

**A PROPOSAL  
FOR A SWEDISH  
INSURANCE  
GUARANTEE  
SYSTEM**

**SUMMARY**

THE INSURANCE GUARANTEE COMMITTEE

SOU 1998:22



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## To the Minister of Finance

At the Cabinet meeting of 7 November 1996, it was decided that a Special Investigator should be appointed with the task of investigating how to develop a system for guaranteeing insurance claims in Sweden.

On 12 December 1996, Associate Professor Lars Nyberg was appointed Special Investigator.

The following advisers participated in the work on this report: Olov Hertzman, Managing Director of Swedish Insurance Federation, Bo Hesselgren, Head of Department at the National Board for Consumer Policies, and Claes-Göran Exerman, Economist at the Financial Supervisory Authority. The following specialists also participated: Ph.D Peter Ekegårdh, Svenska Handelsbanken, Thomas Norling, Legal Advisor at the Ministry of Finance, Margareta Kettis, Deputy Head of Department at Sveriges Riksbank, Associate Professor Staffan Viotti, Sveriges Riksbank, and, from 18 August 1997, Magnus Georgsson, Head of Section at the Ministry of Finance.

The secretaries for the investigation were Judge Stellan Fors and Erik Utterström MA.

The Committee adopted the name "The Insurance Guarantee Committee".

The Committee hereby submits its report, SOU 1998:22, Insurance Guarantee.

Stockholm, January 1998

(signed)  
Lars Nyberg

/Stellan Fors  
Erik Utterström

*Försäkringsgarantiutredningen*



## Summary

### Introduction

A guarantee system for insurance compensation, "insurance guarantee", should be seen as a complement to the proposals put forward by the Swedish Insurance Committee (Försäkringsutredningen) in its final report (SOU 1995:87). (A summary of the final report is available in English translation.) The proposals of the Swedish Insurance Committee give insurance companies greater freedom in product design, which is expected to improve competition and benefit policyholders. The proposals inevitably mean, however, that the risk of bankruptcy among insurance companies will increase, which necessitates that the protection for policyholders in such a situation be strengthened.

A starting point for the present proposal for a guarantee system for insurance compensation is that the proposals of the Swedish Insurance Committee are implemented.

The aim of the guarantee system is that the policyholder receives compensation in accordance with the contract entered into, even if the insurance company runs into financial trouble. After a company is declared bankrupt, a guarantee will secure at least the major part of the insurance compensation for those entitled to compensation. In order to reduce costs and to achieve greater flexibility, actions may be taken by the system even before a declaration of bankruptcy. The guarantee system will also allow those entitled to compensation to receive payment of the insurance compensation more quickly than if they had to wait for payment until the distribution after bankruptcy was complete.

### EU regulations

There is no compulsion under EU regulations to introduce a guarantee system. However, under Article 45 of the Third Council Directive on Non-life Insurance (92/49/EEC), the Directive does not prohibit national regulations which prescribe that insurance companies must participate in guarantee systems intended to safeguard the payment of insurance compensation to policyholders and third parties who have suffered damage. No equivalent provision was incorporated in the Third Council Directive on Life Insurance (92/96/EEC). The provisions of the

Non-life Insurance Directive must, however, be understood to mean that guarantee systems can be prescribed for both non-life and life insurance undertakings. It should be borne in mind that Great Britain has had such a system for life insurance since the mid-1970s. The proposals put forward in the report are compatible with EU rules both in the insurance area and in general.

## Administration

The guarantee system shall be administered through a body established under civil law as a non-profit association, and to some extent subject to public regulation. Insurers who provide insurance that may establish a right to compensation under the guarantee must be members of the association, known as the Insurance Guarantee Association, to carry on insurance business.

In order to create satisfactory public control, and to safeguard, among other things, the interests of policyholders, the Chairman and one other member of the Association's Management Committee should be appointed by the government. Other members will be appointed by the Association, and will preferably be selected from the insurance industry. Further provisions as to how the operations of the Association are to be run can be included in the Charter of the Association.

## Insurers

The Committee proposes that rules for the guarantee system should apply to insurers who are under the supervision of the Swedish Financial Supervisory Authority. This applies, accordingly, to Swedish companies which are supervised under the Insurance Operations Act (1982:713)(FRL) and those foreign companies which are supervised under the Act on Foreign Insurance Company Operations in Sweden (1950:272)(LUF). Insurers who are based in an EEA country other than Sweden are consequently not covered, even if they conduct business in Sweden. These insurers are subject to the legislation and supervision which applies in their respective countries of origin, where other provisions for the protection of policyholders have been made. This has also led the Committee to not prepare any opportunity for voluntary participation for insurers from other EEA countries.

All branches of Swedish companies, even outside the EEA, are under the supervision of the Swedish Financial Supervisory Authority. If no limitation is made in respect of where the risk is located or where a



commitment is to be fulfilled, policyholders with Swedish branches outside the EEA are also covered. This is not justified, since these branches are, in the majority of cases, also subject to other legislation in the host country. The Committee has concluded that for a risk to be covered by the guarantee system, it should be located in the EEA. This means, for example, that an Italian citizen who takes out home or life insurance in his home country with a Swedish company will be covered by the system.

For insurers who provide insurance that will be covered by the guarantee system, it shall be obligatory to be a member of the Association which administers the system. This applies both to Swedish and foreign insurers, and will, consequently, be a condition for conducting insurance business. For foreign companies, it will, naturally, only be their operations in Sweden that will be covered by the guarantee system.

It is proposed that the provisions also apply to mutual companies that may, under their articles of association, charge their policyholders a levy to cover losses.

## Non-life insurance

The Committee proposes that the guarantee system shall cover non-life insurance compensation that is based on insurance which is taken out by the consumer primarily for private purposes, and which, therefore, does not refer to the policyholder's business or commercial activities. In this connection a deceased person's estate is given parity of treatment with a consumer.

Compensation based on liability insurance is always covered if the injured party damage is a physical person. A company may receive compensation from the system if it is subject to a claim that is covered by liability insurance taken out by a consumer. On the other hand, no compensation is payable under the guarantee if both the injured party and the policyholder are companies.

The guarantee does not cover insurance compensation from non-life insurance based on collective agreement by the labour market parties.

Besides unregulated damages in the event of a declaration of bankruptcy, the guarantee covers insurance cases that occur within three months from the date of declaration of bankruptcy. This gives the policyholder reasonable time to inform himself about the bankruptcy and to take out a new insurance policy with another company.

The proposed lower limit for compensation claims from a non-life insurance policy covered by the guarantee should be one quarter of the basic amount; for 1998 this would be just over SEK 9,000. An advan-

tage of this is that it would exclude compensation for all minor injuries, which is an advantage from an administrative point of view. This amount constitutes an excess for which the insured is himself responsible.

The proposed upper limit for compensation paid out for each claim under the guarantee is 100 base amounts, i.e. a level currently of SEK 3.6 million. This sum is considered to accommodate the highest estimated claim for compensation from a normal consumer, e.g. if a house burned down.

The limits on compensation levels do not apply to third parties entitled to compensation. For annuities and sickness payments, it is proposed that the compensation be limited in the same way as for life insurance.

## Life insurance

All life insurance compensation is covered by the guarantee irrespective of what kind of insurance the compensation is based on. However, compensation, which is based on collective agreement based insurance, is not covered. The life insurance system works on the principle that life insurance policies retain their term and are transferred to another insurer. It is proposed that the compensation to be paid out under the guarantee system, irrespective of the form this takes, amounts to 90 per cent of the contracted insurance benefits, and this makes the excess 10 per cent.

## Reinsurance

Claims for compensation based on reinsurance taken out are not covered by the guarantee.

## Action before bankruptcy

With the aim of giving the guarantee system greater flexibility, the system may also be activated before an insurance company is declared bankrupt. The company itself must approach the Insurance Guarantee Association with a request for support. The Association then has to decide whether financial support shall be paid. This support may, for example, consist of funds that must be contributed before the transfer of an insurance portfolio can take place. When the Association is assessing whether to provide support to a company in financial difficulties,



the essential starting point is to reduce costs compared to what would have to be paid out in the event of a declaration of bankruptcy. The crisis-hit company should then be in such a situation that the guarantee system sooner or later would have had to give financial support. A condition of support should always be that it be repaid in the event the company recovers financially and continues trading. Nor may any support go to benefit shareholders.

The supervisory activities of the Swedish Financial Supervisory Authority are not affected by the rules covering the guarantee system. If an insurance company encounters financial difficulties, the Swedish Financial Supervisory Authority must take action under the current supervision legislation.

## Payment after bankruptcy

In the event of bankruptcy for an insurance company, it is important that those who are waiting for compensation from the company, or who receive compensation on a continuous basis, should have access to their money as quickly as possible. There are currently no rules which ensure this. If a guarantee system is introduced, however, it is reasonable that it also be used for this purpose. The bankruptcy process can unfortunately take a long time. The official receiver can, of course, pay out any surplus before the division takes place. It can, however, take a comparatively long time before such a payment of surplus can take place, and the regulations provide no guarantee that those who are entitled to compensation receive compensation within what can be considered a reasonable time. To avoid delay, the guarantee system should come into effect prior to the distribution of the bankruptcy estate, and should, within a period stated in the law, pay the insurance compensation with the limits laid down for the guarantee, including excess. When payments are being made, the Association should take over the claims of those entitled to compensation under the bankruptcy.

It will take some time before the Insurance Guarantee Association has been notified of the information necessary as a basis for paying out insurance compensation. The Association will also need time to acquire the funds for the payment. At the same time, policyholders should have access as soon as possible to the insurance compensation they are entitled to. Three months could be considered as a reasonable time for the Association to make provision for payment. If exceptional circumstances arise, the Association should be able to further extend this period.



## Financing

The rules to which insurance companies are subject have led the Committee to conclude that the likelihood of an insurance company going bankrupt is small. Priority right, international experience, slow development of insolvency situations in a life company and limitations in the obligations of the system have led the Committee to conclude that costs in the event of a bankruptcy would be relatively low. The financing of the system should be based on this assumption.

The Committee considers that costs that arise for the guarantee system should be financed through a levy. Funding outside companies, or as a reserve in the companies' balance sheets, is not necessary, given that the system is only expected to be used to a small extent. Furthermore, the setting of the levy when funds are required would be arbitrary, since it is not possible to determine the costs of the system. Nor is there any reason to believe that insurance companies would not be able to cope with costs of the system when they do arise. In most countries with an equivalent guarantee system, the chosen financing system has involved levies charged after the event.

Companies that are members of the Association at the date on which the levies are imposed will contribute to the payment of the Association's costs.

As in other countries that have a guarantee system, it is proposed that the levy be set in relation to the premium income of the insurance companies. This ensures that companies' contributions are in proportion to their business volume, which can be considered a fair division of the levy. Levies for life and non-life insurance companies should be imposed separately.

The levy should be based on an average of figures for the company's operations for the three years prior to the levy being imposed. Spreading the figures in this way can help to avoid, to some extent, fluctuations in premium income having a substantial impact on the collection of the levy.

The proposed maximum levy is one per cent per year, a level that has proved completely satisfactory in other countries. The insurance companies are at liberty to make a higher deduction on condition that the companies in the Association agree. If the Association is to be able to compensate policyholders rapidly, it is essential that it can obtain financing from its member companies in a short time. The basis for charging the levy should, therefore, be determined annually by the Association.

## Priority right

One condition for the guarantee system should be that the policyholders have a priority right to assets that have been registered as reserves to cover insurance provisions. Under the current regulations, only life insurance policyholders have such a priority right. If the registered assets are not used primarily to cover the claims of policyholders in a bankruptcy, this may mean that these assets are used to compensate other claim owners, prioritised or unprioritised. The funds levied on other insurance companies for the guarantee system can then be used to repay debts other than the policyholders' during the bankruptcy, and this would mean an increased load on the system. The Committee therefore proposes that the special priority right should also cover all non-life insurance claims and apply to all those entitled to compensation, not only to policyholders. This is also in accordance with a proposal in the EC Directive from 1987 on the co-ordination of rules for compulsory liquidation of insurance companies.

## Disclosure requirements

An insurer who undertakes insurance operations in any form in Sweden must inform all those who have taken out, or who intend to take out, an insurance policy about the insurance guarantee. Through this general provision, those who are not covered by the guarantee are also to be informed.

## Judicial Review

The Association's decisions cannot be appealed in the same way as if the guarantee system was administered by a public authority. If a party who is entitled to compensation under the guarantee system is dissatisfied with the decision, an action may be brought in court to have the matter reviewed.







