53rd UIA CONGRESS

Seville - Spain
October 27-31, 2009

INSURANCE LAW

Date of the session: e.g.: Thursday, October 29, 2009

INSURANCE AND FINANCIAL OPERATIONS

THE INSURANCE AND ITS ROLE IN FINANCIAL OPERATIONS UNDER THE ROMANIAN LAW

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1. THE ROMANIAN LEGAL REGIME OF INSURANCES

Romania, as any other country belonging to the East-European region, has passed through a long and difficult process of adopting new legislation corresponding to the economical changes generated by the collapse of the communist system by the end of 1989.

Until December 1989, the insurance activity was under the state monopole, being controlled and performed by the State Insurance Administration, which was liquidated by Government's Decision no. 1279/1990. After 1990, the insurances legislation was in a dynamic process of adapting to the political and economical changes which continues today as well, and regulates the extensive field of insurances.

The insurance activities were regulated by Title XIII, Book I of the Commercial Code "About the insurance agreement", Decree no. 471/1971 regarding the state insurances, republished in 1988, the Ministers' Council Decision no. 1715/1971 for establishing some measures for the application of Decree no. 471/1971 and Government's Decision no. 387/1990 regarding some measures for vehicles insurance.

Insurances are regulated nowadays by two main normative acts: **Law no. 136/ December 29, 1995,** regarding insurances and reinsurances in Romania and **Law no. 32/ April 3, 2000** regarding the insurance activities and their survey. Both enactments were severally modified and amended by the Romanian legislator, especially with a view to harmonize the insurance legal system with the European specific regulations and provisions.

The survey of the insurance activities is provided by the National Commission for Surveying the Insurance Activity, an independent authority organized and functioning under Law no. 32/2000.

For the purposes of this report, there was observed a significant role paid by the insurance system in relation with the financial operations, this its relation with other domains such as security interest in personal property, real estate mortgage etc.

2. THE GUARANTEES' LEGAL FRAME

Under the Romanian legal system, guarantees are governed by one general enactment and several other special laws and regulations. The general issues regarding the guarantees are governed by Title XIV, "About the personal guarantee", Title XV, "About pledges" and Title XVIII "About privileges and mortgages" of the **Romanian Civil Code**. The general provisions regulated by the Civil Code are integrated by various special laws, from which the most important are **Law no. 99/1999** regarding some measures for accelerating the economic reform and **Law no. 190/1999** regarding the mortgage credit for real estate investments.

Law no. 99/1999 is the main enactment regulating both civil and commercial securities within Title VI "The legal regime of securities" (herein after the "**Security Law**"). The Security Law contains various provisions regarding the security institution, including, without limiting to the creation of securities, the publicity and priority rules, the enforcement procedure and international operations.

3. THE INSURANCES, OBJECT OF THE SECURITY AGREEMENT

One of the most important elements in financial operations is to secure the accomplishment of the debtors' obligations. The Security Law reflects the role of guarantees in financial operations providing that the guarantees are meant to secure the accomplishment of both civil and commercial obligations created by any contract concluded between natural or legal persons.

The Security Law provides two different ways of securing the obligations over insurances: securing the obligation with insurance policies and designating the creditor as the beneficiary of the insurance.

3.1 The insurance policies

Securing the obligations with insurance policies represent a very common practice in financial operations, due to the large use of insurances in commercial activities. The insurance policies are designated by the Security Law among other assets which can be pledged under the terms and conditions prescribed thereto. Although the Security Law indicates the insurance policy as object of the security, the object of the security is represented by the patrimonial rights created by the insurance policy.

The insurance policy does not enjoy a legal definition but, generally, designates the document attesting the essential terms of the insurance agreement. The Romanian Insurances Law institutes a special rule in attesting the existence and content of the insurance agreement, providing that the insurance agreement can be attested only with the insurance policies or with the insurance certificate issued and signed by the insurer, respectively with the coverage note issued and signed by the insurance broker. This restriction only applies with respect to the existence of the insurance contract. The facts which exceed the insurance contract, as well as the occurrence of the insured situation, the responsible party and the damages are subject to the general rules provided by the Commercial Code and can be proved by any means and with the observance of the Commercial Code and, in addition of the Civil Code.

Law no. 136/ December 29, 1995, regarding insurances and reinsurances in Romania (hereinafter called the "**Romanian Insurances Law**") prescribes the general terms and conditions of the insurance agreement and also indicates the special rules applying to each insurance category.

According to the Romanian Insurances Law, the insurance contract is the contract by which the insured party undertakes to pay to the insurer a prime and the insurer undertakes that, when a certain risk arises, pay to the insured party or to the beneficiary the reparation or the insured amount, hereinafter called the indemnity, within the convened limits and delay.

The legal definition of the insurance contract refers to its most important elements evidenced through the essential obligations of the contractual parties, meaning the obligation to pay the insurance premium, respectively the obligation to pay the insurance indemnification. In case the insured risk occurs, the insurer has the obligation to indemnify the insured party or the beneficiary by paying the indemnity.

This specific element of the insurance agreement outlines the possibility of the creditor to secure the obligations with the amount paid by the insurer as indemnity to the insured party or to the beneficiary. The creditor has the possibility of securing the obligation with insurance policies, but his right of enforcing the guarantee over the indemnity is effective only when the insured risk arises.

Considering that the indemnity can be paid by the insurer either to the insured party or to the beneficiary, one clarification needs to be done with respect to the entitled person who can secure the obligations with insurance policies.

It is beyond any doubt that the insured party is entitled to secure the obligations with the insurance policy, as he is part of the insurance contract and consequently, the holder of rights and obligations.

The beneficiary is the person designated by the insured party to receive the indemnity in case the insured risk arises. The beneficiary is not part of the insurance contract and has no incumbent obligations arisen

from the insurance contract. The beneficiary has a conditional right created by the insured party for his benefit. Also, the insured party is entitled to change the beneficiary at his own convenience.

Taking into consideration the above mentioned, we consider that the beneficiary is entitled to secure his obligations with the insurance policy attesting his position only under the condition of maintaining his right during the existence of the security agreement. If the insured party changes the beneficiary of the insurance, the security agreement terminates as the condition has occurred.

3.2 The beneficiary of the insurance contract

In accordance with article 2 of the Security Law, any agreement which is concluded with a view to secure the fulfilment of obligations with an asset is submitted to the provisions of the Security Law regarding the priority, publicity and enforcement procedures.

The parties of the insurance contract are the insurer and the insured party. Usually, the terms of "contractual party" and "beneficiary" are specific for the insurance of persons regulated by the Romanian Insurances Law. The term of "contractual party" is generally used by the Romanian Insurances law in order to designate the insurance contracts for securing risks of third parties.

According to the Romanian Insurances Law, the beneficiary of the insurance contract can be another person than the insured party. The beneficiary can be designated either at the execution of the insurance agreement, or during its availability. Using this mechanism permitted by the Romanian Insurances Law, the insured party has the possibility of guaranteeing his obligations by designating his creditor as beneficiary of the insurance. The right to collect the indemnity is effective only if the insured party does not accomplish the secured obligation.

If the insured party designates the beneficiary of the insurance in order to secure his obligation, the insurance contract will be submitted to article 2 of the Security Law.

4. PRIORITY RULES

The insured risk is one of the essential elements of the insurance contract, its ineffectiveness determining the termination of the contract. In accordance with article 14 of the Romanian Insurances Law, if the risk occurs before the insured obligations are performed or if it became impossible or, even if the insured obligations are in force, but the risk becomes impossible; the insurance agreement is deemed *de jure* terminated.

In case the insured party or the contractual party already paid the prime or a part of it, he will be entitled to recover the prime proportionately with the remaining unexpired duration of the insurance contract.

The Romanian Insurances Law also protects the insurer from the potential abuse of the insured parties by instituting the insurer's right of declining the request of the insured party to recover the total or part of the paid prime if the risk is intentionally caused by the insured party.

It is very important to distinguish between the guarantee created over the assets and the guarantee created over the insurance policy which secures the respective asset. The guarantee created over the asset expands *de jure* over the insurance policy. In case the guarantor does not accomplish his obligations, the guaranteed party will have the right to enforce the guarantee over the asset, or, if the insured risk occurs, the guaranteed creditor over the asset will have the right to cover the debt from the indemnity paid by the insurer. If the guarantee is created over the insurance policy the guaranteed creditor will only have the right to receive the indemnity.

Assuming that there are two different guaranteed creditors, one having the guarantee over the insurance policy and the other one over the asset, and the insured risk occurs, both guaranteed creditors will have the right over the indemnity with the observance of the priority rules provided by the Security law.

5. THE INSURANCE OF CREDIT AND GUARANTEES, THE INSURANCE OF FINANCIAL LOSSES AND OTHER INSURANCES

Insurance of credit and guarantees, insurance of financial losses and other insurances are regulated by the Romanian Insurances Law and by Law no. 32/ April 3, 2000 regarding the insurance activities and their survey.

These categories of insurances are qualified as general insurances and each of them represent a different class of insurances.

5.1 The insurances of credit and guarantees

The insurance of credit is qualified as the 14-th class of general insurances and cover the risks of general insolvency, credits for export, sale purchase with instalment payments, mortgage credits and agriculture credits.

The insurance of guarantees constitute the 15-th class of general insurances and cover the risks of direct and indirect guarantees.

The term "credit" has two different meanings: the general concept used in ordinary commercial activities, which incorporates the debt and the time granted for payment and the special concept used in financial-banking activities.

For example, the special concept of credit is defined by Law no. 190/1999 regarding the mortgage credit for real estate investments according to which, the mortgage credit for real estate investments means the credit granted under the following cumulative conditions:

- The credit is granted for real estate investments for locative destination or other destinations or for reimbursing a real estate credit for investments previously executed;
- The credit is secured at least with the mortgage over the real estate-object of the investment for which the credit is granted, respectively with the mortgage over the real estate-object of the investment for which the previous credit was granted and which shall be reimbursed by the new financing.

Although each category of credits has a special legal regime, all credits can be object of the insurance contract. This conclusion is based on the legal text which indicates the risks covered by the insurances of credits. For example, the risk of sale purchase with instalments payment is specific for ordinary credits granted for commercial activities. On the contrary, the risk of mortgage credits and agriculture credits occur in connection with financial-banking activities.

5.1.1 The insurance of financial-banking credits.

The object of insurances of financial-banking credits is represented by the credits granted by the financial-banking institutions. The insured risk of this category of insurances consists in the non-payment of the credit or of the related interest when they become due according to the credit agreement.

We must distinguish between the two categories of insurances of financial-banking credits: unconditional and conditional insurances of financial-banking credits.

The unconditional insurances of financial-banking credits cover the risk of non-payment of the credit or of the related interest in case the debtor does not fulfil his obligations when they become due. The insurer shall be compelled to pay the insured amount when the insured party (in this particular case the financial-banking institution) proves that the credit or the interest was not paid at the payment date provided within the credit agreement. No other conditions are required.

The conditional insurances of financial-banking credits cover the risk of non-payment of the credit or of the related interest in case the debtor does not fulfil his obligations when they are due and if such infringement is caused by specific situations provided within the insurance agreement. Usually, the situations generating the non-payment of credit or interest are: insolvency, litigations, adjournment of activity and other similar situations. In such case, the insured party is compelled to prove that the debtor did not pay the credit or the interest when due and also the cause of such infringement.

As mentioned above, the mortgage credits for real estate investments represent a special category of financial-banking credits. One of the characteristic of this particular credit is represented by the obligation of the debtor to secure the credit at least with the mortgage over the real estate-object of the investment for which the credit is granted, respectively with the mortgage over the real estate-object of the investment for which the previous credit was granted and which shall be reimbursed by the new financing. The object of the insurance of credit is the credit itself and not the real estates or the assets by which the debtor secures the credit. In case the insured risk occurs, the insurer will pay the insured amount and afterwards, he will be *de jure* deemed to recover this amount by enforcing the guarantees created in favour of the insured party by the effect of the law.

5.1.2 The insurance of goods regulated by Law 190/1999 regarding the mortgage credits for real estate investments

According to this enactment, the borrower who mortgages a building is obliged to conclude an insurance agreement in order to cover all the risks which may occur with respect thereto on the entire duration of the credit contract. The rights of the insured party shall be assigned in favour of the mortgage creditor for the entire availability period of the credit contract. The publicity of the assignment in order to produce effects towards third parties shall be conferred by the registration with the Securities Electronic Archive. The insured party shall notify the insurer about the assignment. Although the creditor is the beneficiary of the insurance indemnification, the borrower will be obliged to pay the insurance premium. The insurance indemnification shall cover the claim as follows: the interest rates due and unpaid, the unpaid credit instalments and any other amounts due to the mortgage creditor when the insurance indemnification is paid.

In case the mortgage credit is granted in order to build a construction, the buildings' consolidation or development, the mortgage creditor is entitled to require the borrower to conclude an insurance agreement regarding the risk of not completing the real estate investment.

5.1.3 The insurance of credit's guarantees.

Another common practice is to insure the guarantees of the credit. The object of the insurance agreement is represented by the assets or the real estates object of the guarantee created in order to secure the credit. The insured risk is the loss or total or partial damages of the assets or the real estates. Consequently, the indemnity paid on behalf of the insurance agreement represents the equivalent of the asset and not the value of the credit.

5.1.4 The insurance of ordinary commercial credits.

The ordinary commercial credits are granted in relation with various contractual relationships as for example the sale purchase agreement, the lease agreement, the service agreement, the entrepreneurial agreement and the increase of the share capital of commercial companies.

The creditor has the right to insure all present and future claims against his debtors. The insurance premium will be calculated proportionately with the number and amount of the debts. In case the value of claims exceeds the insured amount, the insured party will have to pay a supplement to the insurance premium in order to obtain the insurance of all claims.

The insurance indemnification is calculated in accordance with the nominal value of the claims as reported by the insured party. The insurance indemnification shall cover only the nominal value of the claim and not the decrease loss or the loss of benefits.

5.2 Insurance of financial losses

The insurances of financial losses represent the 16-th class of general insurances and cover the risks of unemployment, deficiency of income, losses for adverse meteorological conditions, the risk of current expenses, unpredictable commercial expenses, not obtaining the benefits, the devaluation of market value, rent losses and other similar incomes, indirect commercial losses, other than those previously mentioned, non-commercial financial losses and other financial losses, according to the provisions of the insurance agreement.

According to the Romanian Insurances Law, the insurance indemnification shall cover both the damage and the loss of profit and also the expenses directly or indirectly caused by the occurrence of the insured risk.

6. PRACTICAL IMPLICATIONS OF THE INSURANCES IN COMMERCIAL ACTIVITIES

6.1 The increase of the share capital

The increase of share capital represents a very common practice used by commercial companies in order to obtain financial resources for different purposes as for example developing and consolidating the companies' activity, reimbursing other debts and creation of financial reserves.

The increase of the share capital represents an alternative for the financial credits granted by financial-banking institutions. As opposed to the credits granted by financial-banking institutions, the increase of the share capital is preferred by many commercial companies since the company will not be obliged to pay the interest and all other penalties and costs incurred by the financial-banking credits.

The increase of the share capital is performed either by external financing, meaning the subscription of new shares, in nature or in cash or by self financing, incorporating the reserves within the share capital, as far as the legal reserves remain intact.

6.2 The entrepreneurial agreement

According to article 1479 of the Civil Code regarding the entrepreneurial agreement, the entrepreneur, as owner of the materials, will stand the risk of the asset-object of the entrepreneurial agreement. If the asset-object of the agreement is damaged or cannot be provided to the beneficiary, the entrepreneur will have to

compensate the beneficiary. The risk is always incurred by the entrepreneur as it is a legal obligation provided by the Civil Code.

This legal obligation usually determines the entrepreneur to conclude an insurance agreement in order to cover the risk of the asset and consequently to obtain the insurance indemnification in case he will be obliged to compensate the beneficiary.

6.3 Real-estate transactions

Real estate transactions are usually financed by credits granted by banks or financial institutions in consideration of the securities created in order to secure the transaction. Financing in real estate transactions is usually granted to the developer either by banks and financial institutions or by leasing companies.

Usually the financing is granted under the condition of creating a mortgage over the real estate or other securities as for example concluding insurance agreements, liens, pledges and security interest in order to secure the loan.

Many investors obtain finances through the real estate leasing which is adapted especially to the company's or the physical person's needs.

6.4 The lease agreement

According to the Civil Code and to Law no. 114/1996, both the landlord and the tenant have obligations related to the asset or to the real estate which constitute the object of the agreement.

The landlord has the obligation to insure the tenant the normal use of the asset during the performance of the agreement, which means that he shall met all the expenses occurred by capital repairs or normal degradation. The landlord shall guarantee the tenant against any disturbance issued by the landlord or by a third party or against the hidden defects of the asset. The parties can modify the obligation of guarantee, i.e. to limit it or to make it more severe.

The tenant has the obligation to use the asset as a good owner, according to asset normal destination and shall meet all the expenses occurred by the normal use, i.e. maintenance expenses, etc.

Taking into consideration that both parties can be obliged to indemnify the other party as based on the occurrence of damages of the asset or of the real estate, the insurance agreement can be concluded either by the landlord or by the tenant, but the insured risk will be different, according to their incumbent obligations.