

Client Brief

BANKING & FINANCE / INSURANCE SECTOR

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LAW REGARDING THE RECOVERY AND RESOLUTION OF INSURANCE UNDERTAKINGS

INTRODUCTION

*The law regarding the recovery and resolution of insurance undertakings (the “**IRR Law**”) was published with the Official Gazette on 02 November 2015 and entered into force on 05 November 2015.*

In a nutshell, the IRR Law is meant to implement principles and tools similar to those applying to the recovery and resolution of credit institutions and investment firms as set out in the Bank Recovery and Resolution Directive (the “**BRRD**”). In contrast with the BRRD and Law no. 312/2015 transposing the BRRD, which lay out the whole set of measures, tools and related safeguards, the IRR Law only includes the main recovery and resolution principles and tools, whilst leaving the specific measures and safeguards to be detailed by norms and regulations to be issued by the Financial Supervisory Authority (the “**FSA**”).

During the first quarter of 2016, the FSA issued a number of regulations for the application of the IRR Law, some of which are relevant from a derivatives’ perspective.

The IRR Law now coexists with Law no. 503/2004 on the financial turnaround, bankruptcy, voluntary dissolution and liquidation proceedings in the insurance activity, as subsequently amended¹, it being specified that insurers which are undergoing financial turnaround proceedings may be subject to IRR Law, if the conditions for applying resolution measures are met.

TOOLS SET FORTH UNDER THE IRR LAW

The IRR Act sets forth the following tools to be used in order to manage a financial crisis:

- A) **Preparation** - entailing the drafting of recovery plans and resolution plans;
- B) **Early intervention** - entailing the supervisory authority’s rights to intervene and require *inter alia* the implementation by the institution’s management body of one or more of the measures set out in the recovery plan or the appointment of one or more temporary administrators to the institution; and

¹ The most important amendment to Law no. 503/2004 was brought in 2014, when all bankruptcy proceedings regulated by this law were repealed as a result of the enactment of Law no. 85/2014 on pre-insolvency and insolvency proceedings, which covers *inter alia* insolvency proceedings for ordinary corporations and bankruptcy proceedings for credit institutions and insurance/reinsurance undertakings.

C) **Resolution** - entailing the resolution authority's right to apply the following resolution tools in the scenario where a distressed institution continues to fail:

- (i) the sale of business and portfolio,
- (ii) the bridge institution tool,
- (iii) the asset separation tool, and
- (iv) the power to reduce the value of, or convert the outstanding amounts due by the institution.

ISSUES RELATING TO DERIVATIVES AND FINANCIAL CONTRACTS - RESOLUTION POWERS AND SAFEGUARDS UNDER THE IRR LAW

The IRR Law provides that, where one or more resolution tools have been applied by the FSA, especially in case of partial transfers, the shareholders and those creditors whose claims have not been transferred, *shall not incur greater losses than they would have incurred if the institution under resolution had been wound up under normal insolvency proceedings.*

Furthermore, the FSA, as resolution authority, makes sure that appropriate *safeguards* are applied against its powers to (i) exercise a partial property transfer and (ii) request the competent court to annul or amend the provisions of an agreement to which the resolved insurance company is a party or replace the counterparty- insurer as signatory party.

According to FSA Norm no. 8/2016, the protection against partial property transfers applies *inter alia* to financial contracts (defined by the IRR Law in line with the relevant definition set forth in the BRRD and Law no. 312/2015 transposing the BRRD) and financial collateral arrangements as defined under the Government Ordinance no. 9/2004 on financial collateral arrangements (which transposes the Collateral Directive). Nonetheless, FSA Norm no. 8/2016 states only that the protection regarding financial contracts and financial collateral arrangements (i) refers to the fact that the assets of the resolved insurer which are affected or encumbered cannot be made subject to the sale of business and portfolio tool set forth in the IRR Law, and (ii) may only apply until the date of the opening of bankruptcy proceedings, without making any reference to the parties' right to set-off or net the rights and liabilities arising from financial contracts and financial collateral arrangements in the context of each relevant resolution tool and power.

According to FSA Norm no. 11/2016, the FSA, as resolution authority, exercises its power to reduce the value of, or convert the outstanding amounts due by an insurance company under a *financial derivative instrument* only on the due date or after the termination by the FSA of the financial derivative contract entered into by the resolved insurance company, it being specified that, with respect to *financial derivatives subject to a netting agreement*, the financial auditor shall determine, as part of the required valuation, the insurance company's liability or claim arising from the terminated transactions on a *net basis*. No bail-in exemptions are currently set forth in the relevant legislation.

Note however that, in accordance with the final article of the IRR Law which lists the matters that are to be further regulated under FSA norms, FSA is supposed to further issue norms and regulations covering (i) the adequate circumstances for applying recapitalisation measures on the basis of the factors corresponding to such measures, (ii) the establishment of the necessary elements for the efficiency of the sale of business tool, (iii) the details regarding the information, the qualitative and quantitative indicators and the financial and severe macroeconomic crisis scenarios relevant for the specific condition of the insurer, which must be included in the recovery plans and (iv) the criteria for assessing the application and implementation procedures with respect to the measures included in the resolution plan.

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