continues today.

**Financial stability implications:** No significant effect on surrender rates for comparable life insurers doing business in the same markets as ELIC. Actually, the markets did not suffer any implications.

**Case 2: Mutual Benefit Life Insurance Company (MBL), a New Jersey-domiciled company that failed in 1991 and which was the 18<sup>th</sup> largest life insurer in the U.S. with assets of about US\$14 billion**

**Main products that led to failure:** MBL wrote individual life insurance; group life, health and disability insurance; group pension and retirement business (including group annuities and GICs issued as investments held by retirement plans); and corporate-owned life insurance (COLI).

**Main assets:** MBL invested more heavily in commercial real estate mortgages and other real estate investments than other U.S. life insurers. When the market went sour, MBL was downgraded by major rating agencies.

**Regulatory intervention:** MBL’s policyholders, especially institutionally owned and managed contracts such as pension plans, had begun surrender activity. Regulators immediately imposed a broad moratorium on voluntary contract surrenders and withdrawals (but not the payment of death benefits or scheduled

---

<sup>8</sup> Including those who opted out of the plan, 85 per cent of contract owners in total received full value on their contracts, and average recoveries were 87.2 per cent of expected account value as of year-end 2006, the last date for which such estimates are available.



annuity instalments). Measures began to be taken to avoid a 'fire sale'. Original values of MBL's contracts were maintained subject to new surrenders or withdrawal penalties. Similarly, crediting rates on MBL contracts were initially reduced. A consortium of life insurance companies, through a reinsurance arrangement, agreed to provide certain guaranties for institutional contracts not covered by guaranty associations. In the long run, troubled real estate and other assets generally recovered substantial value over the course of the workout period.

**Policyholders' protection:** Overall outcomes for contract owners and other MBL creditors were quite favourable. Contract owners who chose to participate in the plan received the full principal amounts. All insurance and annuity contracts were eventually acquired by healthy carriers in marketplace transactions.

**Financial stability implications:** The highly publicised troubles of MBL appeared to have had no significant effect on surrender rates for comparable life insurers doing business in the same markets as MBL.

### **Case 3: Confederation Life Insurance Company (Confed), Canada, Michigan and Georgia, 1994—an international mutual insurer based in Canada with operations in the U.S.**

**Main products that led to failure:** Confed for most of its history had operated as a conservative, conventional mutual insurer focused on traditional life insurance and annuity projects. In the early 1980s, it began selling more exotic insurance products, converting itself into a multi-faceted financial services conglomerate. In 1994, Confed's U.S. business was roughly evenly divided among three categories: traditional life and annuity business, structured settlement annuities (SSAs), and guaranteed investment contracts (GICs).

**Main assets:** Confed was mainly in commercial real estate mortgage loans and other real estate investments, The Canadian real estate market was under considerable stress in the early 1990s and the company was downgraded.

**Regulatory action:** There was very successful cross-border cooperation. Again, Confed's receivers imposed a broad moratorium on voluntary contract surrenders and withdrawals (but not the payment of death benefits or scheduled annuity instalments). The regulatory regimes were successful in harmonising different (though parallel) insolvency proceedings in Canada and two U.S. states. The receivers engineered the largest commercial mortgage securitisation in history (at the time), and the receivers and the guaranty associations established various procedures for realising value on illiquid assets and pursuing litigation claims for the benefit of insolvency stakeholders.

**Policyholders' protection:** The successful resolution resulted in insurance and annuity contract owners being completely protected. There was also transfer of contracts to healthy carriers.

**Financial stability implications:** The highly publicised troubles of Confed in 1994 appeared to have had no significant effect on surrender rates for comparable life insurers doing business in the same markets.

### 3. THE JAPANESE LIFE INSURANCE INSOLVENCIES CASES

Seven life insurance companies went bankrupt in Japan around 2000, and one went bankrupt following the Lehman Brothers collapse. Financial assistance of about JPY 780 billion was implemented on a cumulative basis in the course of bankruptcy proceedings (the total cost was borne by the industry without government funding). Despite some differences in the reasons for the bankruptcies, they had the following three factors in common:

- a large number of policies with high assumed interest rates sold during Japan's asset bubble, and huge negative spreads under the ensuing low-interest rate environment;
- falling prices for company-held assets along with an increasing balance of bad debt among loans receivable;
- high-risk investments, including in foreign securities, by life insurance companies in order to reverse the negative spread.

As described above, Japan experienced the perfect storm which impacted the life insurance sector and companies that were providing high interest rate guarantees. The resolution system in Japan was improved as a result of these insolvencies. In essence, the changes included that, in the event of the bankruptcy of a life insurer, the 'Life Insurance Policyholder Protection Corporation of Japan' (PPCJ), through a mutual support system for the purpose of protecting policyholders:

- provides financial assistance to saviour companies that take over insurance policies;
- takes over insurance policies in the event that no saviour company steps forward;
- acts as a procedural representative for insurance policyholders in the event that the bankruptcy undergoes rehabilitation proceedings.

In practice, in every case, some insurance companies were willing to acquire the business because the blocks of business were viewed as profitable and sustainable

in the future. In certain instances the acquiring companies received approval to modify certain contract terms to allow the future premium rates of existing contracts to be prospectively modified at the time of insolvency, which directly limited the financial burdens associated with the resolution. A well-established history of contract transfers is also an important factor to make the resolution even more orderly.

In 2003, a revision was made to the Insurance Business Law to permit the reduction of the assumed interest rate before insolvency in order to prevent bankruptcy, subject to the approval by the policyholder meeting (3/4 majority).

In the case of all life insurance insolvencies, surrenders were suspended, but customers continued their premium payments. As a result, the liquidity positions of insolvent insurers improved significantly after the insolvency.

## 4. CONCLUSIONS AND MAIN LESSONS LEARNED

The insurance insolvencies that went into resolution in the period 2008–2012 among a sampling of countries representing 94 per cent of global assets had a global 'default rate' of between 0.002 and 0.0038 per cent and a weighted average of 0.0139 per cent for the whole 2008–2012 period. This level is lower than the default rate expected for AAA bonds. These data do not include insurers that did not end up in resolution or those that received governmental support.

For the U.S. life insolvency case studies, the most significant lesson to be drawn from the history of these receiverships is that there have been so few of them in this, the most robust life insurance market in the world. Usually, the regulatory actions protected as much of the assets as possible by:

- creating disincentives to surrender the products;
- securing the assets from fire sales;
- finding healthy carriers to take on the asset and liabilities;
- transferring as many of the contracts as possible to healthy carriers;
- triggering the guaranty funds;
- securing the welfare of the policyholders;
- allowing for a long term run off of policies (some are still on-going);
- modifying terms of certain insurance contracts in rehabilitation or as part of liquidation resolution plans;
- potentially greater oversight over the diversification of the assets held by insurers to match to their liabilities.

### **Main lessons learned**

Due to the long-term nature of insurance products, there are ways to put a 'strong dam' against 'run on the bank' behaviour in insurance. Short-term resolution tools such as immediate moratoriums on surrenders and with careful changes to provisions in the contracts, as the U.S. and Japanese cases demonstrate, can preserve most or (in various cases) all of policyholders' asset values. Moreover, the current systems in both the U.S. and Japan are educational in that they show how systematic use of laws and regulations protect policyholders and the financial system from knee-jerk reactions that lead to crises.

## CHAPTER 2

# U.S. LIFE INSURERS INSOLVENCIES AND RESOLUTION CASE STUDIES

by Peter Gallanis

## 1. PRELIMINARY OBSERVATIONS: MODERN U.S. LIFE AND ANNUITY SOLVENCY EXPERIENCE

The most notable facts about any review of financially material U.S. life and annuity company failures that occurred in living memory are, first, that there have been so few of them; second, that the most material cases happened a generation ago (no material cases occurred during the recent financial crisis); third, that none of those failures revealed any systemic connection with other insurers or other financial institutions; and finally, that outcomes to consumers in those cases—and in the vast majority of smaller cases—have been generally positive.

In the past 25 years, about 20 U.S. companies writing any material amount of life and annuity business have entered liquidation (the final and most serious stage of U.S. insurance receivership, roughly analogous to a liquidating bankruptcy under Chapter 7 of the U.S. Bankruptcy Code).<sup>9</sup> In the years 2008–2011, the worst years of the recent financial crisis and its aftermath, a total of five companies writing life and annuity business entered liquidation. Those companies had aggregate policyholder liabilities of slightly less than \$700 million—an amount dwarfed by the more than \$600 billion in general creditor liabilities of bankrupt investment bank Lehman Brothers alone—to say nothing of all of the other commercial banks and thrifts, investment banking firms, hedge funds, finance companies, pension plans, government-sponsored entities and other financial and non-financial firms that failed during the crisis. And of those roughly US\$700 million of liabilities to insurance consumers, almost all of the liabilities were honoured through conventional insurer resolution processes.<sup>10</sup>

The fundamental experience of U.S. life and annuity writers in the past generation or more (few insolvencies and generally satisfactory outcomes for consumers in those few cases) is consistent with experience over the past century. Even in

<sup>9</sup> For an overview of the U.S. insurance receivership process, see Subcommittee on Insurance, Housing and Community Opportunity (2012) pp. 107–108.

<sup>10</sup> The author and all readers are, of course, aware of the crisis at AIG that resulted in the delivery of a U.S. government financial support package commencing in mid-September 2008. Whether any of AIG's subsidiary insurers would have failed in the absence of government support is doubtful, but what is clear is that the problems in the holding company were precipitated by, and largely consisted of, primarily, a large portfolio of credit default swaps (which are not insurance products) issued through the non-insurer subsidiary AIG Financial Products; and, secondarily, a very non-traditional, company-wide strategy for securities lending activities that was imposed upon the insurer subsidiaries from within the holding company. Details of the evolution of both the AIG Financial Products credit default swap programme and the securities lending programme are set forth in Boyd, *Fatal Risk: A Cautionary Tale of AIG's Corporate Suicide* (Wiley 2011). Federal Reserve Board Chairman Ben Bernanke correctly noted at that time (Bloomberg, 2009) that AIG was, '...[a] hedge fund basically that was attached to a large and stable insurance company'.

the Great Depression of the 1930s, when thousands of U.S. banks and other businesses failed, few insurance consumers suffered financial losses because of insurer failures.<sup>11</sup>

It was not accidental that so few U.S. insurance company failures occurred during the recent crisis, nor that the outcomes for consumers were satisfactory. Rather, the performance of the industry in adverse circumstances—and perhaps also the behaviour of the industry’s consumers—appear to be attributable to four major factors: a financially conservative industry and business model, a strong system of financial solvency regulation, an established resolution/receivership framework aimed at protecting insurance consumers, and (in the rare cases when insurers fail) an effective and able policyholder protection mechanism provided by the U.S. insurance guaranty system.<sup>12</sup>

An examination of the details of several cases of U.S. life insurance company failures underscores the ability of U.S. regulatory and resolution mechanisms to mitigate the impact when insurers do fail and to provide a high level of protection to consumers and other stakeholders.

## 2. INSURER LIQUIDATION CASE STUDIES

***Life and annuity insolvencies, generally.*** While NOLHGA has been involved in approximately 73 multi-state<sup>13</sup> receivership cases since the late 1980s through 2013 (the last date for which the data in the following paragraph is available), most of those involved small carriers that predominantly wrote health insurance business. Of those 73 multi-state cases, 50 involved life and annuity business.

Although no publicly available central database exists for U.S. insurer insolvency statistics, the National Organization of Life and Health Insurance Guaranty Association’s (NOLHGA) believes that a reliable estimate of the aggregate

---

11 See generally, Vaughan (2014).

12 For more detail on the significance of these four interrelated factors in preventing insurer failures and promoting positive outcomes in the rare cases when failures occur, see Gallanis (2014), p. 13.

13 NOLHGA becomes involved in cases where the obligations of multiple state guaranty associations are (or are likely to be) ‘triggered’ by the insolvency and liquidation of an insurer that has written life, annuity or health insurance products that those guaranty associations are statutorily required to protect. Some insurer liquidations do not involve NOLHGA, either because the failed company restricted its business to a single state (thus triggering only one guaranty association) or because the insurer wrote no business covered by NOLHGA’s member guaranty associations. NOLHGA’s role is more fully discussed at Subcommittee in Insurance, Housing and Community Opportunity (2012), p. 109.

amount of policyholder obligations owed by the 50 insolvent issuers of life and annuities contracts was approximately US\$32.3 billion. Of that amount, assets available from the insolvency estates of the failed carriers, in the aggregate, are estimated to have totalled approximately 73.9 per cent, and guaranty association expenditures to assure that consumers received full guaranty association protection were approximately US\$5.4 billion. In those cases, the average recoveries by consumers (from estate assets, guaranty association protection and ceding commissions from the transfer of business to healthy assuming carriers) slightly exceeded 96 per cent on life insurance contracts, and approximately 88 per cent on annuity contracts.

Statistics and outcomes obviously vary from case to case, but history does teach one lesson about insurer failures above all others: the social costs of receiverships—to consumers whose claims are not fully covered by the guaranty system because of statutory coverage limits, and to the insurers, consumers, and taxpayers who ultimately fund the guaranty system—are minimised by prompt and effective regulatory intervention when a solvency crisis develops, and by careful design and execution of an effective plan to resolve a carrier's financial crisis.<sup>14</sup>

The 50 cases involving life and annuity business may usefully be viewed as falling into several size categories. A total of 28 cases involved total policyholder liabilities ranging up to US\$100 million; a total of 16 cases involved total policyholder liabilities between US\$100 and US\$999 million; and only six cases involved total policyholder liabilities exceeding US\$1 billion. Only two or three cases involved companies that approached the size of the smaller companies ranking among the top 25 life insurers in the U.S., while the other cases were smaller—and most of those, much smaller.

### 3. THE THREE LARGEST U.S. LIFE AND ANNUITY LIQUIDATIONS

Any experience-based conclusions about the capabilities of current U.S. regulatory, receivership and policyholder protection institutions—and about systemic implications of a life or annuity writer's failure—should be most apparent in the three cases that were, by a large measure, the most financially significant liquidations in U.S. insurance history. The cases concerned are: Executive Life Insurance Company (ELIC), a California-domiciled insurer that failed in 1991; Mutual Benefit Life Insurance Company (MBL), a New Jersey-domiciled company

<sup>14</sup> This point is developed at length in United States Department of the Treasury (2011).

that also failed in 1991; and Confederation Life Insurance Company (Confed), a Canadian-based insurer with significant U.S. business, which operated in the U.S. through a Michigan 'port of entry' statute and through a subsidiary in Georgia.

Each of these cases, as with any complex insolvency proceeding, involved years of highly specialised work to resolve, and the receivership court records alone fill scores of thousands of pages. The brief summaries below are intended, in each case, to provide a high-level overview of the types of business involved; the resolution strategies pursued by the regulators, receivers, and guaranty system; the outcomes for insurance consumers; and any known 'externalities' either affecting the receiverships or created by them.

### **Case 1: Executive Life Insurance Company (ELIC), California, 1991**

#### ***Background***

ELIC was a California-domiciled writer of life and annuity products. As of year-end 1990, ELIC was the 33<sup>rd</sup> largest life insurer in the U.S., with approximately US\$10 billion in assets. Its parent company, First Executive Corp., had US\$19 billion in total assets (including ELIC) at the end of 1989 (Schulte, 1991, p. 5). ELIC, at the end of 1989, had slightly over US\$5 billion in annuity reserves, and about US\$3 billion in life insurance reserves. A significant portion of the annuity business was 'non-traditional' and involved contracts with unusually high account values, particularly including guaranteed investment contracts (GICs) issued as credit enhancement for municipal bond offerings and as bond-alternative investments for pension plans, and large-face-amount annuities issued to fund structured settlements of litigated matters ('structured settlement annuities' or SSAs) (Schulte, p. 89). Slightly less than half of ELIC's annuities were either single premium immediate annuities (SPIAs) or SSAs that were not surrenderable and that had no cash value (Schulte, p. 96). Products that were surrenderable typically bore comparatively low surrender charges (p. 99).

The company's business grew rapidly in the late 1980s, in part because it offered express and implied guaranteed returns on its annuity (and later, interest-sensitive life) products that exceeded returns available from most other carriers in the market (p. 35). Those above-market returns were fuelled in part by an extraordinarily high concentration (roughly 10 times that of the



---

life industry average) of ELIC's investment portfolio in high-yield fixed-income securities (sometimes called 'junk bonds') marketed to ELIC by Drexel Burnham Lambert during the years in which that firm was led by Michael Milken, a close friend and business associate of ELIC's CEO, Fred Carr (p. 185).

By 1989, more than half of ELIC's obligations were fixed annuities, and of those, almost half were SSAs, SPIAs or GICs that were not surrenderable by owners. Many of the company's other products were surrenderable by owners with little (if any) penalty charge or other financial disincentives for surrender. In general, the explicit or implicit crediting rates on ELIC's various types of fixed annuities were markedly higher than those of other significant U.S. life insurers.

### ***Leading to failure***

ELIC's ability to honour those rich contractual promises was dependent on the performance of its portfolio of junk bond investments (p. 35). The company's high concentration of junk bond investments became the focus of several national media inquiries in the late 1980s, and particularly so as default rates on such investments climbed as the U.S. moved towards recession in 1990 (pp. 171–180; 224–5). Negative performance by the ELIC junk bond portfolio resulted in reports of significant investment losses on the parent company's year-end statements filed with the U.S. Securities and Exchange Commission (SEC) and as otherwise reported by the company in 1989 and 1990; particularly troubling was the report of a net loss at the parent company of US\$776 million for 1989 (pp. 226–227). Those reported losses in turn generated adverse media coverage, provoking ratings downgrades and increased surrender activity by owners of surrenderable ELIC contracts. Meanwhile, as the recession developed in late 1990, junk bond defaults became even more of a problem. In early 1991, the parent company's auditors expressed reservations about ELIC's ability to survive as a 'going concern' (p. 272).

### ***Regulatory actions***

The California Insurance Commissioner responded by monitoring ELIC through 1990 and early 1991 (p. 235). After the developments of early 1991—particularly the April filing of the parent company's SEC annual report on form 10-K (showing that the market value of year-end bond holdings had fallen to more than US\$2.5 billion below book value), the Commissioner petitioned the courts for initiation of receivership proceedings on 11 April 1991. The Commissioner's response involved

two principal thrusts—preventing further deterioration of the company’s financial condition, and pursuit of a durable resolution strategy. In order to eliminate the need to engage in accelerated disposition of ELIC assets (some of which were illiquid or trading at well below book value) as a consequence of voluntary surrenders and withdrawals of contract values on surrenderable products, the Commissioner took a step routinely taken as a matter of U.S. insurer insolvency practice: the Commissioner imposed a moratorium on contract payments. Initially, the moratorium stayed all contract payments pending an assessment of the financial situation. Shortly afterwards, the moratorium order was modified to permit payment in full of death and medical payments and payments of 70 per cent of amounts scheduled to be paid on SSAs, single premium annuities and specified retirement products.

In seeking a durable resolution plan, the Commissioner began a competitive bidding process for the disposition of ELIC’s assets and liabilities, using, as a ‘stalking horse’ bid, a preliminary proposal from Altus Finance, S.A., an affiliate of the French bank *Crédit Lyonnais* (‘Altus’). Three serious bids were ultimately considered. The final resolution plan involved the acquisition of the bond portfolio by Altus, and the assumption of ELIC’s liabilities by an entity called Aurora National Life Insurance Company (‘Aurora’). That assumption was supported by the proceeds of the sale of bonds to Altus, other ELIC assets, an interest in a liquidating trust and ongoing ‘enhancement’ payments from guaranty associations to satisfy their obligations to consumers.

### **Impact on policyholders**

The consequences of the plan for ELIC consumers who participated in (‘opted into’) the resolution plan<sup>15</sup> included the following: (i) contract values were completely protected up to the amounts covered by the various affected guaranty associations; (ii) contract claims in excess of guaranty association coverage were guaranteed to receive at least 77.7 cents on the dollar, with the potential for greater recoveries as assets remaining with ELIC were worked out and litigation matters were resolved; and (iii) contract owners were permitted to surrender their contracts, but subject to a new schedule of surrender charges that graded off over a period of five years. The combination of assets transferred to Aurora, recoveries from litigation and troubled asset workouts, and enhancement payments by the guaranty associations has resulted in roughly 92 per cent of ELIC contract owners who opted into the plan being made whole, while average recoveries by

---

<sup>15</sup> Contract owners were given the choice, exercised by some, to ‘opt out’ of the resolution plan and receive immediate, reduced payments of approximately 78 per cent of their account values, based on the liquidation value of ELIC.

---

ELIC opt-in contract owners were approximately 91.5 cents on the dollar.<sup>16</sup> The ELIC resolution plan essentially established a programme for the 'runoff' of ELIC's insurance business, and that runoff continues today.

The highly publicised troubles of ELIC appeared to have no significant effect on contract sales or surrender rates for comparable life insurers doing business in the same markets as ELIC. Stated differently, ELIC's troubles appeared to result in no 'contagion' to comparable insurers operating in the same marketplace.

## **Case 2: Mutual Benefit Life Insurance Company (MBL), New Jersey, 1991**

### ***Background***

MBL, domiciled in New Jersey and founded in 1845, was a writer of life insurance and annuity business. It operated as a mutual insurer. Measured by insurance in force at the end of 1990, it was the 18th largest life insurer in the U.S. and had assets of about US\$14 billion. MBL wrote individual life insurance; group life, health, and disability insurance; group pension and retirement business (including group annuities and GICs issued as investments held by retirement plans); and corporate-owned life insurance (COLI).

During the 1980s, MBL invested more heavily in commercial real estate mortgages and other real estate investments than other U.S. life insurers. The value of such investments was severely negatively affected by the contraction in the national commercial real estate market that occurred in the late 1980s, resulting in a significant increase in, for example, delinquencies in mortgage payments owed to MBL.

### ***Towards the insolvency***

As a consequence of these developments, the ratings for MBL were downgraded by major rating agencies. In turn, surrender activity increased, especially for institutionally owned and managed contracts, such as pension plans. These surrenders increased liquidity pressures on a company that was heavily invested in illiquid assets (see, for example, Standard & Poor's Rating Services, 2013, p. 4). Surrender activity increased even more after ratings downgrades were announced in May and July of 1991.

---

<sup>16</sup> Including those who opted out of the plan, 85 per cent of contract owners in total received full value on their contracts, and average recoveries were 87.2 per cent of expected account value as of year-end 2006, the last date for which such estimates are available.

### **Regulatory intervention**

The combination of decreased asset values, liquidity strain, and the pressure of institutional surrender activity prompted MBL's board of directors to consent on 15 July 1991 to entry of an order of rehabilitation the next day. The original rehabilitation order, consistent with standard U.S. insurer receivership practice, imposed a broad moratorium on voluntary contract surrenders and withdrawals (but not the payment of death benefits or scheduled annuity instalments) in order to stabilise the blocks of in-force business pending development of a resolution plan. The New Jersey Commissioner and the Commissioner's rehabilitation team immediately commenced an analysis of the prospects for resolution and began consulting intensively with interested parties, including the guaranty associations and life industry leaders. The result of that analysis and consultation process was a plan of rehabilitation that was filed with the New Jersey receivership court in January 1993 and approved after a notice and comment process in November 1993.

The essence of the MBL rehabilitation plan was the recognition that contract owners as a group would fare much better economically if troubled assets of the MBL receivership estate were worked out over time than if such assets were subjected to a 'fire sale' and their proceeds distributed to contract owners at the start of the receivership. In order to provide the time needed to conduct a managed workout of the assets (the plan contemplated a seven-year workout period), contract owners needed to keep their contracts with MBL in force. Consequently, the rehabilitation plan maintained the original contract values of MBL's contracts, but subjected any contract surrenders or withdrawals to new penalties that were substantial at the commencement of the rehabilitation and that decreased annually over the next several years. Similarly, crediting rates on MBL contracts were initially reduced, with provisions for subsequent increases over the course of the asset workout.

Contract liabilities (subject to the 'restructuring' adjustments described above) and most of the assets of MBL were transferred to MBL Life Assurance Corporation, an MBL New Jersey-domiciled subsidiary (MBLLAC) to facilitate the ultimate transfer of the contracts to other carriers. Rights in the stock of MBLLAC and certain troubled MBL assets were retained in the MBL estate for the benefit of contract owners. Affected guaranty associations entered into a 'participation agreement' under which they guaranteed restructured contract values of guaranty association-covered contracts to the extent of guaranty association statutory coverage provisions in the event that assets dedicated to the contracts under

---

the plan proved inadequate to fund covered contractual benefits. Additionally, a consortium of life insurance companies, through a reinsurance arrangement, agreed as an accommodation to provide certain guaranties for institutional contracts not covered by guaranty associations, in the event assets dedicated to such contracts under the plan proved inadequate to fund benefits under those contracts .

The MBL rehabilitation plan performed as it was designed to perform. Troubled real estate and other assets generally recovered substantial value over the course of the workout period, and the various blocks of MBL business were acquired from MBLLAC by healthy carriers over a period of several years following the start of the plan.

#### ***Policyholders' impact***

Overall outcomes to contract owners and other MBL creditors were quite favourable. Contract owners who chose to participate in the plan (i.e. who did not 'opt out' for payment of a lower, stipulated liquidation value) received the full principal amounts owed on their contracts plus interest; all general creditors were paid in full; and all insurance and annuity contracts were eventually acquired by healthy carriers in marketplace transactions.

The highly publicised troubles of MBL appeared to have no significant effect on surrender rates for comparable life insurers doing business in the same markets as MBL. Stated differently, MBL's troubles appeared to result in no 'contagion' to comparable insurers operating in the same marketplace.

### **Case 3: Confederation Life Insurance Company (Confed), Canada, Michigan and Georgia, 1994**

#### ***Background***

Confederation Life Insurance Company was an international mutual insurer founded in Canada in 1871 (McQueen, 1996, p. 6). It began operations in the U.S. in 1926, and as of 1994 had two major U.S. operations: Confederation Life Insurance Company (CLIC), the Canadian parent insurer, operating as a U.S. branch under a Michigan 'port of entry' statute that designated the Michigan Insurance Commissioner as its domiciliary U.S. regulator and (if need be) U.S. receiver; and Confederation Life Insurance & Annuity Company (CLIAC), a CLIC subsidiary company chartered in Georgia. Over most of its history, Confed operated as a conservative, conventional mutual insurer focused on traditional life insurance and annuity projects.

### ***Towards the insolvency***

Beginning in the early 1980s, new management at the company sought to grow more rapidly, to offer newer and more exotic insurance products and to convert the entity into a multi-faceted financial services conglomerate (McQueen, p. 26). By the end of 1993 and early 1994, Confed had grown to be the fourth largest life insurer in Canada and one of the thirty largest in North America (p. 4). Its total assets exceeded US\$16 billion and its assets in the U.S. exceeded US\$6 billion. As of early 1994, Confed's U.S. business was roughly evenly divided among three categories: traditional life and annuity business; structured settlement annuities (SSAs); and guaranteed investment contracts (GICs). In the meantime, Confed had developed an investment portfolio that was primarily centred on commercial real estate mortgage loans and other real estate investments,<sup>17</sup> which collectively made up more than 70 per cent of its assets. (U.S. life companies at the time averaged less than half that level of real estate investment.) Canadian rules at the time also allowed insurers to count as profits a percentage of unrealised real estate gains.

The Canadian real estate market was under considerable stress in the early 1990s and, as a consequence, Confed's non-performing assets and commercial mortgage delinquencies increased sharply in 1993 and early 1994. Confed reported a net loss in the first quarter of 1994 in the amount of CA\$3.5 million compared to a profit of CA\$5.8 million a year earlier. The company was downgraded by leading rating agencies in early 1994.

### ***Regulatory action***

The deterioration of the Confed investment portfolio had earlier attracted the attention of the Canadian regulators, who had encouraged the company's efforts to find a healthy company to invest in Confed. However, when efforts to effect such an investment fell through in the summer of 1994 and other efforts to secure rescue financing in the U.S. and Canada failed, the Canadian regulator placed Confed in liquidation on 11 August, and receiverships for the Michigan and Georgia operations followed the next day. In order to preserve the value of in-force books of business while developing a resolution strategy, and consistent with standard U.S. insurer receivership practice, the Confed receivers imposed a broad moratorium on voluntary contract surrenders and withdrawals (but not the payment of death benefits or scheduled annuity instalments).

---

<sup>17</sup> These included construction loans on new developments and high loan-to-value mortgages. See Standard & Poors Rating Services (2013, p. 6).

---

In the early stages of resolution planning, regulators and receivers in Canada and the U.S. successfully harmonised the different (though parallel) insolvency proceedings in Canada and two U.S. states, and the need to resolve claims against a pool of assets whose ownership was not clear, the receivership proceedings on both sides of the border moved with dispatch towards a successful resolution that resulted in insurance and annuity contract owners being completely protected.

### ***Policyholders' impact***

The Canadian blocks of business were all transferred to other Canadian carriers in 1994 and 1995. The U.S. business was transferred in blocks (supported by segments of the U.S. asset portfolio matched to the liability characteristics of the transferred contracts in each block) in a series of transactions over the several years following the initiation of the Confed receiverships. Along the way, the receivers engineered what was, at the time, the largest commercial mortgage securitisation in history, and the receivers and the guaranty associations established various procedures for realising value on illiquid assets and pursuing litigation claims for the benefit of insolvency stakeholders. By the end of 1999, all U.S. and Canadian policyholders had been fully protected through the transfer of their contracts to healthy carriers, and within three years after that, the Canadian liquidator reported that all general creditors had received the entire principal amounts of their claims, plus post-liquidation interest, and that even holders of subordinated debt had received substantial recoveries on their investments in CLIC (Ontario Superior Court of Justice, 2002).

Cooperation among the Canadian receiver, the U.S. liquidators, NOLHGA's member guarantee associations in the U.S., and CompCorp in Canada (the Canadian life insurance policyholder protection body now known as Assuris) resulted in successfully maximising asset value realisations, avoiding asset fire sales, and benefiting from the matching of assets to appropriate liabilities, all while effecting the transfers of policy blocks into the hands of responsible assuming insurance carriers.

The highly publicised troubles of Confed in 1994 appeared to have no significant effect on surrender rates for comparable life insurers doing business in the same markets as Confed. Stated differently, Confed's troubles appeared to result in no 'contagion' to comparable insurers operating in the same marketplace.

## SUMMARY AND LESSONS FROM U.S. INSOLVENT LIFE INSURER EXPERIENCE

**Table 4: Main U.S. life insolvencies in the past three decades**

Insolvency case:	Executive Life	Confederation Life	Mutual Benefit Life
Date of insolvency (regulatory action):	December 1991	August 1994	July 1991
Trigger of insolvency:	Liquidity crisis, junk bond market collapse	Asset illiquidity	Illiquid real estate investments
Country (state):	U.S. (IL)	Canada & U.S. (MI, GA)	USA (NJ)
Industry:	Life & annuities	Life & annuities	Life & annuities
Size by assets:	US\$10.2bn <sup>a</sup>	US\$19.2bn <sup>b</sup>	US\$13.4bn <sup>c</sup>
Size by liabilities:	US\$9.6bn <sup>a</sup>	US\$16.0bn <sup>b</sup>	US\$13.0bn <sup>c</sup>
Method of recovery:	Liquidation plan	Liquidation plan coordinated with Canadian receiver	Liquidation plan
Method of resolution:	Transfer of liabilities to new insurer with GA enhancement agreement	Transfer of separate blocks to various insurers	Initially, transfer of business to run-off vehicle. Business later transferred to other insurers. Industry defined guaranty of certain uncovered benefits.
Role of government:	Regulator-controlled liquidation	Canadian regulators controlled Canadian receivership; U.S. regulators in MI and GA controlled U.S. receiverships	Regulator-controlled liquidation
Tax payer used?	No federal or state appropriations applied.	No federal or state appropriations applied.	No federal or state appropriations applied.
Any non-core insurance products (specifics)?	Significant guaranteed investment contract book including GICs securing bond obligations	GICs	GICs
Substitutions?	When the nature of the insurance product is for savings, there are many substitutions available. Most important is the recovery of the savings.	When the nature of the insurance product is for savings, there are many substitutions available. Most important is the recovery of the savings.	When the nature of the insurance product is for savings, there are many substitutions available. Most important is the recovery of the savings.
Full payment to policyholders?	91.5% for contract owners 'opting in' to plan	Y	Y
Sources of recovery of policyholders claims:	Combination of estate assets and guaranty fund protection	Management disposition of estate assets backed by guaranty fund protection	Management disposition of estate assets backed by guaranty fund protection and industry
Trigger of guaranty funds?	Y	Y	Y



Stabilisation of strategy	Stay of voluntary surrenders/ withdrawals	Stay of voluntary surrenders/ withdrawals	Stay of voluntary surrenders/ withdrawals
Fraud?	Fraud did not appear to cause failure.	(Unknown)	Fraud did not appear to cause failure.
Other financial failures?	N	N	N
Interruption to financial sector and/or economy?	N	N	N
Orderly failure?	Y	Y	Y
Lessons learned:	Led in part to development of risk based capital & the NAIC accreditation programme.	Value of carefully managed asset disposition plan	Led in part to development of risk based capital & the NAIC accreditation programme. Also, value of carefully managed asset disposition plan

a Per AM Best year end 1990

b Per AM Best year end 1993

c Per AM Best year end 1990

In one sense, the most significant lesson to be drawn from the history of U.S. life and annuity writer receiverships is that there have been so few of them in this, the largest life insurance market in the world. Indeed, with the international focus today on simulation 'stress testing' of financial institutions to determine their potential resilience if confronted with hypothetical adverse economic circumstances, it should be observed that the recent financial crisis was *itself* a type of real-world, 'live-fire' stress test. As noted elsewhere, under that stress test, the U.S. life and annuity sector fared very well against almost all other financial services sectors (Gallanis, 2014, p.14).

The few significant U.S. life and annuity receivership cases that have occurred support several important general conclusions. First, unlike commercial bankruptcies, insurer failures typically involve a high percentage of asset-to-liability coverage (sometimes referred to as the 'liquidation ratio') at the time when a liquidation commences. A high liquidation ratio is a key factor in permitting receivers and the guaranty system

to develop an effective resolution plan. That high liquidation ratios are typical follows from both the core business model of insurers (whose balance sheets usually are dominated both by high-quality, long-term investments and (as noted in the next paragraph) 'sticky' liabilities) and from a regulatory regime that is designed to identify and intercept budding solvency concerns early, and that usually does so effectively.

Second, because most insurer liabilities to policyholders are 'sticky' liabilities—the core promises of which are not due and payable immediately on liquidation, but that rather only become due over a period of years, decades, or even generations—liquidity is less of a concern in a life or annuity issuer's failure than in the case of, for example, a depository institution whose core obligations to consumers are primarily due and payable on demand.

Third, because of the typically high liquidation ratios and long-term liabilities, and because of the ability and willingness of receivers to protect the financial integrity of the estate by limiting voluntary surrenders and withdrawals of contract values, most insurer receiverships permit an orderly workout of those 'estate' assets that may be temporarily troubled. As a result, there is seldom any need to engage in 'fire sales' of assets. Accordingly, nothing in historical experience suggests that an insurance receiver would sell distressed assets into the financial markets, with possible negative consequences for other market participants.

Fourth, the historical experience does not reflect, in the cases of any of the insurers reviewed above, any evidence that consumers have engaged in 'run on the bank' behaviour at other insurance companies. On the contrary, all the evidence so far adduced suggests that troubles at one insurer in a particular market—even troubles leading to highly publicised liquidations—have had no material effect on policyholder behaviour at similar companies in the same geographical markets. Moreover, there is some evidence that, during the recent financial crisis, consumers with investable funds were moving into the comparatively safe life insurance marketplace from other markets perceived to be less safe, as a 'flight to quality'.

## CHAPTER 3

# JAPAN LIFE INSURERS INSOLVENCIES AND RESOLUTION CASE STUDIES

*by Makoto Okubo*

Since the end of World War II, Japan has experienced eight life insurance insolvencies, seven of which occurred around 2000 and one of them following the demise of Lehman Brothers. When Japan's bubble economy collapsed in early 1992, the country entered a long-lasting, severe investment environment with low interest rates and poorly performing stock prices. This, combined with a market dominated by insurance products with high guaranteed returns, led to negative spread problems in the mid-1990s.

Although most Japanese life insurers pulled through the severe business environment, several life insurance companies went insolvent around the year 2000. Japanese life insurers, however, as opposed to banks, did not need any government funding. Moreover, some companies, including the two largest ones, did not require any financial support from the industry through the Policyholder Protection Corporation of Japan (PCCJ). Mainly due to the long-term nature of the business and the suspension of surrenders, all of those failures were resolved in an 'orderly' fashion.

The combined total assets of these seven insolvent life insurers in the late 1990s and the year 2000 exceeded JPY 16 trillion, which was equivalent to US\$152 billion (with the exchange rate of 106.15JPY/1US\$ at the end of March 2000) and 8.6 per cent of the total assets of the life insurers in Japan at the end of March 2000. The largest insolvency in terms of assets was Kyoei Life, and the second largest was Chiyoda Mutual. Both went insolvent during October 2000, the same month of the same year. These were by far the largest life insurance insolvencies in the world.

Despite some differences in the reasons for insolvency, the following three factors were common to most of those insolvent life insurers:

- After selling large numbers of policies with high-assumed interest rates during Japan's asset bubble era, life insurers were saddled with huge negative spreads under the enduring low-interest rate environment.
- Prices for assets they held fell, while the share of bad debt among loans receivable expanded.
- Life insurers turned to high-risk investments, including foreign securities, in order to reverse the negative spreads.

## 1. THE POLICYHOLDER PROTECTION AND RESOLUTION REGIME IN JAPAN

Financial assistance of approximately JPY 780 billion was implemented on a cumulative basis in the course of bankruptcy proceedings. The total cost was borne by the industry without government funding through the policyholder protection regimes. The system has been improved with the passage of time, which is assumed to have contributed to the orderly resolution of all life insolvencies.

In 1996, the first insurance guaranty scheme—the ‘Life Insurance Policyholder Protection Fund’—was established in Japan. It was based on voluntary participation with a relatively small financial support limit of JPY 200 billion. Other shortcomings included an unclear definition of the scope of coverage and the inability to provide financial assistance until a saviour insurance company stepped forward. After providing JPY 200 billion to Nissan Mutual, the scheme was discontinued. In 1998, the second scheme, ‘Life Insurance Policyholder Protection Corporation of Japan’ (PPCJ), was created. It was based on mandatory participation with a larger financial support limit of JPY 400 billion.

### ***Funding of the policyholder protection scheme***

The financial resources of the PPCJ are basically contributions paid by the member companies. The system was designed to be ‘pre-funded’; the amount was allocated to each member based on policy reserves and premium incomes. With the 1998 revision, the PPCJ may obtain loans from financial institutions with a government guarantee, if its reserves are not enough to provide financial assistance. This borrowing facility turned out to be crucial, as the pre-funded amount had already been nearly exhausted with the insolvency of Toho Mutual in 1999. In a series of later larger insolvencies, financial assistance from the PPCJ has been provided with funds borrowed from other financial institutions. The system worked as ‘post-funded’ in practice. In 2000, further revisions were made to the scheme, including the introduction of a government subsidy as a temporary measure. Several changes in the financial capacity of the PPCJ<sup>18</sup> have been made since then, and as of today until March 2017, in the event that these financial resources (maximum JPY 460 billion) prove to be insufficient to provide financial support to a life insurer that goes insolvent, the Japanese government was to provide financial assistance (maximum JPY 500 billion) to the PPCJ, subject to

---

<sup>18</sup> For changes in the financial capacity of the PPCJ, see ‘How Should Resolution Regimes for Insurers Be Established? Experiences in Japan and Implications for Global Standard Setting’, by Shinya Kobayashi (2014).

approval by the National Diet. This provision was of significance for restoring the confidence of the general public in the system, although it was seen as theoretical, since financial assistance from the government had never been provided and was highly unlikely.

### **Reduction of policy reserve at the time of insolvency**

The coverage depended on the type of policy, but, in principle, was 90 per cent of policy reserves (see Table 5). This reduction aimed at lessening moral hazard on the part of consumers and incentivises them to choose cheaper products irrespective of financial soundness. With the objective of adjusting coverage by the difference between the guaranteed rate and the market rate, a revision was made in 2006 to allow the PPCJ to reduce the covered policy reserves in the case of a higher assumed interest rate policy. Yamato Mutual applied this provision and reduced the coverage of technical provisions from 90 per cent for policies with high assumed interest rates that consistently exceeded the base rate of 3 per cent.

**Table 5: Japan's reduction of policy reserve at the time of insolvency**

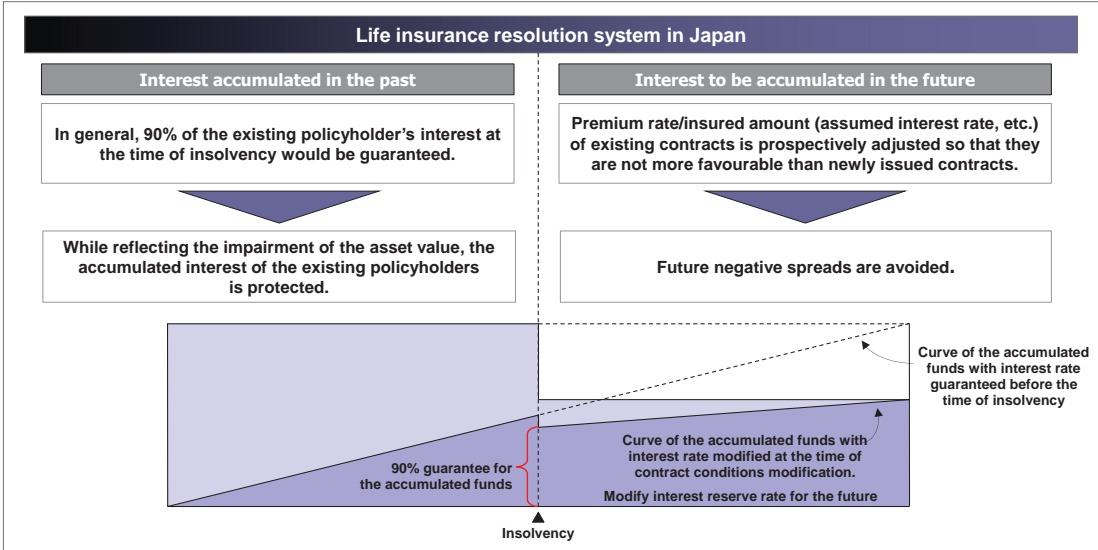
Type of insurance	Types of coverage	
Individual insurance	General policies	Policy reserves x 90%
	High assumed interest rate policies	Policy reserves x (90%-set rate)
Group insurance	General policies	Policy reserves x 90%
	High assumed interest rate	Policy reserves x (90%-set rate)
	Portion related to separate accounts of group annuity policies	Not eligible for indemnification

*Set rate = (sum of assumed interest rates for the previous five years less reserve interest rates)/2*

Source: Nippon Life Insurance Company.

Modification of contract terms at the time of insolvency: in addition to the modification of the existing policyholder's accumulated interest at the time of insolvency described above, the system allowed the insurer to reduce the assumed interest rate prospectively (see Figure 1). Such modification was considered justified in terms of fairness among policyholders of different generations, adjusting conditions prospectively so that they were not more favourable than those set in newly issued contracts. In other words, a grandfather right to receive benefits higher than the market permitted would cease at the time of insolvency.

Figure 1: Modification of contract terms at time of insolvency



Source: Nippon Life Insurance Company.

Table 6 summarises figures and final triggers as concerns the eight Japanese life insurance insolvencies. In the cases of Chiyoda Life, Kyoei Life and Tokyo Mutual, no financial assistance was needed from the industry, since negative spread problems were to be self-resolved with this adjustment of prospective assumed interest rates. In the case of Kyoei Life (8 per cent) and Tokyo Mutual (0 per cent), a 10 per cent reduction of policy reserves was not deemed necessary, as these companies had more than enough funding.

Interestingly, the financial support needed from the PPCJ was not proportional to the size of the insurer. In the case of the much smaller company Yamato Life, financial assistance was needed because their asset deterioration—mainly caused by their speculative investments—was important, and the negative spreads effect was not large enough to absorb the losses. The need for financial support, therefore, depended on the activities of the insurer as well as the causes of the failure, rather than on the asset size of the company.

Modification of contract terms brought a significant cost saving for the industry. Without the reduction of policy reserves and the modification of prospective assumed interest rates, the potential financial assistance from the industry might have increased from the actual JPY 780 billion to approximately JPY 6 trillion.<sup>19</sup>

<sup>19</sup> Estimated by multiplying total liabilities of insolvent life insurers by the difference in assumed interest rate before and after the revision for 15 years, assuming the duration of liabilities of 15 years.

**Table 6: Japan life insurance insolvencies (in JPY billion)**

	Nissan Mutual	Toho Mutual	Daihyaku Mutual	Taisho Life
Start of bankruptcy proceedings	April 1997	June 1999	May 2000	Aug 2000
Applicable law for bankruptcy proceedings	Insurance Business Act	Insurance Business Act	Insurance Business Act	Insurance Business Act
Assets	1,822.0	2,190.0	1,300.0	154.5
Liabilities	2,124.9	2,840.0	1,617.7	191.0
Negative net worth (Liabilities exceeding assets)	302.9	650.0	317.7	36.5
Financial assistance	200.0	366.3	145.0	26.7
Government assistance	—	—	0	0
Reduction of policy reserves	0	10%	10%	10%
Assumed interest rate after revision	2.75%	1.5%	1.0%	1.0%
Final trigger (based on external analysis and media reports)	In the fiscal year ended March 1997, Nissan Mutual booked a huge loss on valuation of marketable securities. Consequently, the company determined that it would be difficult to continue business operations.	In the fiscal year ended March 1999, Toho Mutual's accounting auditor demanded that the company carry out costly additional accounting procedures concerning the amortization of losses on valuation of marketable securities, write-off or provide for loans receivable and other matters. Consequently, the company determined that it would be difficult to continue business operations.	In the fiscal year ended March 2000, Daihyaku Mutual booked a loss on valuation of marketable securities and other items, based on discussions with its accounting auditors. Consequently, the company determined that it would be difficult to continue business operations.	In August 2000, the president of an investment company with which Taisho Life had a capital alliance was arrested on allegations of committing fraud against Taisho Life. In response, the authorities ordered the company to cease certain business operations.
Potential financial support without rate change	Approx. 600	Approx. 1,800	Approx. 1,000	Approx. 100

¥billion

	Chiyoda Mutual	Kyoei Life	Tokyo Mutual	Yamato Life
Start of bankruptcy proceedings	October 2000	October 2000	March 2001	October 2008
Applicable law for bankruptcy proceedings	Special exemption under the Corporate Rehabilitation Law	Special exemption under the Corporate Rehabilitation Law	Special exemption under the Corporate Rehabilitation Law	Special exemption under the Corporate Rehabilitation Law
Assets	2,233.0	3,725.0	690.1	194.9
Liabilities	2,828.0	4,414.5	763.2	259.2
Negative net worth (Liabilities exceeding assets)	595.0	689.5	73.1	64.3
Financial assistance	0	0	0	27.7
Government assistance	0	0	0	0
Reduction of policy reserves	10%	8%	0	10%*
Assumed interest rate after revision	1.5%	1.75%	2.60%	1.0%
Final trigger (based on external analysis and media reports)	Negotiations on financial assistance from banks were broken off. For this and other reasons Chiyoda Mutual filed to start bankruptcy protection.	Negotiations on a capital alliance with a foreign insurer, with whom Kyoei Life had entered into a memorandum of understanding, were broken off. For this and other reasons, Kyoei Life filed for bankruptcy protection.	Negotiations for an alliance with a foreign insurer and financial assistance from The Daiwa Bank, Limited failed. For this reason, Tokyo Mutual filed for bankruptcy protection.	Unable to find a capital alliance partner, Yamato Life posted negative net worth at the closing of accounts for the interim period ended September 2008. For this reason, Yamato Life filed for bankruptcy protection.
Potential financial support without rate change	Approx. 900	Approx. 1,500	Approx. 200	Approx. 100

\* Policies with high assumed interest rates were subject to additional reductions.

Source: Nippon Life Insurance Company.

Another important aspect was the change in the mortality rate. Despite the reduced assumed interest rate, the improvement of the mortality rate meanwhile would at least partially offset the loss caused by this reduced rate. For protection products, the gain from the impact of the improved mortality rate may often be higher than the loss due to the lower interest rate. In such cases, the same death benefits would be protected.

## 2. IMPROVEMENT OF THE RESOLUTION SYSTEM

An improvement of the resolution system implemented in 2000 was the introduction of a provision on corporate rehabilitation proceedings for the resolution of insurers, making it possible to stipulate recourse on ordinary debt in the rehabilitation plan authorised by the courts. Japan's 1995 Insurance Business Act did not govern recourse on ordinary debts that had hindered speedy bankruptcy proceedings. Four companies, Chiyoda Mutual, Kyoei Life, Tokyo Mutual and Yamato Life, used this new provision in their winding-up processes.

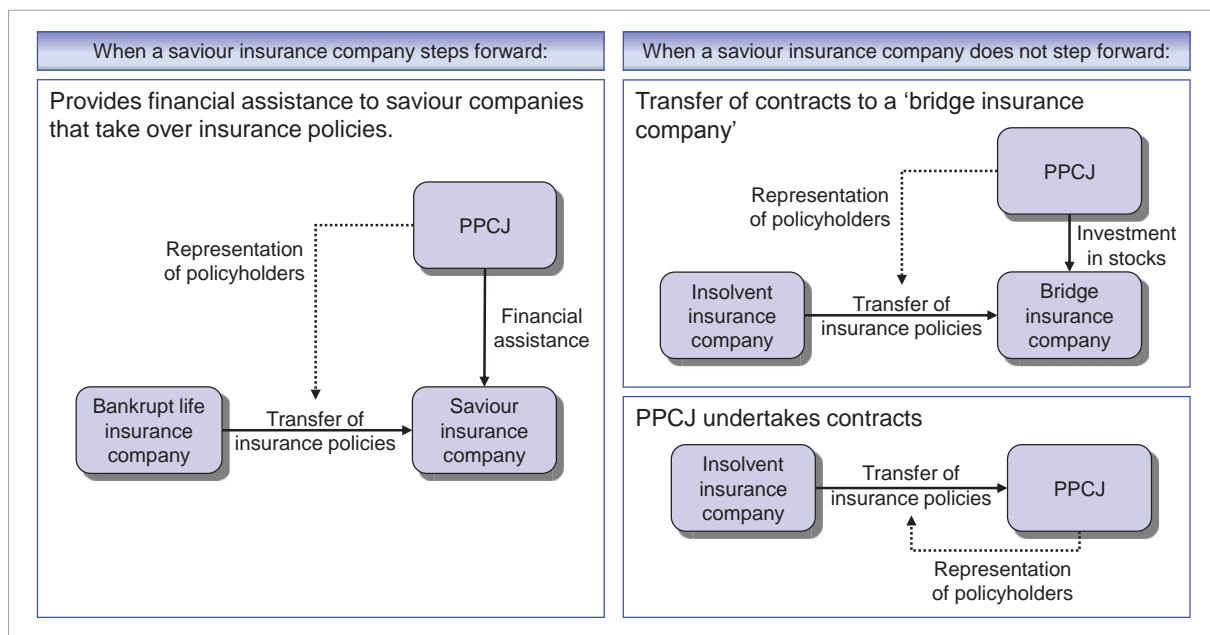
Importantly, the mechanism was established to provide financial support whether or not a saviour insurance company steps forward. As is shown in Figure 2, in the event of the bankruptcy of a life insurer, the PPCJ, through a mutual support system for the purpose of protecting policyholders:

- provides financial assistance to saviour companies that take over insurance policies;
- takes over insurance policies in the event that no saviour company steps forward;
- acts as a procedural representative for insurance policyholders in the event that the bankruptcy undergoes rehabilitation proceedings.

In practice, in every case, some insurance companies were willing to acquire the business because the blocks of business were viewed as profitable and sustainable in the future. In certain instances the acquiring companies received approval to modify certain contract terms to allow the future assumed interest rates of existing contracts to be prospectively modified at the time of insolvency. There were competitions among the potential acquirers. A well-established history of contract transfers is also an important factor to make the resolution even more orderly. In Japan, foreign insurers acquired many insolvent companies to expand, and contributed to make the Japanese market more global.



**Figure 2: Operations of Policyholder Protection Corporation of Japan (PCCJ)**



Source: Nippon Life Insurance Company.

In 2003, a revision was made to the Insurance Business Law to permit the reduction of the assumed interest rate before insolvency, to prevent bankruptcy, subject to the approval by the policyholder meeting (3/4 majority). The legislation appears to be effective in enhancing people's trust, although it has never been exercised in practice.

### **Suspension of surrender and liquidity**

At the time of insolvency, the surrenders of insurance contracts are typically suspended as necessary. In the case of banks, the right of customers to withdraw money from bank accounts should be a core concern of supervisors. On the other hand, in the case of life insurance, there are a number of additional disadvantages when surrendering the contracts such as the loss of insurance coverage and of earned tax benefits. Such action is deemed warranted to protect the interests of policyholders as well as ensure financial stability. In the case of all life insurance insolvencies, the surrender was suspended, but customers continued their premium payments.

Liquidity positions of insolvent insurers improved significantly after the insolvency. The situations were rather challenging before the insolvency; despite the existence of FSA's authority under the Insurance Business Act to suspend surrenders, this prerogative has never been exercised and it is highly unlikely that the surrender be suspended before

insolvency. Therefore, companies facing 'reputational' concerns had to deal with liquidity risk. Ironically, the early bankruptcy proceedings rescued those insurers from the liquidity crisis and minimised the impact in the financial market. Avoiding the insolvency would not have been a better solution for life insurance. In many cases, bankruptcy was filed by the company for protection to preserve assets and the interests of policyholders.

---

## CHAPTER 4

# CONCLUSION AND LESSONS LEARNED: THE DEFAULT RATE OF INSURANCE INSOLVENCIES AND THE U.S. AND JAPAN LIFE INSURANCE INSOLVENCY CASE STUDIES

---

While the global insurance industry had not experienced large waves of insolvencies and default rates, not even during the 2008-2012 period of the financial crisis and its aftermath, the few life insolvencies described in this study can shed light on effective practices to protect insurance policyholders, the financial markets and economy in cases of defaults.

In this study, we analysed U.S. and Japanese life insurance insolvency cases to derive findings that can inform the current resolution debate.

As described in Chapters 2 and 3, three insolvent U.S. companies were outliers. With aggressively-structured GICs and other life and annuity products, these life insurers engaged in comparatively risky investment strategies with insufficient diversification. As the values of their investments collapsed, their ability to pay their guaranteed promises could not be honoured. U.S. regulators took immediate action to limit voluntary surrenders and generally devised resolution strategies involving the long-term, managed disposition of assets so as to avoid losses from 'fire sales.' Policyholder protection was strong and overall market stability was not affected.

In Japan, market conditions were the main trigger for the failure of the seven large insurers in the aftermath of the collapse of Japan's bubble economy in early 1992. Low interest rates and falling stock prices combined with a market dominated by insurance products with high guaranteed returns, led to negative spread problems in the mid-1990s, and ultimately, to the collapse of seven insolvent life insurers in the late 1990s through 2000, worth US\$152 billion—8.6 per cent of the total assets of life insurers in Japan at the end of March 2000. These were the largest life insurance insolvencies globally.

The regulatory responses in the U.S. and in Japan were rather similar. As much as possible, the regulators put a moratorium on surrenders of policies and adjusted the contracts to require steeper surrender charges and allow provision changes, such as lowering the interest rates guarantees. The insurance regulators tried to find healthy companies to take over the assets and liabilities of insolvent players. They also employed resolution strategies generally involving the managed disposition of assets over time, rather than pursuing asset 'fire sales'. The industry helps as the insurance sector reputational risk is an important objective.

U.S. and Japanese national laws and insurance regulations protected policyholders from major losses. They appeared to be very dynamic tools. While, for the cases discussed in this report, most of the actions were done on an *ex post* basis (after the insolvency), there are current laws in Japan allowing changes in contract provisions on an *ex ante* basis (before insolvency) with the agreement of three-

quarters of the policyholders. Until now, this has been done on an *ex post* level. However, in Japan, new laws allow *ex ante* changes, because life insurers' products and assets are based on long-term liabilities and investments. It is acknowledged that there is scope for allowing longer-term solutions to take effect for an industry that deals in long-term products and assets.

The most important lessons from these examples for current and future resolution regimes are the imposition of judicious moratoriums on voluntary surrenders and withdrawals, finding savior or bridge companies and the triggering of guaranty funds. As noted by Gallanis in reference to a major U.S. insurer resolution in 1991, 'The [California] Commissioner's response involved two principal thrusts—preventing further deterioration of the company's financial condition, and pursuit of a durable resolution strategy.' In typical practice, this is accomplished by using moratoriums to halt deterioration of an insurer in trouble, and by devising asset disposition strategies that maximize asset value through managed sales over a period of market recovery. Such an approach has repeatedly proven to be effective in the resolution of insolvent companies. History provides no evidence that problems with a particular U.S. insurer have generated ripple effects on other insurers, let alone contagion failures.

The Financial Stability Board has acknowledged the effectiveness of these supervisory powers by adding them to the list of "General resolution powers"<sup>20</sup> and the case studies demonstrate the importance of the wide implementation of these particular standards into national law.

Other important lessons to be retained are:

1. There is a need for *ex ante* market conduct regulation in addition to solvency regulation. This should in particular focus on any form of policyholder implicit incentives from execution of contractual options (including lapsation) under certain capital market conditions. Market conduct regulation should in turn not be understood as a door-opener for excess regulation of product innovations by local regulators.
2. There needs to be a mechanism that allows changes in contract provisions in the long-term life insurance contracts and annuities sold by the industry. The generational equity and equivalency among the products described as an incentive for contract modifications in Japan appears to be a moral solution. It also incentivises policyholders to be more judicious consumers.

---

<sup>20</sup> Financial Stability Board (2014), p. 7.

## REFERENCES

- Baranoff (2011) 'An analysis of the AIG case: understanding systemic risk and its relation to insurance' in D. Haefeli and P. Liedtke (eds) *Considerations for Identifying Systemically Important Financial Institutions in Insurance*, Geneva: The Geneva Association, pp. 27–57.
- Bloomberg (2009) 'Bernanke Says Insurer AIG Operated Like a Hedge Fund', 3 March, [http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a0n7q0AGB\\_m4](http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a0n7q0AGB_m4), accessed 17 September 2013.
- Financial Crisis Inquiry Commission (2011) *The Financial Crisis Inquiry Report : Final Report of the National Commission on the causes of the Financial and Economic Crisis in the United States*, Washington, DC: Financial Crisis Inquiry Commission
- Financial Stability Board (2014) *Key Attributes for Effective Resolution Regimes for Financial Institutions*, October, Basel: FSB. [http://www.financialstabilityboard.org/2014/10/r\\_141015/](http://www.financialstabilityboard.org/2014/10/r_141015/)
- Gallanis, P. (2014) 'The 'resolvability' of a major insurer', Geneva Association *Insurance and Finance Newsletter*, No. 13, pp. 13–16, <https://www.genevaassociation.org/media/859961/ga2014-if13.pdf>.
- Haefeli, D. and Liedtke, P. (eds) (2012) *Insurance and Resolution in Light of the Systemic Risk Debate*, Geneva: The Geneva Association. [https://www.genevaassociation.org/media/99359/ga2012-insurance\\_and\\_resolution\\_in\\_light\\_of\\_the\\_systemic\\_risk\\_debate.pdf](https://www.genevaassociation.org/media/99359/ga2012-insurance_and_resolution_in_light_of_the_systemic_risk_debate.pdf)
- Hamilton, D.T. (2007) *Corporate default and recovery rates: 1920–2006*, Special Comment Report No.102071, New York: Moody's Investors Service, Inc. <https://www.moody.com/sites/products/DefaultResearch/2006400000429618.pdf>
- IAIS (2013) *Issues Paper on Policyholder Protection Schemes*, International Association of Insurance Supervisors, [http://www.iaisweb.org/view/element\\_href.cfm?src=1/20142.pdf](http://www.iaisweb.org/view/element_href.cfm?src=1/20142.pdf)
- Kobayashi, S. (2014) *How Should Resolution Regimes for Insurers Be Established? Experiences in Japan and Implications for Global Standard Setting*, Geneva Association Newsletter on Regulation and Supervision (PROGRES), Special Contribution No. 5, [https://www.genevaassociation.org/media/905874/ga2014-progres\\_sc5.pdf](https://www.genevaassociation.org/media/905874/ga2014-progres_sc5.pdf)
- Langohr, H.M. and Langohr, P.T. (2008) *The Rating Agencies and Their Credit Ratings: What They Are, How They Work*, Hoboken, NJ: Wiley.
- McQueen, R. (1996) *Who Killed Confederation Life?: The Inside Story*, Toronto: McClellan & Stewart.
- Ontario Superior Court of Justice (2002) *Report of KPMG Inc., the Liquidator of Confederation Life Insurance Company, Commercial List Court File No. 97-BK-00543*, 20 November. [http://www.courtcanada.com/ccdocs/dsf/q6293347597872\\_16/0514488364544.pdf](http://www.courtcanada.com/ccdocs/dsf/q6293347597872_16/0514488364544.pdf)
- Schulte, G. (1991) *The Fall of First Executive: the House that Fred Carr Built*, New, NY: Harper Business.
- Standard & Poor's Rating Services (2013) *What May Cause Insurance Companies to Fail—and How This Influences our Criteria*. [http://www.standardandpoors.com/spf/upload/Ratings\\_EMEA/2013-06-13\\_WhatMayCauseInsuranceCompaniesToFail.pdf](http://www.standardandpoors.com/spf/upload/Ratings_EMEA/2013-06-13_WhatMayCauseInsuranceCompaniesToFail.pdf)
- Subcommittee on Insurance, Housing and Community Opportunity (2012) Hearing before the Subcommittee on Insurance, Housing and Community Opportunity of the Committee on Financial Services, U.S. House of Representatives, November 16, 2011, Serial No. 112-84, Washington, DC: U.S. Printing Office, pp. 105–122, from <http://financialservices.house.gov/uploadedfiles/112-84.pdf>

United States Department of the Treasury (2011) *Report to the Congress on Prompt Corrective Action*, Financial Stability Oversight Council, Completed pursuant to Section 202(g)(4) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, <http://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC%20PCA%20Report%20FINAL.pdf>

Vaughan, T.M. (2014) 'Life Insurance: Providing Long-term Stability in a Volatile World', *Risk Management and Insurance Review*, 15 (2), pages 255–261, Fall 2012. <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6296.2012.01220.x/abstract>

## APPENDIX

## INSOLVENCIES 2008-2012 BY COUNTRY

## Australia

Name	Liquidation date	Total liabilities
HIH	2001	AUD 7,100,000,000

## Germany

Name	Liquidation date	Total liabilities
Mannheimer	2003	EUR 2,700,000,000
Lauenburg-Alslebener	2011	EUR 351,046
Ver. Vers. Ges.Dtschl. (U.S.)	2011	EUR 18,038,360
Almeda Versicherung	2012	EUR 172,331
Globale Rück	2012	EUR 134,174,476
Prorück	2012	EUR 1,876,485
HDI-Gerling Friedrich	2012	EUR 1,258,296
Gothaer Finanzholding	2012	EUR 297,288,621
ThyssenKrupp Rein AG	2012	EUR 2,030,151
		<b>EUR 3,155,189,766</b>

## Ireland

Name	Liquidation date	Total liabilities
Quinn Direct Insurance Ltd	2010	EUR 1,650,000,000

## Italy

Name	Liquidation date	Total liabilities
Progress Assicurazioni SpA	2008	EUR 184,000,000
Arfin SpA	2009	EUR 39,000,000
Faro Assicurazioni SpA	2010	EUR 385,000,000
Novit Assicurazioni	2011	EUR 84,000,000
		<b>EUR 692,000,000</b>

**Japon**

Name	Liquidation date	Total liabilities
Nissan Mutual Life Insurance Company	1997	JPY 2,144,000,000,000
Tokyo Mutual Life Insurance Co.	1999	JPY 2,840,000,000,000
Chiyoda Mutual Life Insurance Company	2000	JPY 2,828,000,000,000
Daihyaku Mutual Life Insurance Company	2000	JPY 1,620,000,000,000
Kyoei Life Insurance Co., Ltd.	2000	JPY 4,415,000,000,000
Taisho Life Insurance Company	2000	JPY 191,000,000,000
Tokyo Mutual Life Insurance Co.	2001	JPY 763,000,000,000
Yamato Mutual Life Insurance Co.	2008	JPY 259,000,000,000
		<b>JPY 15,060,000,000,000</b>

**United Kingdom**

Name	Liquidation date	Total liabilities
Equitable Life Assurance Society	2000	GBP 1,500,000,000
Eurolife Assurance (Internation) Ltd.	2009	GBP 954,879
The Aldgate Insurance Company Ltd.	2009	GBP 6,828,292
The Exchange Insurance Company Ltd.	2010	GBP 71,099
LEMMA Europe Insurance Company Ltd.	2012	GBP 4,622,607
Municipal Mutual Insurance Ltd.	2012	GBP 295,641
		<b>GBP 1,512,772,518</b>

**U.S. Life and Health**

Name	Liquidation date	Total liabilities
Mutual Benefit	1991	US\$13,000,000,000
Confederation Life	1994	US\$16,000,000,000
Lincoln Memorial Life Insurance Company	22/09/2008	US\$672,215,165
Memorial Service Life Insurance Company	22/09/2008	US\$208,964,312
Medical Savings Insurance Company	26/02/2009	US\$16,042,702
Imerica Life and Health Insurance Company	03/05/2010	US\$12,254,210
Booker T Washington Insurance Company, Inc.	05/05/2010	US\$26,934,713
Universal Life Insurance Company	05/05/2010	US\$11,743,129
National States Insurance Company	15/11/2010	US\$58,514,838
Golden State Mutual Life Insurance Company	28/01/2011	US\$8,191,012
Standard Life of Indiana	26/07/2012	US\$33,591,246
Universal Health Care Insurance Company	01/04/2013	US\$54,560,175
Executive Life Insurance Company of New York	08/08/2013	US\$2,571,399,582
		<b>US\$42,862,140,359</b>



## U.S. P&amp;C

Name	Liquidation date	Total liabilities
Superior National Insurance Company	2000	US\$559,000,000.00
Reliance Insurance Company	2001	US\$9,800,000,000.00
Phico Insurance Company	2002	US\$633,000,000.00
Fremont Indemnity	2003	US\$1,100,000,000.00
Legion Insurance Company	2003	US\$3,500,000,000.00
New Jersey Exchange Insurance Company	11/02/2008	US\$1,539,611.00
MIIX Insurance Co.	09/04/2008	US\$791,719,507.00
Guarantee Title and Trust Company	27/10/2008	US\$6,705,610.00
Austin Indemnity Lloyds Insurance Company	29/12/2008	US\$2,502,030.00
Valor Insurance Company, Inc.	27/05/2009	US\$1,741,364.00
Colonial Indemnity Insurance Company	07/07/2009	US\$1,116,898.00
Consumer First Insurance Company	21/07/2009	US\$7,086,996.00
First Commercial Insurance Co.	24/08/2009	US\$62,378,003.00
First Commercial Transportation and Property Insurance Co.	24/08/2009	US\$11,710,581.00
American Keystone Insurance Co.	09/10/2009	US\$16,081,225.00
Southeastern U.S. Insurance Inc.	27/10/2009	US\$38,811,569.00
Park Avenue Property and Casualty Insurance Co.	18/11/2009	US\$75,653,621.00
Insurance Corporation of NY	10/03/2010	US\$174,920,439.00
Magnolia Insurance Co.	20/04/2010	US\$84,277,097.00
Northern Capital Insurance Company	01/05/2010	US\$64,077,343.00
Imperial Casualty and Indemnity Insurance Co.	12/05/2010	US\$27,270,745.00
Financial Advisors Assurance Select RRG	20/05/2010	US\$1,134,367.00
Gibraltar National Insurance Company	21/05/2010	US\$3,567,827.00
Titledge Insurance Company of New York	16/06/2010	US\$30,198.00
Coral Insurance Co.	26/07/2010	US\$5,120,503.00
Pegasus Insurance Co.	12/08/2010	US\$4,196,997.00
Georgia Restaurant Mutual Captive Insurance Company	21/09/2010	US\$1,077,528.00
Colonial Cooperative Insurance Company	30/09/2010	
Constitutional Casualty Co.	03/01/2011	US\$15,436,561.00
Aequicap Insurance Co.	07/03/2011	US\$25,881,133.00
Seminole Casualty Insurance Company	15/03/2011	US\$31,605,541.00
Atlantic Mutual Insurance Company	27/04/2011	US\$230,553,824.00
Centennial Insurance Company	27/04/2011	US\$76,888,317.00
Reinsurance Company of America	27/04/2011	US\$4,602,676.00
Western Insurance Company	13/09/2011	US\$19,531,409.00
National Group Insurance Company	10/10/2011	US\$2,627,145.00
National Insurance Company	25/10/2011	US\$63,695,269.00
American Sterling Insurance Company	26/10/2011	US\$2,427,631.00
Homewise Preferred Insurance Company	04/11/2011	US\$16,242,012.00
Homewise Insurance Company	18/11/2011	US\$24,638,533.00
Southern Eagle Insurance Company	16/12/2011	US\$9,896,263.00
Autoglass Insurance Company	09/01/2012	US\$275,683.00
First Sealord Surety, Inc.	08/02/2012	US\$1,424,543.00
Garden State Indemnity Company, Inc.	22/06/2012	US\$4,421,315.00
Northern Plains Insurance Company, Inc.	18/09/2012	US\$1,029,811.00
Frontier Insurance Company	09/11/2012	US\$149,664,046.00
Santa Fe Auto Insurance Company	05/04/2013	US\$25,209,640.00
American Manufacturers Mutual Insurance Company (1)	10/05/2013	US\$172,664,150.00
American Motorists Insurance Company (1)	10/05/2013	US\$596,184,940.00
Lumbermens Mutual Casualty Company (1)	10/05/2013	US\$1,118,812,471.00
Drivers Insurance Company	13/05/2013	US\$31,607,771.00
Ullico Casualty Company	30/05/2013	US\$380,604,067.00
American Fellowship Mutual Insurance Company	12/06/2013	US\$7,362,756.00
Pride National Insurance Company	10/07/2013	US\$17,055,624.00
Gramercy Insurance Company	26/08/2013	US\$49,401,330.00
ICM Insurance Company	23/12/2013	US\$4,235,388.00
		<b>US\$20,058,699,908.00</b>

1: companies part of Lumbermens group.

---

---

## ABOUT THE AUTHORS

### **Etti Baranoff, Research Director, Insurance and Finance, The Geneva Association**

Etti Baranoff has been the Research Director for Insurance and Finance at The Geneva Association since October 2010. She has also been an associate professor of Insurance and Finance at Virginia Commonwealth University (VCU) in Richmond VA since 1995. At VCU she teaches insurance, pensions, employee benefits and finance topics. Prior to her academic career, she served as a Texas insurance regulator for 12 years. Baranoff is a former member of the prestigious Risk Theory Society and has authored or co-authored more than 50 papers relating to risk management and insurance as well as textbooks in risk management and insurance. She is also co-laureate of the Geneva Association/IIS Shin Research Excellence Award of 1997, 2004, 2006 and 2008. She earned her Ph.D. in finance, insurance and statistics from the University of Texas at Austin in 1993. Her research subjects include solvency detection models, capital and risk relationship, risk financing, enterprise risk management, asset allocation models and market discipline.

### **Peter Gallanis, President, NOLHGA**

Peter Gallanis joined the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) as its president in April 1999. He is responsible for the financial, legal, administrative, and educational services that NOLHGA provides to its 51 member associations.

Before coming to NOLHGA, Gallanis served as the special deputy receiver for the state of Illinois. He was also an adjunct professor of Insurance Law at DePaul University College of Law and an attorney in private practice in Chicago. He holds a bachelor's degree from the University of Chicago and a law degree from the University of Illinois College of Law.

### **Makoto (Mack) Okubo, General Manager, Nippon Life Insurance Company**

Mack is assigned as General Manager, International Affairs, Nippon Life Insurance Company. He is based in New York and responsible for international accounting and regulatory matters. Among other global activities, he is currently serving as the Sherpa of the Asia Pacific Financial Forum (APFF) Insurance and Retirement Income Work Stream in APEC region. Previously, he reviewed Nippon Life's overseas operations, mergers and acquisitions, and global risk management strategy from July 2006 to January 2008.

From April 2002 to June 2006, he was employed by the Bank for International Settlements (BIS) and served as a member of the IAIS (International Association of Insurance Supervisors) Secretariat, sponsored by FSA Japan. Within the Secretariat, he was responsible for standards implementation, including technical assistance and training of insurance supervisors over 150 countries.

Prior to the BIS, he had 14 years of experience in Nippon Life Group, mainly on planning and research on accounting, pensions and financial service laws and regulations. He also spent 5 years in New York as a lead researcher at NLI Research Institute on banking, securities and insurance sectors in the United States and Canada, and launched his personal site, Insurance-Finance.Com, a research portal for industry professionals, regulators and researchers used in over 90 countries.

He holds a bachelor of law from Kyoto University, and MBA and MS Finance from HEC School of Management, France. He speaks Japanese, English, French, Spanish and some German.







This report presents some of The Geneva Association's investigations over the past few years into insurance insolvency cases from around the world and the most important lessons learned for improving resolution regimes. In this first report, the case studies include three U.S. and eight Japanese life insurance insolvencies. The main objective in examining these cases is to identify the best practices for ensuring smooth, non-disruptive resolutions, with a focus on policyholder protection and the overall stability of financial markets and economies.



The Geneva Association—“International Association for the Study of Insurance Economics”  
Geneva | Route de Malagnou 53, CH-1208 Geneva | Tel: +41 22 707 66 00 | Fax: +41 22 736 75 36  
Basel | Sternengasse 17, CH-4051 Basel | Tel: +41 61 201 35 20 | Fax: +41 61 201 35 29