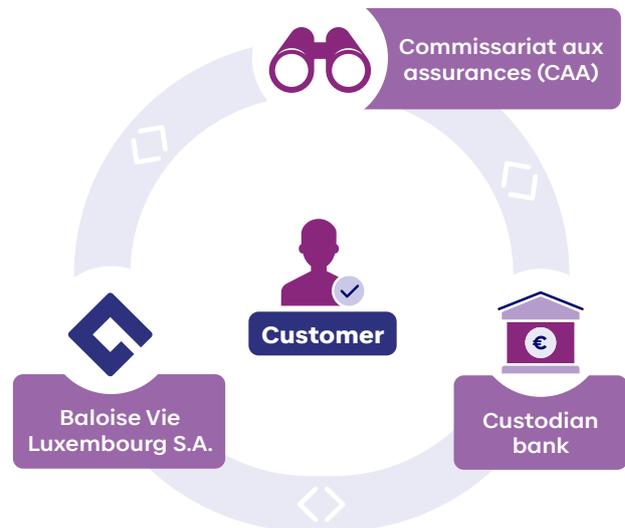


The regulated investor protection mechanism for Luxembourg life insurance contracts

The policyholders to unit-linked life insurance contracts issued by Luxembourg insurers benefit from a unique investor protection mechanism. The regime, commonly referred to as the Triangle of Security, protects investors in the case of the bankruptcy of either the Luxembourg insurance company and/or the custodian bank (Luxembourg regulations demand that the assets underpinning a policy are held with an approved 3rd party custodian bank).



1. Protection in case of default of the insurance company.

Three elements ensure the policyholder's protection.

1.1. Technical provisions and covering assets

Luxembourg life insurance companies have the obligation to hold sufficient technical reserves to meet their balance sheet liabilities and their commitments to policyholders. The matching assets on the balance sheet are referred to as covering assets.

These assets must be deposited within the European Union, with the exception of those specifically authorised by the insurance regulator (Commissariat aux Assurances. – CAA). The covering assets must be recorded in a permanent inventory in order to constitute assets totally separate from the company's general assets.

Insurers must also always provide proof of a sufficient solvency margin, that is to say that they must be able to meet their commitments at all times by having sufficient 'own' funds at their disposal.

Insurers are required to have regular independent external audit of these accounts. Insurers are also subject to inspections and oversight (continuous prudential supervision) by the CAA.

1.2. Depositing of covering assets with a custodian bank

The covering assets must be deposited with a custodian bank that is approved by the CAA. A tripartite agreement, hence the Triangle of Security, is concluded between the insurance company, the bank and the CAA. The template for that agreement is provided by the CAA.

The covering assets are held separately from all other commitments and assets of the insurer. There must be no offsetting (charge, lien or other use) of these regulated assets. Moreover, the covering assets must not be used as security or be subject to any preferential payment right.

In the event of default by the insurance company, the Commissariat aux Assurances has the option of blocking the company's accounts with the custodian bank in order to protect the rights of the insurance creditors..



1.3. The super-preferential right of policyholders.

Policyholders have a first tier preferential right (special privilege). This first ranking privilege is applied in different ways, depending on the type of claims involved: all unit-linked policies and all lump sum protection policies are guaranteed by distinct and separate assets.

Thus, for claims relating to unit-linked policies, the first ranking preference applies to the proceeds from realisation of the asset to which the claim relates, while for claims relating to other types of policy, the first ranking preference applies to the proceeds from the winding-up of all the representative assets earmarked for such claims.

In both cases, if the proceeds from winding-up are less than the rights of the insurance creditors, then their first ranking preference is reduced proportionately.

This privilege applies when the assets have been recorded in the permanent inventory, on the regulated assets for the complete payment of their insurance claim. This “super preferential right” has priority over all other creditors, that is to say in the case of default of the insurance company no other creditor can claim payment from these assets.

The creditors of unit-linked policies may also have their claims paid by transfer of all or part of the assets relating to their policies, subject to their agreement and only if this is permitted by the insurance policy in question.

The policyholders also have a second-tier preferential right over the company’s free assets, if the covering assets prove to be insufficient to pay all the insurance claims. This preferential right follows the preferential rights in respect of (i) legal costs, (ii) company employees, (iii) those engaged in a legal action against a legal liability insurer and (iv) the Luxembourg Treasury and social welfare bodies.

2. Protection in case of default of the custodian bank

Should the approved custodian bank incur financial difficulties, the insurer can retain free access to the covering assets deposited with it and recover or transfer them to another custodian.

With respect to securities (fungible assets), the custodian bank must enter these assets in its accounts separately from its own assets. As a result, the depositing party (the insurer) may recover these securities in the event that the custodian is bankrupt/insolvent.

As regards cash deposits (non-fungible assets), the insurance company (and therefore the policyholders, insured persons and beneficiaries) do not have a priority right in relation to the custodian’s other clients and creditors if the bank finds itself in difficulty. That is to say, cash deposits as unsecured deposits do not benefit from any specific protection. Therefore, it may be more advantageous to hold cash exposures via money-market instruments which benefit from the same protection as securities.

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