The Resolution of Insolvent Life Insurers in Korea

Navigating the Way Forward for the Last-resort Protection to Policyholders

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Overview of Resolution Regime in Korea

Overview of Resolution Regime in Korea

- **Given the nature of insurance contracts, insurance company failures tend to be more complex to resolve than bank failures.**
  - ✓ Insurance policies provide a social safety net.
  - ✓ It is hard to determine the amounts covered in an insurance company failure.
- **IFIGS survey (2021) on IGSs around world shows:**
  - ✓ Only several IGSs participate in the resolution process of failed insurers.
- **Purpose of this presentation**
  - ✓ The KDIC has mandates and powers of a resolution authority.
  - ✓ Sharing Korea's experiences to help establish an effective resolution regime and expanding IGS's role in resolution

Overview of Resolution Regime in Korea

- **20 cases of insurance company failures since the 1997 Asian financial crisis in Korea**
  - ✓ Total of 17.6 bil. USD injected for the bail-out of 15 life insurers and 5 non-life insurers

- **Portfolio Transfer, M&A, and Open Bank Assistance (OBA) were used for the resolution**
  - ✓ Portfolio Transfer 11, M&A 7, and OBA 2 cases

	1998	1999	2000	2001	2002	2004	2012
Portfolio Transfer	Life (4)	Life (1)		Life (2)	Life (1) Non-life (1)	Life (1)	Non-life (1)
M&A			Life (5)	Non-life (2)			
OBA		Life (1) Non-life (1)					

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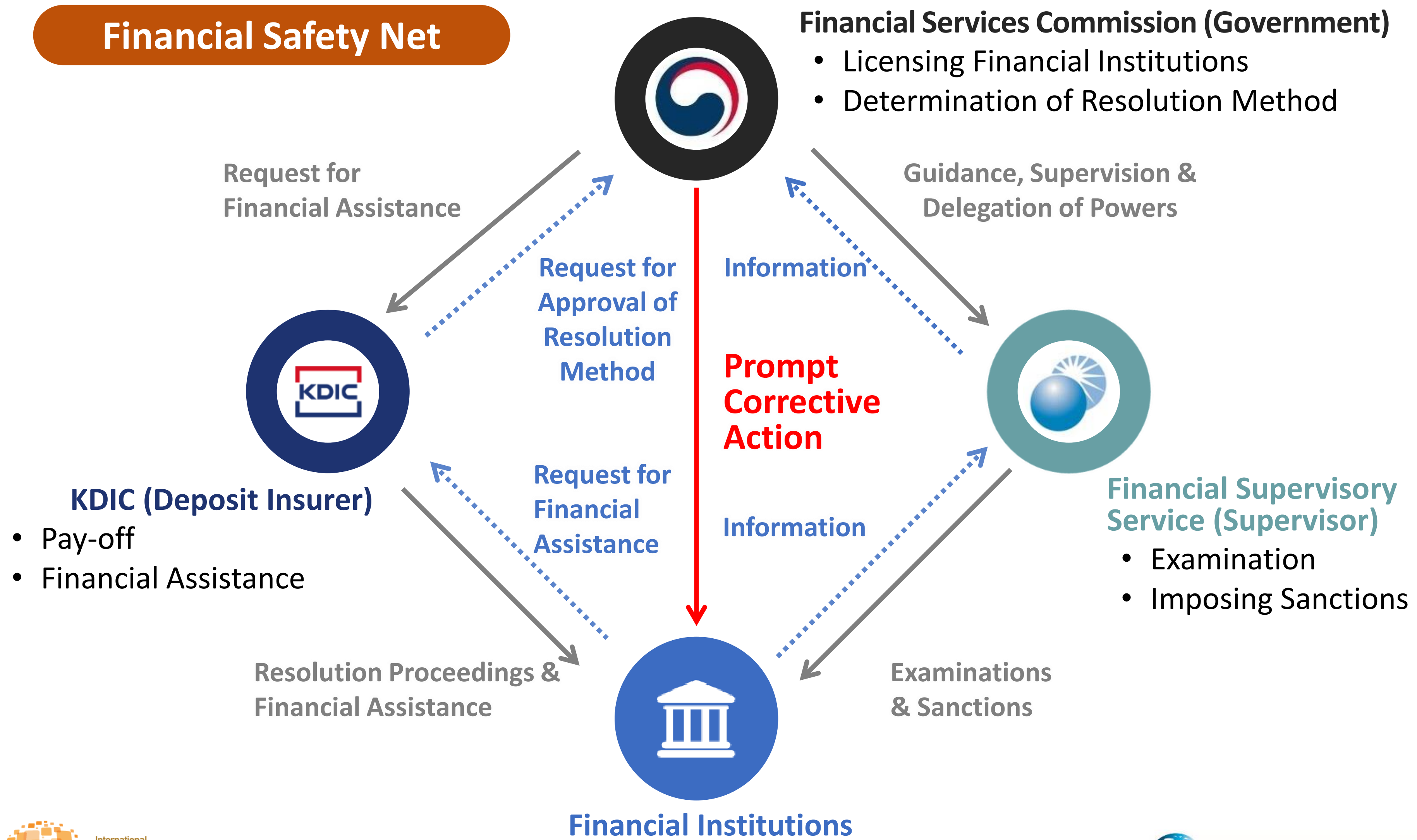
(Ref.) Resolution Framework in Korea



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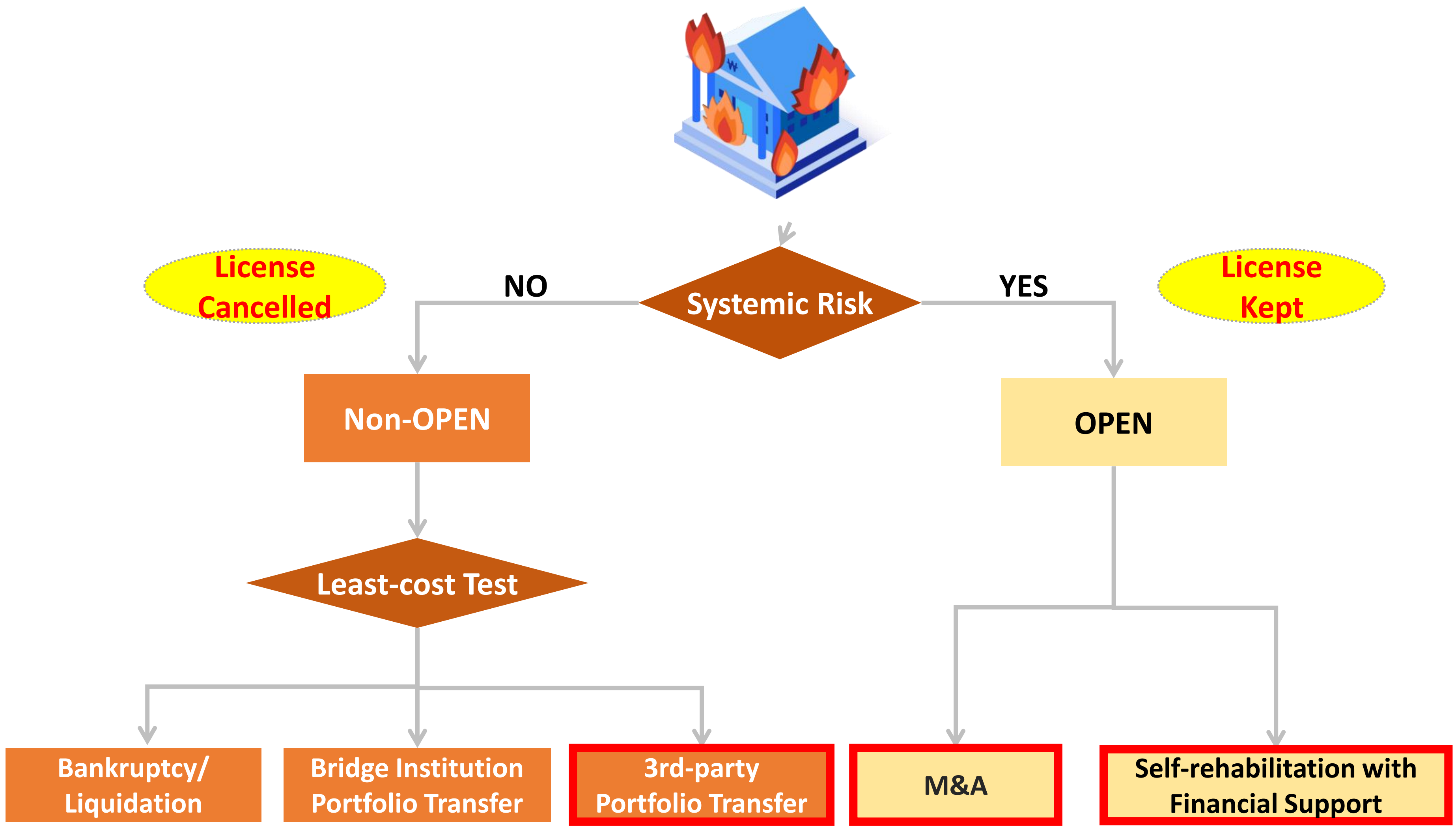
Case Study: Korea Life Insurance Co.

Causes of Failure

- **Korea Life Insurance Co. was established in 1946 and became the 3rd biggest insurer in terms of total assets (10.5 bil. USD) in 1999.**
  - ✓ 6,694 employees and 1,554 branches
- **Why the case of Korea Life Insurance Co.?**
  - ✓ Biggest among the 15 failed life insurers and resolved using open bank assistance (OBA)
  - ✓ To prevent contagion effect on small and medium sized insurers, the government decided to inject public funds and maintain its business.
- **Causes of Failure**
  - ✓ Excessive financial assistance to subsidiaries within Daesaeng Group
  - ✓ Management's embezzlement of company money

(Ref.) Resolution Methods for Failed Insurance Companies



Resolution Principles and Capital Injection

- **Korea Life was found to have a net asset shortfall of 2.7 bil. USD in Feb. 1999. The FSC* approached the issue with three principles in mind:**

  *** Financial Supervisory Committee (Government)**

  ✓ Minimize the burden on government finances and prevent market panic

  ✓ Keep the company's value from falling by keeping the company in operation

  ✓ Competitive bidding to ensure a fair and transparent sale of the company

- **After appointing an administrator and suspending the management team in Mar. 1999, the FSC tried to sell the company in the open market three times between May and July, but without results.**

- **In Sep. 1999, the FSC declared Korea Life insolvent and asked the KDIC to provide equity investment.**

  ✓ Wipe-out of existing shareholders' equity

  ✓ The KDIC issued Deposit Insurance Fund bonds with government guarantees and provided 3.2 bil. USD in equity investments in three installments and received 100% of the company's shares in exchange.

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MOU and Sale of Korea Life

- **In Nov. 1999, a new management team was appointed and a memorandum of understanding (MOU) for business turnaround was signed with KDIC in Apr. 2000.**
  - ✓ Each quarter, the KDIC checked how much progress Korea Life had made in restoring growth and profits.
  - ✓ The MOU contained commitments to improve financial ratios, achieve non-financial business goals such as increasing flexibility in hiring, and receive penalties for failure to meet such targets.

- **When the PFOC* decided to sell Korea Life in Mar. 2001, KDIC was put in charge of the marketing and sale of the company**

  *** Public Fund Oversight Committee (Sales Review Sub-committee)**

  - ✓ However, any important issues like deciding sale terms and selecting preferred bidders had to be consulted with the FSC and the Ministry of Finance and Economy and then reviewed and coordinated by the PFOC before being acted upon.

- **In Oct. 2002, KDIC signed an agreement with Hanwha Consortium to sell a 51% stake in Korea Life and handed over business control.**

  ※ Of the remaining 49% of shares, 39% were sold through call options or sold as existing shares at the IPO or in one of two block sales. The KDIC is currently trying to find buyers for the last remaining 10%. (The company's name was changed from Korea Life to Hanwha Life.)

Sales Process of the Recapitalized Korea Life

Feb. 1999, FSS
Due Diligence and Special Examination

Mar. 1999, FSC
Appointment of an Administrator and Suspension of the Management Board

Sep. 1999, FSC
Declaration of Insolvency, Reduction of Shareholder's Equity and the KDIC's Capital Injection

Mar. 2001, PFOC
Sale by the KDIC Decided

Oct. 2002, KDIC
Agreement with Hanwha Consortium to Sell a 51% Stake

90% of Equity Shares Sold, Remaining Shares (10%) Put Up for Sale

*** FSS: Financial Supervisory Service (Supervisor)**

FSC: Financial Supervisory Committee (Government)

PFOC: Public Fund Oversight Committee

Lessons and Future Challenges

Lessons Learned

- **Massive injection of public funds for policyholder protection and financial stability inevitable**
  - ✓ The government (FSC and PFOC) played a big role in containing a systemic crisis in 1997.
- **Efficient resolution regime with principles essential**
  - ✓ Responsible resolution authority with regulation and funding mechanisms
  - ✓ Coordination and cooperation among financial safety net players and experts in the market
  - ✓ Resolution principles for minimizing resolution costs and moral hazard
- **The KDIC's role: resolution funding and financial assistance, sale of Korea Life, and MOU**

Future Challenges

- **Expanding the IGS's mandates and powers for resolution**
- **Recovery and Resolution Plan (RRP) for SII under consideration**
  - ✓ The KDIC is to prepare resolution plans for SIFIs in 2021.
- **Powers to restructure or modify insurance contracts under consideration to reduce moral hazard and for more effective resolution**
  - ✓ The liquidation tool was never used in an insurance company failure to fully protect policyholders, which led to increased moral hazard.
- **A funding mechanism that precludes any bail-out must be established in advance**
  - ✓ A consensus emerged after the 2007-08 global financial crisis that there should be no more bail-outs for financial institutions.
  - ✓ The IGS and resolution regime should have a funding mechanism for the resolution of failed insurance companies without using taxpayers' money.