Position Paper

Response to EIOPA consultation on Proposals for Solvency II 2020 Review Harmonisation of National Insurance Guarantee Schemes

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General comments

Insurance Europe supports the status quo and opposes an EU initiative on IGS. This is because the IGS currently in place vary significantly across Europe but work generally well within their local context and laws. Some Member States currently have arrangements equivalent to an IGS that protect policyholders in the same way, whereas other Member States do not have an IGS but consider that policyholder protection is nevertheless sufficient.

Even a minimum level of harmonisation would create significant costs and involve complex challenges for which there may not be acceptable solutions. The focus and priority instead should be on ensuring that Solvency II is actually applied appropriately in all member states and there is coordinated supervision of FOS/FOE (in this context, consideration should be given to the recent amendments of Directive 2009/138/EG on notification requirements and the establishment of collaboration platforms for FOS/FOE). National authorities should be allowed significant flexibility to choose the features that best suit their market, to reflect the important differences between member states regarding social welfare systems, winding-up process for insurers and insurance product lines. In any case, the issue of failures of FOS/FOE undertakings should be addressed in such way as to provide rules making home national supervisory authorities accountable for the failure.

- It is important to reiterate that Solvency II already provides very high levels of policyholder protection and safeguards that need to be duly considered. The Solvency Capital Requirement (SCR) ensures a high level of capital buffer, calibrated to ensure a firm will remain able to meet all obligations to policyholders even after a 1-in-200-year loss event. The supervisory ladder of intervention in Solvency II allows supervisors to begin taking actions when the SCR is breached and to fully take over the company if the MCR is breached – a point at which an insurance company still has significant assets in excess of those needed to meet its obligations to policyholders. Besides capital requirements (pillar 1), Solvency II also imposes higher standards regarding governance and transparency in pillars 2 and 3. While Solvency II compliance is not a guarantee against insolvency in the insurance industry, it is undeniable that it significantly diminishes this risk. Even before Solvency II, there were very few failures and even fewer resulting in any losses for policyholders. Insurers have rarely needed to benefit from

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government support, and under Solvency II they will be far less likely to do so in the future. Finally, Solvency II also includes provisions for the winding-up of insurers and national insolvency laws complement these.

- In the lead-up to this consultation, EIOPA has built a case for IGS harmonisation, notably in its 2018 Discussion Paper on this topic. While EIOPA agrees that the adequate protection of policyholders is at the core of Solvency II, it has relied on an analysis based on pre-Solvency II failures and near misses to determine that minimum harmonisation is necessary. Insurance Europe strongly believes that a better case needs to be made by EIOPA, including the effects that Solvency II has had on the risks in insurance companies and on policyholder protection, and how this affects the need for changes to the existing regime of national IGS. More time is needed to appropriately evaluate the efficiency of this new regulatory framework.

- There is simply insufficient data to justify EIOPA's proposal for harmonisation of national IGS, particularly with respect to: insurers that went bankrupt under Solvency II, which types of insurers and insurance products face the greatest risk of insolvency, the main reasons for the insolvencies, what losses have the customers of the insolvent insurers sustained and what could have been done to avoid the insolvencies through effective supervision/supervisory collaboration and other available measures.

- EIOPA published an ambitious Supervisory Convergence Plan for 2018-2019 that would ensure an effective and consistent level of supervision with the aim of guaranteeing a similar level of protection of policyholders and beneficiaries across jurisdictions, regardless of the location of the insurance undertaking's head office. Insurance Europe agrees with the main objective of this plan and believes that adequate prevention is better than any curative measure.

- Moreover, when harmonisation of IGS is considered in isolation, without taking into account other elements (e.g. national insolvency laws, preferential rights of policyholders, divergent implementation of Solvency II in member states, existence of national resolution regimes), this harmonisation might create or exacerbate distortions of the European level playing field and even lead to more unequal treatment of policyholders across the European Union.

- EIOPA should better recognise that consumer protection needs are different in the insurance sector to the banking sector and that the risk profiles of insurers and banks differ fundamentally. Therefore, the type of problems that bank guarantee schemes address does not exist in the insurance sector, where winding-up procedures usually take years and there is less risk of contagion between entities.

- IGS bears the danger of moral hazard as it cannot be excluded that IGS encourage less responsible conduct. With IGS in place, policyholders might be inclined to pay less attention to the insurance company's financial solidity and choose their insurer solely on the basis of the lowest premium. Equally, insurance intermediaries might not necessarily offer their clients the products of a financially sound insurer, but rather those which come at the lowest price. Furthermore, a company's directors and officers might be less prudent in their management behaviour if they know that consumers' protection will no longer fully depend on their efficient management.

  In the majority of European insurance markets (mostly showing a high concentration, i.e. the Top 4 insurers having 70-80% of market share), should other insurance companies be required to fill IGS funding gaps in the case of a large insurance company's collapse, inappropriate funding mechanisms would create interconnectedness between insurance companies and create an environment in which vulnerabilities in the financial position of otherwise healthy insurers could develop.

However, if the European Commission can evidence, after considering all elements provided, that minimum harmonisation is necessary, Insurance Europe would make following suggestions regarding such an initiative (without prejudice to the positions set out above):

- **IGS should not be used to prevent or reduce risk of company failure and IGS should play no role in recovery and resolution** as doing so may breach the state aid rules. IGS should remain a "last-resort mechanism" providing additional protection after all resources from the insurance company have been exhausted (i.e. after resolution),
- **Home responsibility for funding with the <u>host country providing the "front office" customer interface</u>**. However, implementing this arrangement, or indeed any other, gives rise to a number of challenges which Insurance Europe outlines in its response.
- **The scope of products included under minimum harmonisation should be as limited and focussed** as possible, so as to allow national authorities to expand it in consultation with local stakeholders according to their own market's realities.
- **Any minimum harmonisation should only cover consumers (natural persons)** and it should be for member states to decide, in consultation with local stakeholders, whether a wider scope is justified.
- **Ex-ante funding should not be imposed, any minimum harmonisation should leave IGS funding (ex-ante or ex-post) to be decided at Member States' level.** In any case, absolute caps on insurers' contributions to an IGS would be needed to avoid that the obligation to fund an IGS exposes the other remaining insurers in the market and their customers to a risk that would not have existed otherwise. National differences in market concentration limit the feasibility of centralised funds. In such cases decentralised, in-house funds may be a viable option.
- Insurance Europe also believes that any IGS proposal should **explicitly prohibit any type of advertising about the existence of an IGS** since doing so would create moral hazard.
- **Information and collaboration (especially on FoS-related issues) should be reinforced** between home and host supervisors. These aspects are part of the ESAs Review and will be helped by inserting Articles 152a ("Notification") and 152b ("Collaboration platform") into the Solvency-II Directive.

1. Do you agree that the legal structure of policyholder protection schemes should be left to the discretion of Member States? Please explain your reasoning.

Insurance Europe agrees that the legal structure of policyholder protection schemes should be left to the discretion of Member States. More generally, Insurance Europe believes that national authorities should be allowed significant flexibility to choose the IGS features that best suit their market, to reflect that there are important differences between member states regarding social welfare systems, winding-up process for insurers and insurance product lines.

2. Do you see the need of a parallel development of the topics recovery and resolution framework and IGSs? Please explain your reasoning.

IGS should not be used to prevent or reduce risk of company failure and IGS should play no role in recovery and resolution. IGS should remain a "last-resort mechanism" providing additional protection after all resources from the insurance company have been exhausted (i.e. after insolvency or resolution). It should be up to the national supervisory/resolution authorities (who have the power to initiate liquidation procedures) and for the member state to decide how the cost of financing resolution (including any losses generated by a reduction of insurance obligations) should be covered. Therefore, Insurance Europe fully agrees with EIOPA's position stated in Paragraph 86, that the mission of IGS should not include the prevention of insurance failures.

Before any initiative on IGS or recovery and resolution, an in-depth assessment of the effects that Solvency II has had on the risks in insurance companies and on policyholder protection is required.

3. Do you agree that the primary objective of an IGS can be achieved by means of the two options proposed (i.e. paying compensation and ensuring the continuity of policies)?

Insurance Europe recognises that the role of an IGS depends on the realities of the market in which it is embedded and therefore determining the role of national IGS should be a matter of national discretion.

Any minimum harmonisation should be solely designed to provide compensation to policyholders for their losses in liquidation. The use of IGS as tools to ensure the continuation of the insurance policies will change the core of their mission. The intervention of IGS must not be preventive: i.e., exclusively limited to funding the gap between the benefit due to policyholders and the remaining resources of the insolvent undertaking. Any minimum harmonisation should not require compensating consumers other than insurance policyholders whose claims arise directly from the liquidation of an insurer – for example, compensation claims arising from liquidations of other financial services firms, including intermediaries, should be out of scope.

4. Do you agree that the continuation of the policies should take precedence in case of life and some long-term-life policies? Please explain your reasoning.

See answer to question 3.

5. What aspects are relevant to be taken into consideration for the effective implementation of the home-country principle?

The following elements should be taken into account when deciding on the geographical scope:

- The main argument in favour of the home-country principle is that, because the financial supervision of insurance and reinsurance undertakings, including business under FoS and FoE, is the sole responsibility of the home Member State (Article 30 of Solvency II), it must therefore also be the responsibility of the home Member State to deal with the consequences of an insolvent insurer, wherever its activities are located.
    - However, under a pure home-country approach, there would be problems because of the need to provide information to policyholders in their language customer identification, etc...
- With respect to the host-country principle, the following aspects are relevant:
    - Under the host-country principle, all policyholders within the same member state are evenly protected regardless of the insurer's location. The host country principle can also help when determining the level of compensation for statutory ("social security-linked") lines of business and facilitate customer identification, communication in the local language and the application of relevant local laws.
    - However, a pure host country approach creates a misalignment between supervision and the responsibility to cover the cost of insurance failures.

Insurance Europe's preference would be for a home approach combined with host elements, in which:

- the home country provides all the funding, because this ensures alignment with the model of the EU supervision already established in Solvency II. The Home country would be responsible for deciding on how the IGS is funded (e.g. ex-ante/ex-post funding, how contributions are allocated to each insurer in their market, contribution caps, etc.)
- the host country provides the "front office" customer interface to facilitate customer, policy and claim identification as well as communication in local language.

While this is considered the best approach there are still significant, and potentially intractable challenges at the operational level in applying this, or indeed any harmonised approach, across the EU and in making sure that policyholders are in fact treated equally. For example:

- How could the availability of sufficient funds be ensured (whether on an ex-post or ex-ante basis)?
- How could equal protection of policyholders be ensured throughout the EU? If harmonised IGS operate under the home state-principle, policyholders situated in the same country but purchasing insurance cover from FoS-insurers in different member states may still suffer unequal protection due to the

different levels of capacity to pay compensation in case of a failure. If harmonised IGS operate under the host state-principle, policyholders of the same failed insurer which are a situated in different member states would be also subject to different guarantee schemes with potentially different financial resources available,

- Accurately assessing FoS risk exposure when determining funding levels (irrespective of ex-ante or ex-post) for the IGS could prove difficult for the home country to do as the required information and data may not be easily available. This uncertainty applies even more to IGS based on the host state-principle, as the competent authorities must rely on the data quality submitted by home state supervisors in order to adequately fund the incoming FoS-business from other member states.
- Which IGS takes responsibility for the operational costs incurred by the host country when providing the "front office" customer interface?

As a result, minimum harmonisation will create challenges and will not ensure equal policyholder protection irrespective of the geographical coverage. If legislative action is taken anyway, the preferred option set out above constitutes the most suitable compromise.

6. Specifically, should the following options be added to the principles of the home-country approach:
- the possibility of the IGS of the host-country to function as a "front office" for the identification of the affected policyholders and beneficiaries?
- the possibility of the IGS of the host-country to make payments to the affected policyholders and beneficiaries (in their country of residence), and then have a right of recourse against the IGS of the home-country ("back office")?

See answer to question 5.
Insurance Europe believes that the "back office" would be much too burdensome and unfeasible to implement due to its complexity and the financial risks involved for the host-country IGS and host-country policyholders; therefore, Insurance Europe does not favour this option.

7. Do you have any other comments on the geographical coverage? For instance, are there any cases, especially in statutory lines of business, where the host-country principle should be preferred?

No further comments.

8. Do you believe that the criteria for selecting the eligible policies (as set out in paragraph 149) capture all relevant policies which should be subject to IGS protection? Please explain your reasoning.

The criteria set out in paragraph 149 will lead to a situation in which a wide variety of insurance products within EU will be covered by IGS, otherwise the arguments in favour of a European network of IGS will not be valid. The reason is that the type of insurance that fulfil the criteria differ between the Member States. This is because there are no EU-rules on what an insurance product is and what a specific insurance product should cover (bank deposits on the other hand are much more similar among the Member States). For example, in some countries home insurance also covers legal protection, liability and travel insurance while in others it does not. Thus, the relative importance of different types of insurance for policyholders differs between member states. This is precisely why there are significant differences in this respect between current IGS in EU member states. The lack of an analysis of the criteria in paragraph 149 in the consultation paper and its practical implications on different insurance products in different Member States makes it impossible to draw conclusions on the implications for IGS. Therefore, under minimum harmonisation, the product scope should be kept as limited and focused as possible, leaving a large degree of national flexibility to ensure that the best solution is found for every market.

9.Which policies should at least be eligible for IGS protection based on these criteria (as set out in paragraph 149)?

Under minimum harmonisation, the product scope should be kept as limited and focused as possible, leaving a large degree of national flexibility to ensure that the best solution is found for every market. While Insurance Europe cannot, for the reasons explained above, endorse a minimum harmonisation on any type of product, it would like to highlight the following considerations regarding the types of products that possibly may be covered by an IGS:

- Life insurance contracts are long term by nature and may have social security implications to a broad cross-section of the population However, the role of life insurance may be very different in different Member States.
- There are significant differences between different types of life insurance products that have to be taken into consideration. For example, the risks differ significantly between unit-linked products without guarantees and (traditional) life insurance products with guarantees. In unit-linked life insurance, the investment risk is borne by the policyholder and the insurance company does not provide any guarantee. Moreover, even if the insurance company would be confronted with financial problems, the units invested in by the policyholder cannot be used for the liquidation of the insurance company but remain with the policyholder. For this reason, unit-linked life insurance should be excluded from IGS.
- The criteria for the coverage of specific policies, which could lead to considerable social hardship seems more relevant in cases where the insurance substitutes state-based pension and/or health care systems.
- It is very important that national specific circumstances are taken into consideration when selecting the range of policies that should be covered by IGS, otherwise there will be damaging and unwarranted consequences for the insurance market as well as for the social welfare systems, including the national pension systems. In particular, the differing structures of the occupational pensions markets and the varying types of schemes existing in different Member States must be respected. In addition, for occupational pensions early payments are usually prohibited or discouraged by fiscal and/or social legislation, thereby limiting the risk of a "run on the insurer". Moreover, in occupational pension insurance where the employer acts as a sponsor, the employees benefit from an additional protection on top of the protection already provided by Solvency II requirements. For these reasons occupational pensions should not be covered by IGS or similar system, regardless if the provider is a life insurance company (applying Solvency II regulations) or a pension fund (applying IORP II regulations). If, however an IGS would be introduced for occupational pension insurance, it is essential – from a level playing field perspective – that an appropriate IGS is also put in place for similar occupational pensions schemes offered by other providers such as pension funds (IORPs). Since pension funds (IORPs) are not subject to comparable prudential regulation (Solvency II), the IORP guarantee scheme should be separated from the insurance guarantee scheme.
- In contrast to life insurance, non-life insurance is generally characterised by a short contract duration (often a one-year policy) and lacks a savings element. In the case of insolvency of a non-life insurance undertaking, the consumer can easily switch from the insolvent insurer to another insurer since, in contrast to life insurance, there is no deterioration of the insured risk with time. Unlike in the case of bank deposits or investments, compensation only must be paid if the insured event occurred and the policyholder's claim is justified. Consequently, the affected number of policyholders is considerably smaller in relation to the total insured portfolio.
- There may however be situations in which including non-life policies under the scope of an IGS may make sense (for example, significant homeowners' insurance claims could well be detrimental to policyholders if unmet by an insurer due to insolvency).
- While there is a logic to including compulsory non-life insurance in a national IGS, the reality is that the types of insurance that are compulsory vary greatly across member states. Therefore, including all compulsory non-life products under the scope of minimum harmonisation would be problematic. Moreover, since life and non-life insurance contracts differ significantly and are handled differently in the event of insolvency, it could be preferable that life and non-life insurance are treated and administered by separate IGS entities. This should, however be up to Member States to decide.

10. Are there any other considerations to be taken into account to select the range of policies to be covered by an IGS? Please explain your reasoning.

No further comments besides those in our responses to Q8 and Q9.

11. Which criteria should be used to determine/exclude the eligible claimants?

Should minimum harmonisation be considered and because the primary aim of harmonising national IGS is effective consumer protection, Insurance Europe believes that the IGS should cover consumers that are natural persons only and that it should be at the discretion of member states, in consultation with local stakeholders, to decide whether a wider scope is justified.

Insurance Europe would add that, in contrast to consumers, legal persons such as micro- and small-sized entities can assess their chosen insurers' strength, seek professional advice and guide themselves by ratings. The administrative and financial burden resulting from the inclusion of legal persons under the scope of a harmonised IGS may therefore ultimately be to the detriment of a quick and effective settlement of consumer claims (given the different definition of this concept across member states).

12. Should coverage be extended to large legal persons where the ultimate beneficiary are retail customers (such as large corporates offering pensions for customers)?

Any minimum harmonisation should only cover consumers (natural persons) and it should be for member states to decide, in consultation with local stakeholders, whether a wider scope is justified.

13 What should be the relevant criteria to determine a minimum coverage level at EU level for different types of insurances?

The compensation paid in the case of a life insurer's insolvency is normally limited to the guaranteed sums and main commitments of the life insurance contract, whereas non-life insurance normally concentrates on outstanding claims and excludes the repayment of pre-paid premiums.

Insurance Europe therefore supports the introduction of minimum requirements on caps and compensation limits, to guarantee appropriate consumer protection while ensuring the financial stability of the national IGS and mitigating dangers of moral hazard. Member states should decide which compensation limits are adequate for the sustainability of their national IGS. They may provide for:

- a de minimis rule (minimum threshold for IGS intervention) which avoids a disproportionate, excessive administrative burden that has only a very minor advantage for the consumer;
- a maximum limit for IGS intervention;
- within the maximum limit, a maximum percentage of the insurance claim covered by the IGS;
- absolute caps on total contributions are needed to avoid that the obligation to fund an IGS exposes the other remaining insurers in the market and their customers at a risk that would not have existed otherwise.

14. What should be the relevant criteria to determine the target level for national IGSs?

Insurance Europe believes that decisions relating to IGS funding should be left to member states' consideration, in consultation with local stakeholders. Minimum harmonisation should merely require member states to

establish funding systems that would deliver adequate and effective consumer protection if an insurance company fails.

The following elements should be taken into account when deciding on the timing of the funding of an IGS:

- If the timing of funding would be subject to harmonisation, ex-ante funding should not be imposed. The main arguments in favour of ex-post funding are that this will not result in contributions from insurers unless there is a failure, so insurers will have more funds at their disposal. This reduces management costs and avoids investment risks. Contributions to the IGS will be computed according to actual need (outstanding claims/policies concerned). With ex-post funding, a certain amount of liquidity is needed on a rather short-notice, yet there is no risk that funds are not used exclusively for the defined purposes of the IGS.
- Further, insurers individually, and taken together as a sector, already hold considerable capital against even remote risk of failure. Ex-ante funding effectively increases this tying up of capital very significantly.
- Some member states could see ex-ante funding as a more efficient way to ensure speedy pay-outs to policyholders in case of an insurer's insolvency. With ex-ante funding, contributors can better schedule payments into the fund. In addition, all insurers (including the one that will fail) will have contributed in advance, which seems a fairer outcome.
- But ex-ante funding also has a number of disadvantages, especially with regard to financial management. Experience has shown that funding on an ex-ante basis often leads to the multiplication of the tasks that the fund needs to run. Ex-ante funding with immediate fund transfer to the IGS also involves greater administrative duties and costs. Unused funds (which become disproportionately large when insurance failures are infrequent or have a limited impact) would block financial resources for a long period of time, exposing them to risks of inefficient use and bad management. Further consideration should be given to sound and sensible approaches to limit the aforementioned burden.
- In any case, an IGS should not be expected to guarantee to repay policyholders in full. Therefore, one would expect there to be restrictions (caps and limits – See Q13) on the amounts that can be reclaimed under this system and IGS funds cannot be expected to be equivalent to the full value of the technical provisions.
- In concentrated markets, as is the case for a majority of the Member States (i.e. the Top 4 insurers having 70%-80% of market share), IGS will only be able to protect consumers from the failure of small insurance companies. Any failure of a large company in a concentrated market will require state assistance in order to protect consumers effectively. In the absence of state assistance and should other insurance companies be required to fill in funding gaps if a large insurance company collapses, this may significantly weaken the financial position of otherwise healthy insurers, thereby exposing their policyholders to risk.

As stated earlier in this response, and because of the technical complexity described above, Insurance Europe believes that decisions relating to IGS funding should be left to member states' consideration in consultation with local stakeholders. However, Insurance Europe would caution against imposing ex-ante funding under minimum harmonisation for the reasons explained above. Should ex-ante funding be considered by a member state, Insurance Europe would suggest doing so through decentralised, in house funds (i.e. a company contributes to a fund that remains under its control until the funds are needed, as long as it can prove to the relevant authority that the required amount exists in the fund).

15. What should be the relevant criteria to determine the level of the annual contributions per individual insurer into IGSs, including the method of calculating such contributions (risk-based, fixed rate, other)?

The contribution basis depends on the type of funding used and, because Insurance Europe argues that IGS funding should be left to member states' consideration, in consultation with local stakeholders, this should extend to the choice of contribution basis. However, Insurance Europe believes that contributions based on fixed rates make more sense in general. Additionally, any contributions should also be refundable; which means that

a kind of "payback mechanisms" should be considered for such cases, where the basis of the contribution to the fund does not exist any longer or declines significantly (e.g. life insurance stock is partially/completely sold).

Insurance Europe also favours the introduction of upper limits to the annual level of contributions to the IGS, the determination of which must be a national competency (See also Q13). The existence of upper limits in insurers' contributions should preclude any further power of the IGS to require additional contributions from the industry.

16. What should be the relevant criteria to determine the level of the annual contributions for the industry as a whole, including the method of calculating such contributions (risk-based, fixed rate, other)?

Insurance Europe favours the introduction of upper limits to the annual level of contributions to the IGS, the determination of which must be a national competency (See also Q13). The existence of upper limits in insurers' contributions should preclude any further power of the IGS to require additional contributions from the industry.

17. Are there any other elements that should be included in the disclosure requirements to policyholders? If so, what are those?

Experience has shown that consumers often are unaware whether - in the event of their insurer's bankruptcy - they are covered by an IGS and of what their basic rights to compensation are. Therefore, Insurance Europe believes that insurers should disclose to their policyholders if their insurance policy is covered by a guarantee scheme and, if so, specify which one. Insurers should also provide information about the basic rules governing the entitlement to coverage under such scheme. At the same time, this should not result in an information overload for consumers, as this would defeat the purpose of disclosure requirements.

Insurance Europe also believes that any IGS proposal should explicitly prohibit any type of advertising about the existence of an IGS since doing so would create moral hazard.

Insurance Europe would point out that, in the case of insurance-based investment products, the PRIIPs regulation already provides for disclosure under Art 8(3)(e): *"(e) under a section titled 'What happens if [the name of the PRIIP manufacturer] is unable to pay out?', a brief description of whether the related loss is covered by an investor compensation or guarantee scheme and if so, which scheme it is, the name of the guarantor and which risks are covered by the scheme and which are not;"*

18. Are there any other elements that are relevant in the context of cross-border cooperation and coordination arrangements in this field, particularly in the context of the home-country approach, please also refer to Q4 and Q5)? If so, what are those?

Insurance Europe believes that this is a weak part of the current EU supervisory system. Information sharing and collaboration between home and host supervisors should be strengthened.