ACPR

BANQUE DE FRANCE

Implementation of resolution instruments applicable to insurance undertakings and resolution strategies

RESOLUTION DIRECTORATE

October 2021

Table of contents

Background 4
1 Overview of resolution instruments 5
1.1 Portfolio transfer 5
1.1.1 Purpose of the instrument 6
1.1.2 Implementation methods..7
1.1.2.1 Scope of the transfer...7
1.1.2.2 Determination of the transferee 7
1.1.2.3 Implementation time frame...8
1.2 The bridge undertaking 9
1.2.1 Purpose of the instrument 9
1.2.2 Implementation methods..10
1.2.2.1 Scope of the transfer...10
1.2.2.2 Establishment of a bridge undertaking 10
1.2.2.3 Implementation time frame...11
1.3 The liability management structure 12
1.3.1 Purpose of the instrument 12
1.3.2 Implementation methods..12
1.3.2.1 Specific characteristics of the trust 12
1.3.2.1.1 Definition of trust and parties to the contract 12
1.3.2.1.2 Accounting and prudential implications of the trust....................................13
1.3.2.1.3 Compensation of the undertaking under resolution and remuneration of the beneficiary in trust...14
1.3.2.2 Scope of the transfer...15
1.3.2.3 Determination of the transferee 15
1.3.2.4 Implementation time frame...16
2 Determination of the resolution strategy 17
2.1 External factors 18
2.1.1 The nature of the critical function to be safeguarded..18
2.1.2 The degree of market concentration 18
2.1.3 Other external factors...19
2.2 Internal factors..19
2.2.1 Portfolio volume and market position of the undertaking 19
2.2.2 The complexity and degree of standardisation of contracts...............................19

2.2.3 The attractiveness of portfolios 19
2.2.4 Other internal factors 20

Background

The resolution regime for insurance undertakings implemented by Ordinance No. 2017-1608 of 27 November 2017 on the creation of a resolution regime for the insurance sector provided public authorities with new powers and tools in order to better prevent the failure of insurance undertakings or groups and to minimise the possible adverse consequences of such failures. It allows for the resolution college of the *Autorité de contrôle prudentiel et de résolution* (ACPR) to have at its disposal swift and enhanced instruments and powers with regard to insurers in difficulty so as to prevent the adverse consequences of possible failures in this sector on policyholders, financial stability, the economy or public finances[1].

The purpose of this note is to provide a first reading of the implementation of the resolution instruments introduced into French law by this Ordinance.

This note presents the specific features of each instrument as well as the operational modalities of their implementation (Part 1) in order to define the most appropriate instruments to be used in relation to a given undertaking and according to the crisis scenario that led to its failure (Part 2).

This initial approach, which may be amended and supplemented in the future based on additional analyses, will be used to draft the first resolution plans of the various undertakings subject to the preventive component of the regime.

[1] Report to the French President on the Ordinance No. 2017-1608 of 27 November 2017 on the creation of a resolution regime for the insurance sector, NOR: ECOT1716783P, ELI: https://www.legifrance.gouv.fr/eli/rapport/2017/11/28/ECOT1716783P/jo/texte, OJFR, No. 0277 of 28 November 2017, Text No. 21

1 Overview of resolution instruments

The ACPR has three instruments at its disposal following the entry into resolution of an insurance undertaking:

- A **portfolio transfer**[2], which entails the transfer of all or part of a portfolio of insurance contracts, transactions, policy or benefit subscription contracts from one failing undertaking to another insurance undertaking;
- The establishment of a **bridge undertaking**[3] the purpose of which is to temporarily hold all or part of the liabilities to be safeguarded and maintained and all or part of the related assets, with a view to placing them on the market;
- The establishment of a **liability management structure**[4] in the form of a trust estate to hold all or part of the insurance contracts and transaction portfolios in view of their extinctive management, as well as part of the assets.

The three resolution strategies for insurance undertakings are therefore based on the following **principle: transferring the activities to be safeguarded**, i.e. the critical functions[5], along with, where appropriate, activities representing a significant source of revenue or profit, and **then winding up the residual undertaking**.

The resolution strategy is tailored to the failing undertaking and to the group it is a part of, as well as to the critical functions it performs and to market conditions. The instruments may be used separately or jointly.

It should be noted that the ACPR also has administrative and disciplinary powers as regards resolution procedures other than portfolio transfers[6]. These powers are either used on their own, or they support or serve the implementation of resolution instruments. They are not the focus of this note.

1.1 Portfolio transfer

An insurance portfolio transfer is the operation by which an undertaking transfers its liabilities to another duly authorised undertaking.

---

[2] See point 4 of Article L. 311-30 of the *Code des assurances*

[3] See Article L. 311-35 of the *Code des assurances*

[4] See Article L. 311-41 of the *Code des assurances*

[5] According to Article L. 311-2 of the *Code des assurances*, "critical functions" shall mean a person's activities, services or operations matching the following characteristics: (i) they are provided by said entity to unrelated third parties; (ii) the inability of said entity to perform them would be likely to have a significant impact on financial stability or on the real economy; and (iii) said entity's contribution cannot be replaced at a reasonable cost and within a reasonable time.
For further information on critical functions, refer to the note on the identification of the critical functions of insurance undertakings published on the ACPR's website.

[6] See Articles L. 311-29 to L. 311-34 of the *Code des assurances*

A distinction should be made between transfers carried out at the request of an insurance undertaking that is not in financial distress, and the various transfers that may be triggered at the request of the ACPR should that undertaking be facing a crisis.

1. Under normal circumstances:
   1.1. Transfer initiated by the undertaking to serve its strategy and subject to approval by the ACPR (Article L. 324-1 of the *Code des assurances*).
2. During the recovery phase:
   2.1. Transfer carried out by the undertaking itself at the request of the supervisory college (Section I, point 13 of Article L. 612-33 of the *Code monétaire et financier*),
   2.2. Mandatory transfer ordered by the supervisory college following the failure of the above-mentioned transfer procedure (Section I, point 14 of Article L. 612-33 of the *Code monétaire et financier*).
3. During the resolution phase:
   3.1. Transfer initiated by the undertaking itself at the request of the supervisory college (Point 3 of Article L. 311-30 of the *Code des assurances*),
   3.2. Mandatory transfer ordered by the resolution college following the failure of the transfer procedure mentioned in section 3.1 (Point 4 of Article L. 311-30 of the *Codes des assurances*).

The transfer that forms a resolution instrument at the resolution college's disposal is referred to above, in point 3.2. It can only be used after the failure of the transfer procedure mentioned in point 3.1 has been acknowledged. For the sake of simplicity, in the remainder of this note, the transfer procedures will be respectively referred to as "**amicable transfer**", for the procedure mentioned in point 3.1, and "**mandatory transfer**" for the one mentioned in point 3.2.

In the context of a resolution procedure as regards an insurance undertaking, the resolution college may order the mandatory transfer to an acquirer of all or part of a portfolio of insurance contracts, transactions, or policy or benefit subscription contracts held by the undertaking under resolution.

1.1.1 Purpose of the instrument

The transfer of a portfolio aims to safeguard a critical function as regards stocks in the best possible conditions, through the management of incurred claims (whether they are declared or not), and cash flows, through the continuation and possible renewal of the coverage of existing contracts.

The management of incurred claims, whether declared or not, is immediately taken over by one or more existing undertakings with the necessary expertise to manage these cases or willing to develop their business in a new business sector.

The expected transfer price should allow for a fair and satisfactory prior compensation of the failing undertaking.

Consequently, the portfolio transfer instrument is the instrument that best safeguards critical functions and is therefore the default preferred resolution strategy for undertakings performing one or more critical functions.

The main obstacle to the implementation of this instrument is the possible lack of a prospective buyer during the tender process. In this case, the resolution college must use another resolution strategy, i.e. combining the mandatory transfer with an additional instrument (e.g. if the obstacle to recovery is the presence of unattractive contracts) or using one or more alternative resolution instruments.

1.1.2 Implementation methods

The mandatory transfer in the resolution phase is similar to the mandatory portfolio transfer procedure carried out in the recovery phase pursuant to Article L. 612-33-2 of the *Code monétaire et financier*.

1.1.2.1 Scope of the transfer

The transfer concerns portfolios representative of a critical function, along with, where appropriate, portfolios that are not representative of a critical function, insofar as their joint disposal serves the objectives of the resolution[7], in particular in the following cases:

- When the critical function is part of a group of products usually marketed together, so as to ensure profitability at the aggregate level;
- When the activity transferred with the critical function increases the attractiveness of the transfer and thus helps in finding a buyer offering better takeover conditions.

The scope of transfer also includes:

- insurance liabilities;
- assets invested to cover transferred insurance liabilities;
- other provisions not directly assigned to the liabilities or assets transferred, including, where applicable, the deferred participation reserveand the capitalisation reserve;
- reinsurance treaties, where applicable.

1.1.2.2 Determination of the transferee

The transferee is selected by means of a call for tenders issued by the resolution college.

The latter selects the offer(s) which it considers to be in the best interest of the policyholders, having regard in particular to the solvency of the applicant undertakings and, in certain

[7] These objectives are defined in Article L. 311-22, section I, of the *Code des assurances*, which states that "the resolution college shall ensure the continuity of critical functions resulting from the activity of that entity, avoid or mitigate negative effects on financial stability, protect the State's resources from recourse to exceptional public financial assistance and protect the rights of policyholders, underwriters, members, participating members and beneficiaries of insurance coverage ".

circumstances, to the possible insurance liabilities reduction rates they offer[8]. When the resolution college resorts to the mandatory transfer instrument, it uses the insurance guarantee funds[9]. The part of the insured persons' rights that is not covered by the transferee is guaranteed by means of a payment from the guarantee fund to the transferee[10].

In addition to these two criteria, the applicant undertaking interested in the takeover shall have either appropriate knowledge of the activity sector considered or the will to develop its business in that sector, as well as sufficient technical expertise, characterised *inter alia* by an authorisation in France for the transferred branches.

1.1.2.3 Implementation time frame

The mandatory transfer procedure occurs following acknowledgement by the resolution college of the failure of the amicable transfer procedure, which remains a mandatory prerequisite under resolution.

In order to initiate this amicable transfer procedure, the resolution college orders the undertaking under resolution to submit a transfer application within a time frame decided by the college which cannot be shorter than a month[11]. If the undertaking succeeds in submitting a transfer project within the allocated time frame, that project is presented to the creditors by way of a notice published in the Official Journal (OJ). Afterwards, creditors have two months to submit their comments[12].

Should the transfer be contrary to the interests of the policyholders, or should it trigger a significant drop in the SCR coverage ratio within the transferee, the supervisory college may reject the project before the end of the creditor consultation period. Conversely, if the project complies with those requirements, the college has two months, following the end of the 2-month period intended for creditor comments, to approve the transfer project where appropriate. This decision is published in the Official Journal, which makes the transfer enforceable against the policyholders, underwriters and beneficiaries of insurance contracts as well as against creditors.

In the event of a transfer involving the intervention of another EU Member State, the approval of that country's supervisory authority is required to obtain that of the ACPR. This approval should take place within a maximum of 3 months[13].

---

[8] See Section I, 3rd subparagraph, of Article L. 612-33-2 of the *Code monétaire et financier* made applicable by reference from Article L. 311-31 of the *Code des assurances*. Should the ACPR consider, in the light of the objectives of the resolution process and in particular the aim to protect the rights of the insured, that the proposed reduction rates are too low, it may deny applications.

[9] See section I of Articles L421-9-1 and L. 423-2 of the *Code des assurances*

[10] See Article L. 423-3 of the *Code des assurances*

[11] See Article L. 311-30, point 3 of the *Code des assurances*

[12] See 2nd subparagraph of Article L. 324-1 of the *Code des assurances*

[13] See 6th subparagraph of Article L. 324-1 of the *Code des assurances*

The acknowledgement of the failure of that amicable procedure may have several causes:

- The failing undertaking cannot find a buyer or is not able to submit its transfer project within the allotted time frame;
- The ACPR does not give its approval to the transfer project;
- The supervisory authorities of the EU Member State, where applicable, notify their refusal.

During the recovery phase, the decision to initiate a mandatory transfer procedure is made known to the entire market by means of a notice published in the Official Journal. This notice gives rise to a fifteen-day period during which interested parties shall make themselves known to the ACPR[14]. In the case of resolution, the same requirements regarding the duration of the tender procedure could apply when the resolution college decides to initiate the mandatory transfer procedure.

Additionally, the transfer decision and the name of the transferee undertaking are subject to disclosure requirements.

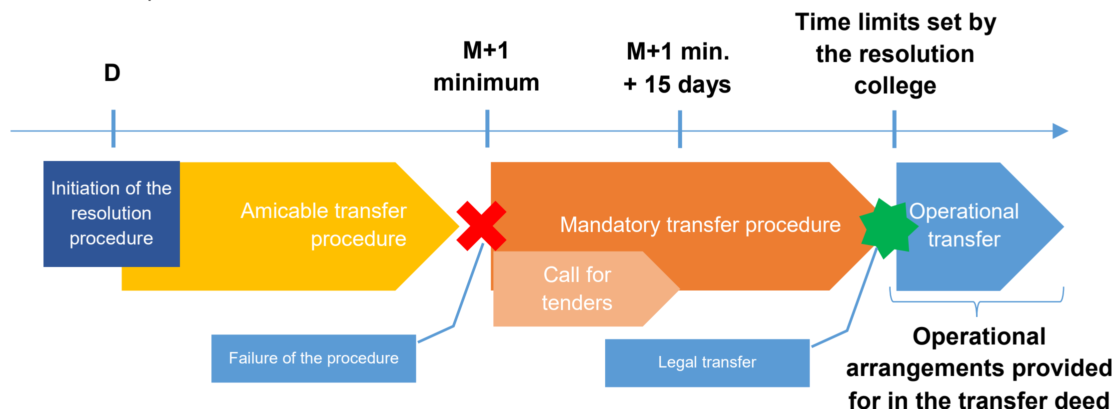

Figure 1 - Minimum time frame for the implementation of the mandatory transfer instrument

1.2 The bridge undertaking

When an undertaking is subject to a resolution procedure, the resolution authority may establish a bridge undertaking to <u>temporarily hold all or part of the liabilities and assets of that undertaking, with a view to the subsequent sale</u> of those portfolios to one or more existing buyers. The bridge undertaking could also, in addition to its main purpose, be used for the run-off management of the short-branches portfolios.

1.2.1 Purpose of the instrument

It should be noted that this procedure may only take place after the resolution college has acknowledged the failure of the amicable portfolio transfer procedure. The establishment of a bridge undertaking is therefore a second-intention procedure, to be used for instance **when**

[14] See Article R. 310-19 of the *Code des assurances*

market conditions are not favourable for a sale at the time when the undertaking goes under resolution. This instrument can also be used in conjunction with a liability management structure, so as to restructure the portfolios of the undertaking under resolution in anticipation of reorganisation measures before they are put on the market.

The use of this instrument allows for the safeguarding of a critical function by ensuring continuity of coverage. Depending on the strategy defined at the time of the establishment of the bridge undertaking, its business may range from the extinctive management of liabilities to a business development goal (e.g. in the case of a bridge undertaking that is co-owned by several market players).

1.2.2 Implementation methods

1.2.2.1 Scope of the transfer

The transfer to the bridge undertaking includes portfolios representing a critical function together with, where appropriate, activities representing a significant source of revenue or profit to the extent that their joint disposal serves the objectives of the resolution procedure.

It should be noted that, upon decision by the resolution college, and if expressly provided for at the time of the initial transfer, for the duration of the resolution procedure, any assets or liabilities acquired by the bridge undertaking may be[15]:

- Transferred back to the undertaking under resolution without the latter being able to dispute such transfer: for example, in cases where a post-transfer analysis shows that poor quality liabilities have been transferred to the bridge undertaking, even though the bridge undertaking was set up to identify economically viable liabilities for transfer;
- Transferred to a third party, including an external buyer if one can be found.

1.2.2.2 Establishment of a bridge undertaking

A bridge undertaking is a legal person distinct from the person subject to the resolution procedure, created in the form of a limited company, for which the resolution college approves:

- The ownership structure;
- The strategy;
- The risk profile;
- The activities.

The authorisation and supervision of the bridge undertaking are the responsibility of the supervisory college.

[15] See article L. 311-37 of the *Code des assurances*

The amount of (share[16] and regulatory) capital required for the establishment of a bridge undertaking and its ownership structure are both determined at the time of its establishment.

The undertaking under resolution, which theoretically has positive net assets at the time of the opening of the resolution procedure, may have to capitalise the bridge undertaking itself. It would then own the equity securities of the new undertaking until they are sold before or during the winding-up proceedings of the residual entity.

The contribution of industry participants could be envisaged through the constitution of a market structure. These co-shareholders would capitalise the bridge undertaking, allowing insurers to share the risk.

A bridge undertaking is initially set up for a period of two years, after which its activities will have to be transferred to one or more buyers. The duration of the institution may be extended if market conditions so require, for a renewable period of one year.

Following the transfer of its activities, the bridge undertaking will have its authorisation withdrawn by decision of the resolution college[17]. In accordance with the provisions of Article L. 326-1 of the *Code des assurances*, this decision automatically entails the dissolution of the bridge undertaking as from its publication in the Official Journal.

1.2.2.3 Implementation time frame

The transfer procedure towards a bridge undertaking may only take place after the resolution college has noted the failure of the amicable transfer procedure. The latter requires the submission of a transfer request by the undertaking under resolution within a time limit set by the resolution college, **which may not be less than one month** (see 1.1.1.3).

When it considers that the probability of finding a buyer offering acceptable takeover conditions is low, the resolution authority may anticipate the establishment of the bridge undertaking during the first phase.

In addition, the transfer decision to the bridge undertaking is subject to disclosure requirements.

---

[16] The minimum amount of share capital required to set up a limited insurance company (*société anonyme d'assurance*) is set out in Article R. 322-5 of the *Code des assurances*, at EUR 800,000 for transactions falling within the classes mentioned in sections 10 to 15, 20, 21, 22, 24, 25 and 28 of Article R. 321-1 as well as for reinsurance transactions. For all other insurance classes, the minimum share capital requirement is set at EUR 480,000.

[17] See Article L. 311-39 of the *Code des assurances*

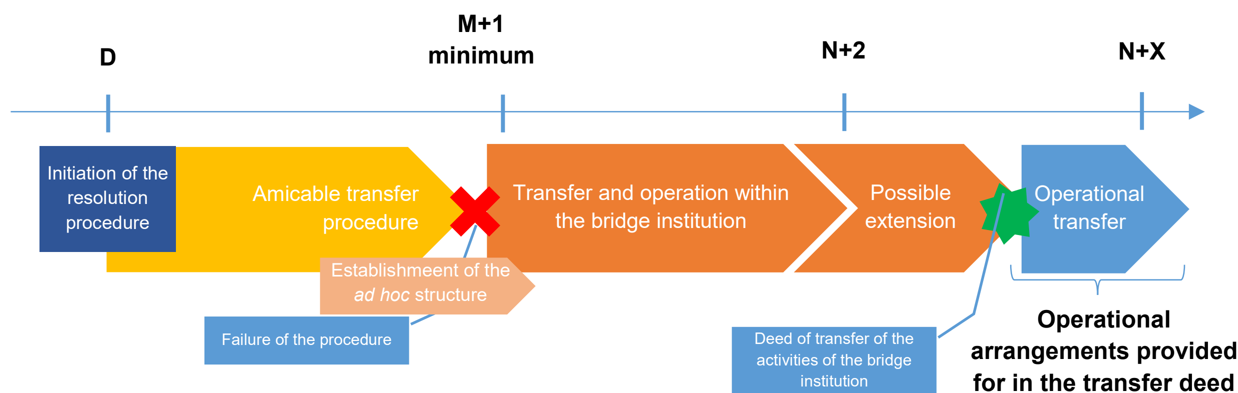

Figure 2 - Minimum time frame for the implementation of the bridge undertaking instrument

1.3 The liability management structure

1.3.1 Purpose of the instrument

The liability management structure is responsible for managing the insurance liabilities transferred to it in run-off mode and until such liabilities are exhausted.

This instrument may be used:

- On its own, to ensure the continuity of a critical function from the point of view of the management of current contracts and claims, when the market is able to naturally absorb new production and contract renewals;
- In addition to another resolution instrument, it allows for a critical portfolio to be restructured by transferring to a defeasance structure the insurance liabilities the intrinsic characteristics of which make their traditional operation unprofitable or generate excessive regulatory capital requirements. The purpose of this transaction is to make it easier to find a buyer for the remainder of the portfolio to be transferred.

The main difficulty in setting up this instrument is finding a buyer interested in managing an impaired portfolio. However, the legal form of this structure entails significant advantages which make it possible to remedy this (reduced regulatory capital requirements, remuneration paid for the management of commitments, profit-sharing on the earnings derived of its management, prospect of a favourable deviation of the loss experience).

1.3.2 Implementation methods

1.3.2.1 Specific characteristics of the trust

1.3.2.1.1 Definition of trust and parties to the contract

This structure shall be set up in the form of a trust, involving one or more existing insurers authorised to operate in France in the insurance classes covered by the contracts to be transferred.

"A trust is a transaction whereby one or more settlors transfer property, rights or guarantees, or a bundle of property, rights or security interests, present or future, to one or more trustees who, **keeping them separate from their own assets**, **act for a specific purpose** for the benefit of one or more beneficiaries"[18].

In the case of resolution, the instrument used to segregate activities is implemented as follows:

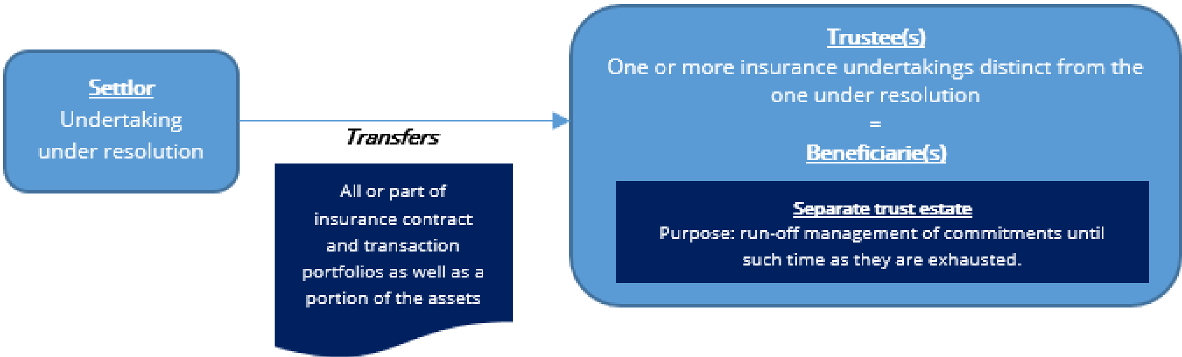

Figure 3 - Implementation of the trust agreement

1.3.2.1.2 Accounting and prudential implications of the trust

The assets and liabilities covered by the trust agreement are transferred from the settlor's assets to the trust, which constitutes special purpose assets separate from the trustee's own assets, with a separate accounting.

In the context of resolution, the trust estate is likely to be constituted through the transfer of positive net assets (excess of assets over liabilities) [19] since, in the event of a shortfall in the trust estate, the estate of the beneficiary-trustees would bear all the liabilities resulting from the trust agreement[20]. In its balance sheet, the settlor replaces the assets and liabilities transferred with a line of rights representing net assets surrendered to the trust[21]. These items are valued at market value since the settlor loses control over them.

---

[18] See Article 2011 of the *Code civil*

[19] See Article 623-4 of the General Chart of Accounts, Regulation No. 2014-03 of the French Accounting Standards Authority (ANC). Commonly a trust estate can be constituted through the transfer of positive net assets (assets exceeding liabilities) or net liabilities (liabilities exceeding assets). In the latter case, the settlor would replace, in its balance sheet, the transferred liabilities with a line of bonds representing net liabilities surrendered to the trust.

[20] See Part IV, section 1 of Article L. 311-42 of the *Code des assurances*

[21] See Article 623-4 of the General Chart of Accounts, Regulation No 2014-03 of the *Autorité des Normes Comptables* (the French Accounting Standards Authority)

By way of symmetry, in the trustee's accounts, the agreement appears as a line equal to the amount of the net assets, valued at market value and vested in trust. The trustee shall also keep separate accounts for the trust estate.

For the purposes of preparing the trustee's prudential balance sheet, the trust estate is represented by an equity security the valuation of which matches the net value[22].

In calculating its Solvency Capital Requirement (SCR), the trustee continues to apply the usual method[23] to the entirety of its own assets, without taking into account its participation in the trust estate. It then adds to this component an additional SCR amount calculated on the basis of the technical provisions of the fiduciary estate up to 0.9% of technical provisions for life[24] and up to 1.65% of the other (non-life) technical provisions[25].

This calculation method makes it possible to alleviate the solvency capital requirements resulting from liabilities vested in trust, in particular by excluding the market risk and operational risk components.

1.3.2.1.3 Compensation of the undertaking under resolution and remuneration of the beneficiary in trust

The *Code civil* states that a trust agreement is deemed null and void if it consists of the gratuitous transfer of assets to the beneficiary. In addition, Article L. 311-42, paragraph VI, of the *Code des assurances* specifies that the agreement shall be entered into in such a way as to guarantee fair and prior compensation for the undertaking under resolution.

At the same time, paragraph IV, section 9 of the same article provides that the trust agreement shall specify the terms and conditions underlying the remuneration of the trustee or trustees received in return for the management services they provide. This remuneration could be paid in the form of a disbursement of funds from the undertaking under resolution to the trustee, or directly taken from the net assets of the trust estate by the trustee.

As this is a transfer for extinctive management purposes, the settlor's customers are not transferred to the trust estate. However, the interest of the trustee insurer will be to develop business relationships with the customers whose contracts have been transferred to the trust under its own brand name. This element could be used to determine the compensation paid by the transferee to the undertaking under resolution (i.e. the transfer price). Other components of the estate (insurance liabilities, other liabilities, assets, etc.) are valued at market value or net asset value. The compensation should not be a disincentive for potential trustee-beneficiaries.

---

[22] See Article R. 323-12 of the *Code des assurances*

[23] In compliance with the rules set up in Article R. 352-2 of the *Code des assurances*

[24] Within the meaning of Article L. 343-3 of the *Code des assurances*

[25] Within the meaning of Article L. 343-7 of the *Code des assurances*

Finally, it should be noted that the trust estate resulting from the extinctive management ultimately passed on to the beneficiary may constitute a gain or a loss, the risk being borne entirely by the trustee.

1.3.2.2 Scope of the transfer

In cases where the liability management structure instrument is used alone, the transfer concerns portfolios representing a critical function, including liabilities and costs.

Where it is used in conjunction with another instrument, the portfolios are split so that the scope of the items to be transferred to the trust is concentrated on:

- the severely impaired contracts in the portfolio that have potentially led to the failure of the undertaking under resolution; and
- the technical provisions related to claims incurred on these contracts at the date of transfer (both reported and unreported).

The insurance contracts or transaction portfolios as well as part of the assets may be transferred to the liability management structure, either by means of a single transfer or several. However, contrary to what the provisions attached to the case of a bridge undertaking allow, there is no right of reverter for the assets and liabilities transferred to the trust estate.

1.3.2.3 Determination of the transferee

The transferee is selected by means of a call for tenders issued by the resolution college.

The resolution college is tasked with selecting the offer(s) which it considers to be in the best interest of policyholders, in particular with regard to the ability of the candidates to efficiently manage the insurance liabilities concerned by the trust agreement.

Industry participants that specialise in the acquisition of insurance portfolios in run-off could be interested in these calls for tenders. This instrument could be appropriate against the background of a downturn in the traditional insurance market. It should be noted that the legal form of a trust implies that the portfolio transfer is limited to undertakings carrying out direct insurance activities as referred to in sections 1, 2 or 3 of Article L 310-1 of the *Code des assurances*[26].

---

[26] Reinsurers, mutual insurance companies and unions governed by the *Code de la mutualité*, including the mutual insurance companies and unions for supplementary occupational pensions mentioned in Article L. 214-1 of this code, provident institutions and unions governed by Book IX, Title III of the *Code de la sécurité sociale* and by section II of Article L. 727-2 of the *Code rural et de la pêche maritime*, and the institutions for supplementary occupational pensions mentioned in Article L. 942-1 of the *Code de la sécurité sociale*, are excluded from the list of potential trustees by Article 2015 of the *Code civil*.

1.3.2.4 Implementation time frame

As with the other instruments, the mandatory transfer to a liability management structure can only take place after an amicable transfer procedure has failed. This may take the form of a portfolio transfer to an insurer or of a transfer to a trustee, this choice being left to the resolution college.

In both cases (portfolio transfer either to an insurer or to a trustee), during the amicable phase of the procedure, the undertaking under resolution has a deadline set by the resolution college, **which may not be less than one month**, to submit a draft portfolio transfer project or trust agreement.

If the amicable transfer procedure fails, the *Codes des assurances* does not mention a deadline for the drafting of the contract. However, the latter must be concluded with a trustee selected by a call for tenders issued by the resolution college. By analogy with the mandatory transfer procedure, candidates may be granted 15 days to make their tender known to the ACPR. Furthermore, the decision approving the trust agreement is subject to disclosure requirements.

The duration of the trust is fixed in the trust agreement, failing which such agreement will be considered null and void. It may not exceed ninety-nine years from the date on which the agreement is signed[27]. Within the framework of resolution, the agreement must also provide that the structure shall be terminated by decision of the resolution college[28] as soon as:

- It has been discharged from or has fulfilled all the liabilities transferred to it;
- It no longer holds any assets;
- Safeguard, receivership or judicial liquidation proceedings are ongoing in respect of the last beneficiary of the trust agreement. The provisions of Article L. 311-48 shall then apply.

Where the resolution college decides to terminate a liability management structure, the liabilities and assets of the trust estate shall be fully incorporated into the estate of the beneficiary in trust without the possibility for the latter to relinquish certain assets or liabilities. The decision is then published in the Official Journal.

[27] See section 2 of Article 2018 of the *Code civil*

[28] See Article L. 311-47 of the *Code des assurances*

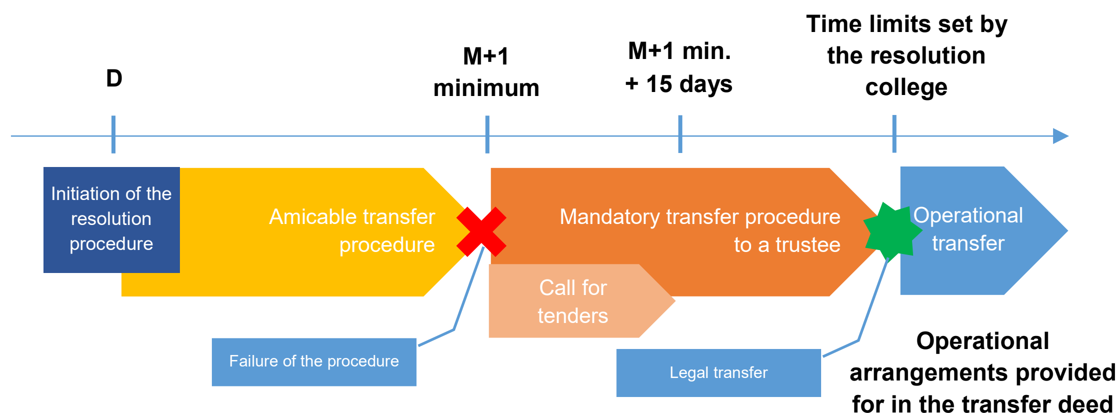

Figure 4 - Minimum time frame for the implementation of the liability management structure instrument

2 Determination of the resolution strategy

In order to identify the most appropriate resolution strategy for each undertaking and according to the critical functions it performs, the following criteria should be considered:

– External factors;

  - The nature of the critical function to be safeguarded;
  - The degree of market concentration;
  - Other external factors that may have an impact on the attractiveness of the portfolios concerned.

– Internal factors:

  - The volume of the portfolios involved;
  - The undertaking's position in this market;
  - The complexity and degree of standardisation of contracts;
  - The attractiveness of the portfolios concerned (profitability, technical complexity, quality of the associated assets, etc.);
  - Other internal factors that may have an impact on the attractiveness of the portfolios concerned (level of interconnectedness within a conglomerate, etc.).

In the event of the initiation of a resolution procedure, the preferred resolution strategies provided for in the preventive resolution plans are likely to be adapted to the causes of the crisis at the origin of undertakings' situation (either failing or being likely to fail). Whether or not such failure comes from the critical functions will be a determining factor in the choice of strategy.

2.1 External factors

2.1.1 The nature of the critical function to be safeguarded

The nature of the function to be safeguarded, especially the insurance class (life/non-life) and the duration of liabilities (short/long class), may have an impact on the resolution instrument to be used.

For non-life insurance, the termination of coverage for the policyholder occurs 40 days after the dissolution of the undertaking. The transfer period should therefore take this factor into account when aiming to maintain the coverage of the insured.

Thus, the shorter the duration of the insurance liabilities, the faster the implementation of the resolution instrument should be. Indeed, if the time needed to transfer activities is longer than the duration of the liabilities, the latter are extinguished without the continuity of the function being ensured.

2.1.2 The degree of market concentration

The degree of market concentration is considered from several angles:

- **Merger control**: the mandatory portfolio transfer is similar to a horizontal merger[29] subject to competition law. The *Code des assurances* exempts the resolution college from the requirement to obtain the agreement of the Competition Authority for resolution-related transfers[30]. However, transactions with a Community dimension must be notified to the European Commission, which then decides on their compatibility with competition law. The only transactions that are presumed compatible with competition law are those leading to a consolidated market share of less than 25% after completion[31]. For more significant concentrations, a procedure comprising an in-depth analysis is conducted by the Commission.
- The **size of stakeholders** and their ability to take over portfolios representing more than 10% of the market share: this criterion may have an impact on the way in which the transfer is carried out (either block transfer or splitting the portfolio).

---

[29] Concentration transactions may take several forms. They may involve two previously independent undertakings merging, the creation of a concentrative joint venture or the takeover of one undertaking by another. They are deemed "horizontal" when they involve a merger between two undertakings that were competitors prior to such transaction.

[30] See Article L. 311-23 of the *Code des assurances*

[31] See Recital 32 of (EC) Council Regulation No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings

2.1.3 Other external factors

As for other external factors that may have an impact on the choice of instrument, they may be manifold and depend on the critical function considered.

Recent divestments or transfers may give some indication of the market's appetite for a particular type of activity.

The regulations applicable to certain insurance activities should also be taken into account (e.g. specific authorisation required for the provision of agricultural insurance).

2.2 Internal factors

2.2.1 Portfolio volume and market position of the undertaking

The size, both in terms of value and number of contracts, of the portfolios that constitute the critical function of an undertaking should be taken into account when choosing the instrument and the way it is implemented.

The more significant the volume of the portfolio, the more delicate a mandatory transfer could be, within a limited timeframe, given the (technical, material, regulatory, etc.) ability of other stakeholders to take on such a volume. A market leader should therefore have a resolution strategy adapted to take account of this criterion. In order to alleviate this constraint, a split of the portfolio into various segments could be envisaged (per commercial brands, distribution networks, etc.).

2.2.2 The complexity and degree of standardisation of contracts

The complexity and degree of standardisation of contracts is a determining factor both for the choice of instrument and the timing of its implementation.

The more standardised the contracts are, the easier they will be transferable to another market participant carrying out the same activity. Highly customised contracts (e.g. negotiated group contracts, contracts for services concluded through a tender procedure, etc.) may be more complex to transfer and may require specific expertise for their takeover.

In addition, too much complexity can curb the appetite of buyers.

2.2.3 The attractiveness of portfolios

In the case of a mandatory transfer and a liability management structure, the buyer is selected through a call for tenders issued by the resolution college. The attractiveness of the portfolio is therefore a paramount factor.

For non-life insurance portfolios, profitability can be assessed based on the loss ratio, or based on the combined ratio[32], and compared with industry standards. For life insurance activities, e.g. savings, the attractiveness will be assessed, *inter alia*, on the basis of the ceding undertaking's paid and guarantees interest rates compared to those of the rest of the market, the profit-sharing provisions made…

In addition, the quality of the assets invested to cover insurance liabilities is another attractiveness factor to be considered. Such quality can be assessed according to the type of assets considered (bonds, shares, etc.), their rating, their liquidity and their adequacy with liabilities.

2.2.4 Other internal factors

Other internal factors may be taken into account in the choice of the instrument. This may include the level of interconnectedness, within a conglomerate, between the insurance and banking business, for example in terms of distribution networks and operational links.

A high level of operational complexity (number of information systems, etc.) can also constitute an impediment to transfer.

[32] The combined ratio is a commonly used measure to communicate the profitability of insurance products. It is the ratio of the sum of benefits and costs incurred to earned premiums.