

CEIOPS Input to the EC work on Insurance Guarantee Schemes

Introduction

In its letter of 5 May 2009¹ the European Commission has asked CEIOPS to give input to its ongoing considerations on whether or not to introduce a European solution on insurance guarantee schemes (IGS), by the end of June 2009.

This report has been prepared by CEIOPS' Task Force on Insurance Guarantee Schemes (TF-IGS) that has been set up in March 2009. Due to the very short time available, CEIOPS has invited the European Commission to take part in the work of its task force on insurance guarantee schemes to make sure that the resources are spent on the issues being most important for helping the European Commission going forward on the dossier.

CEIOPS has understood the mandate from the Commission to be limited to look at possible solutions for a future European regulation on IGS based on the current European legislation in the financial sector. CEIOPS has thus not suggested changes e.g. to the Winding up Directive².

Insurance Guarantee Schemes have been discussed over a number of years in different fora and in various documents, most notably in the Oxera report³ and in the papers produced by the Commission's working group on insurance guarantee schemes⁴. CEIOPS would also like to refer to its reply of 7 July 2008 to the Commission's consultation paper on Insurance Guarantee Schemes. The current report is not seeking to repeat or duplicate either of the discussions and evaluations done in those documents, but rather to supplement and update them in some important areas. On the Commission's request, an update of the inventory of existing guarantee schemes in the insurance sector given in the Oxera report has been conducted and is annexed to this report. To the extent possible, the report is giving exact references to the Oxera report, though there may be traces of the discussions in this paper of text being influenced by the Oxera report without it being explicitly mentioned.

The report is divided in 7 sections:

- I. Degree of harmonisation
- II. Role and ways of intervention of an IGS
- III. Coverage (policies, claims and claimants) of an IGS

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http://ec.europa.eu/internal_market/insurance/docs/guarantee/white_paper_march2009/letter_from_DG_to_CEIOPS_Chair_2009_5_5_en.pdf

² Winding Up Directive, OJ L 110/28

³ Insurance guarantee schemes in the EU. Comparative analysis of existing schemes, analysis of problems and evaluation of options -

http://ec.europa.eu/internal_market/insurance/docs/guarantee_schemes_en.pdf

⁴ http://ec.europa.eu/internal_market/insurance/guarantee_en.htm

- IV. Geographic scope of an IGS
- V. Organisational structure and funding of an IGS
- VI. Further considerations
- VII. Occupational Pension sector

Each section starts with an introductory note and presents the summary of the findings of the Oxera report on the issue. Where an agreement/consensus of CEIOPS Members and Observers was reached on certain options, CEIOPS makes recommendations. Where no conclusion was reached, CEIOPS only presents the pro et contra arguments estimated relevant for the discussion.

The report also includes two annexes: Annex 1 – A note on Pension Guarantee Schemes; Annex 2 – the Oxera report updated national data.

It is our understanding, after taking part in the stakeholders’ meetings organised by the Commission Services that for the moment it is neither likely nor desirable that a possible suggested directive will include the pensions sector. Since CEIOPS had already started developing a paper on its preliminary thinking on the idea of introducing a European requirement to establish guarantee schemes in that particular sector, we have included the outcome of additional work on occupational pensions as well. The structure of the part on Pension Guarantee Schemes differs slightly from that of the rest, as it includes no recommendations for preferred options on how to design a guarantee scheme in this sector.

CEIOPS’ recommendations are:

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| <p>1. For the sake of progress, a minimum harmonisation approach should be adopted to fill in the gaps of the current European coverage. As a second step a higher level of harmonisation should be envisaged, especially with respect to level playing field and a possible mutual support system.</p> |
| <p>2. The preferred option is for a guarantee scheme of last resort set up by individual Member States for life and non life insurance, leaving some flexibility to choose among a number of techniques to find the best possible solution in each individual case.</p> |
| <p>3. Respecting the fact that the decision to start winding up procedures is under the jurisdiction of the Member State in which the undertaking is licensed and that existing level of harmonisation is seen as adequate in the banking sector, CEIOPS recommends the intervention of an IGS should be triggered according to the same conditions as for the Deposit Guarantee Schemes.</p> <p>The introduction of an IGS directive may call for the revision of the winding up procedures.</p> |
| <p>4. IGS covers all classes of life insurance and non-life insurance.</p> <p>Member States are however allowed to exclude from coverage insurance claims arising out of marine, railway, transport and aviation insurance (see points 4 to 6 and 11 to 12 in Annex A of the Non-life directive). However, these exemptions should not be in contradiction to CEIOPS’ Recommendations 5.</p> |

<p>5. Claimants should include, at the minimum, all natural persons be it policyholders and other beneficiaries covered by the insurance contract.</p> <p>Member States are however allowed to exclude from coverage insurance claims by some categories of persons as defined in Annex 1 points 7 and 8 of the Deposit Guarantee Schemes directive (directors, managers, qualified shareholders of the failed undertaking etc.).</p>
<p>6. Member States are allowed to extend the scope of coverage to other claimants.</p>
<p>7. The basic starting premise is that the value of claims is to be determined on a contractual and legal basis. There may be a case for excluding investment risk on the part of the policyholder. The guarantee scheme rules can provide that "excessive benefits" are excluded from cover.</p>
<p>8. CEIOPS acknowledges the different importance of unearned premium in life vs. non-life insurance.</p> <p>It should be voluntary to include unearned premiums in the cover and to differentiate between life insurance and non-life insurance.</p>
<p>9. Insurance which is compulsory at EU level should not be subject to co-payments (i.e. fixed deductibles, minimum floors, percentage reductions or caps).</p>
<p>10. CEIOPS expresses a preference for the home state principle so that companies are covered by the IGS in the state where the company is authorized. This includes the company's branch and services business throughout the EEA.</p>
<p>11. The organisation of national insurance guarantee schemes is left to the individual member states.</p>
<p>12. CEIOPS recommends that IGS should be required to make payments as soon as practicable after the claim has been assessed. There may be significant variations on what is desirable for different types of product; shorter pay outs could be justified for third party liability insurance, compulsory insurance and health insurance.</p>
<p>13. If the EU were to introduce a European regime for insurance guarantee schemes, this should not be extended to the occupational pensions sector.</p>

I. Degree of harmonisation

The Oxera report does not explicitly dedicate a chapter to the question of minimum and maximum harmonisation.

Due to the current differences in the existing national IGS and insurance markets, CEIOPS considers a full harmonisation of all aspects of an IGS unlikely. If not stated otherwise, CEIOPS favours a minimum harmonisation.

CEIOPS Recommendation 1

For the sake of progress, a **minimum** harmonisation approach should be adopted to fill in the gaps of the current European coverage. As a second step a higher level of harmonisation should be envisaged, especially with respect to level playing field and a possible mutual support system.

Some Member States, that currently have no insurance guarantee schemes, expressed some concerns if the advantages of introducing an insurance guarantee scheme outweigh the disadvantages, especially related to moral hazard.

<u>Advantages</u>	<u>Disadvantages</u>
<p>Compared to the current situation, minimum harmonisation rules provide for a minimum level of protection across Member States thereby ensuring that all consumers are protected to, at least, the same extent.</p> <p>Member States with existing IGS that embody more extensive cover would not be required to reduce this cover.</p> <p>Member States can develop their IGS incrementally should they so desire. Starting with the EU minima, a Member State may wish to extend the coverage of their IGS over time to reflect local preferences.</p>	<p>Minimum harmonisation rules with many options may create varying cover across EU. The more options allowed, the greater the variance in cover across the EU. This situation would not directly match the increased (regulatory) level playing field under the harmonised SII Directive.</p> <p>Minimum harmonisation rules would be less transparent than a maximum harmonisation approach from the perspective of the consumer. The potential variations in coverage would make it difficult for consumers to evaluate the protection available. Under minimum or insufficiently harmonised IGSs, consumers face a more complex trade off in buying policies with regard to the desired level of security (GS), transaction costs and costs of the scheme/premiums. However this assumes that consumers are aware of the existence of GS cover and take this into account when taking financial decisions which may not be the case at present.</p> <p>There would also be a clear risk of forum shopping. For example, insurers may have an incentive to sell from Member</p>

	States with minimal or (ex ante) least costly IGS.
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II. Role and ways of intervention of the IGS

II. 1. Introduction

This section considers the role of an insurance guarantee scheme and the pros and cons of the main possible roles, a guarantee scheme of last resort or an extension to early intervention arrangements. It also considers the main possible forms of interventions of an IGS. These are broadly a pay box IGS, an IGS which can contribute to a solution based on a transfer of a portfolio of policies or an IGS which can undertake both these forms of intervention. It considers the possible triggers for the intervention of an IGS.

In this section no particular distinction is made between life and non-life sector. This distinction could be the subject of further analysis.

II. 2. Reference to the findings of the Oxera report evaluation of options

The Oxera report⁵ says that some IGS have as their exclusive function the payment of compensation while others intervene to secure the continuity of insurance policies. It notes that from a consumer protection point of view and to limit wider market impacts, continuity may be advantageous, particularly for life assurance policyholders. However in the case of non-life insurance, the arguments for continuity may apply less, since contracts are generally short-term. Nevertheless there may be instances where there could be benefits for an IGS to secure continuity of non-life policies e.g. where policies are 'non-standard' or the failed insurer has a significant share of the market and so it may be difficult for policyholders to find alternative cover quickly at the same price if supply is restricted. The Oxera report also notes that in some cases it may not be possible to find another insurer willing to take over the entire (or part of) the failed insurer's portfolio. Also in some cases securing continuity may involve additional costs.

II. 3. CEIOPS Recommendation

CEIOPS Recommendation 2

The preferred option is for a guarantee scheme of **last resort** set up by individual Member States for life and non life insurance, leaving some flexibility to choose among a number of techniques to find the best possible solution in each individual case.

⁵ Oxera pages 23, 25 (Table 2.5), 153 – 154, 156 (Table 7.2).

<u>Advantages</u>	<u>Disadvantages</u>
The existence of an IGS as a scheme of last resort can contribute to policyholders' level of certainty that their insurance company will meet its obligations to them and it can therefore enhance market confidence in the financial sector. The IGS would become involved only after all other possible options have been exhausted. The role of the IGS is to protect policyholders, in a cost efficient way, but not to prevent a crisis or an insurer getting into financial difficulties or becoming insolvent (which is the role of prudential supervision).	There appears to be relatively few disadvantages to an IGS as a scheme of last resort. An IGS will entail a cost (both as regards the protection it provides and the administration of the scheme) but this cost results from the existence of the IGS rather than its role as a scheme of last resort. A too generous scheme would not only increase the costs of the IGS but could also induce moral hazard on the part of insurance companies and policyholders.

II. 4. Other Options

II. 4.1 Ways of intervention

The aforementioned CEIOPS recommendation 1 leaves some discretion with Member States, in accordance with the minimum harmonisation concept that has been chosen as appropriate at this stage.

Member States would be free to decide whether the scheme would:

- act as a pay box, i.e. its role would be restricted to the payment of compensation; or
- be able to facilitate the transfer of a portfolio of policies.

In addition to this, Member States can choose to give the IGS the responsibility to pay benefits falling due while the scheme is seeking to secure continuity of insurance. Also, Member States can opt for the IGS to be able both to act as a pay box and to facilitate a transfer of a portfolio of policies, depending on the circumstances in each individual case.

II.4.2. Pay Box

An IGS of last resort could be a mere pay-box covering individual insurance claims after winding up procedures of the insurer is finished and the deficit of the estate is established, or it could come into play once it is clear that the particular undertaking will not be able to pay its claims as they fall due, either to advance payments to claimants or to seek a solution in which the portfolio (or parts of the portfolio) is transferred to another insurance undertaking.

<u>Advantages</u>	<u>Disadvantages</u>
An IGS which acts as a pay box, i.e. pays compensation, means that policyholders do not have to wait for the winding up to be completed before	In the case of some policies, particularly life insurance, the amount of compensation payable may be insufficient to enable a policyholder of

<p>receiving compensation. This can take a number of years in the case of an insurance company. At that point, the IGS can seek to recover the compensation it has paid by claiming as a creditor in the winding up of the insurer (subrogation) if it financed the compensation without access to the assets of the insurer.</p> <p>As far as non-life insurance is concerned, the possibility of paying compensation in advance of the winding up may prevent policyholders from getting into serious financial difficulties. This could occur in relation, for example, to compensation in respect of a property insurance policy which a policyholder needed to rebuild his home after a fire or compensation in respect of a life insurance policy on which the policyholder was relying for their financial support in retirement.</p> <p>A solution where it is clear that the failed institution will no longer be an active player in the market will contribute to the general acceptance of an IGS amongst market participants, as they will not have to pay for the continued life of a competitor.</p>	<p>increased age and worse health to buy comparable life insurance from another insurer.</p> <p>It is difficult to compare the administrative costs of paying compensation and facilitating a transfer.</p>
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II. 4.3. IGS as a facilitator of a portfolio transfer

This would include different ways of safeguarding the continuation of the contracts by having the portfolio (in whole or parts) taken over by another undertaking.

<u>Advantages</u>	<u>Disadvantages</u>
<p>If an IGS is able to facilitate a transfer this provides direct continuity and therefore overcomes the difficulty that the payment of compensation may not provide adequate consumer protection, particularly where the payment of compensation is considerably delayed or the compensation is insufficient to enable policyholders to buy comparable life insurance.</p> <p>Securing continuity in the case of life</p>	<p>If an IGS is able to facilitate a transfer this will involve the difficulty that securing continuity of cover will generally depend on the willingness of another insurer to take on the business of the failed company. The rules will need to require at least the minimum level of protection e.g. 90% to be secured. In addition, this may involve some payment to the insurer if the assets transferred are insufficient to provide the minimum required level of cover.</p>

insurance may be **less costly** than the payment of compensation as the bulk of policyholders' protection is expected to be secured by the transfer of policies and assets to a new insurer from the failed insurer.

Securing continuity will not be necessary to protect policyholders in the case of the generality of **non-life** insurance contracts which are, by their nature, short term contracts. However health insurance may be general insurance and may be difficult to replace. With this exception, policyholders can easily obtain replacement general insurance cover with another insurer without suffering undue financial loss.

Facilitating a transfer is likely to involve **less administration** than paying compensation to individual policyholders. It avoids the administrative **costs** involved in the valuation of benefits under life insurance contracts and the payment of compensation to individual policyholders.

Payment of benefits falling due

While the IGS is making arrangements to secure continuity of cover, its role may include paying benefits to policyholders which fall due to be paid before continuity has been secured or the insurer is wound up. These could include sums payable to policyholders when their life insurance policies mature or regular income payments such as annuities.

II. 4.4. Broadening the role of the IGS

When compared to the preferred option of a last resort measure, the role of the IGS could be broadened to an early intervention scheme. There is as yet no harmonised definition of "early intervention" in the insurance sector. For the purpose of this report, early intervention will involve different techniques (guarantees, capital injections etc) to avoid winding up of the undertaking and thus safeguard the future life of the company.

Early intervention may occur in a number of circumstances while the insurer can still meet claims against it. When early intervention occurs, it would be necessary to consider whether the IGS should become involved as part of the regulatory toolbox.

<u>Advantages</u>	<u>Disadvantages</u>
<p>It could be to the benefit of the consumer, that an IGS intervenes to avoid the winding-up of an undertaking.</p> <p>It could also be beneficial to the overall system of regulating insurance companies' insolvencies, reducing the financial impact of the failure.</p> <p>The possible negative impact of a failure on the market (e.g. in case of large insurance undertakings/groups) could be an argument for an early intervention by an IGS.</p> <p>Facilitating a portfolio transfer to avoid insolvency could be a cheaper solution than covering claims in case of insolvency.</p>	<p>An early intervention could mean the support of an insurance undertaking, rather than the claimants.</p> <p>While the costs of an IGS which is an extension to early intervention might be quite high, it is not possible to say that this will be the case as we have no agreed understanding of what "early intervention" is in the insurance context and what trigger should be used in this option.</p> <p>A too generous or too broad defined scheme would not only increase the costs of the IGS but could also induce moral hazard on the part of insurance companies and policyholders.</p>

II. 5. Triggers for the intervention of an IGS⁶

The triggers for the intervention of an IGS need to be defined in some way by reference to the financial position of the insurer. Management and regulatory action have failed and the insurer is no longer a going concern.

These triggers could possibly be defined by reference to the breach of Solvency II capital requirements (e.g. non compliance with the finance scheme approved to restore the Minimum Capital Requirement (MCR)), by reference to the commencement of insolvency proceedings and / or by reference to a determination by the regulator and / or a court that the insurer is no longer able to meet claims against it. It should be noted that supervisory assessment involves judgement and assessment of different factors in the particular circumstances of each case and that there is not a black and white answer as to an insurer's financial position.

Winding up of insurance undertaking are according to directive 2001/17/EC left to the jurisdiction of the member state in which the undertaking is licensed.

According to the Deposit Guarantee Schemes directive the relevant DGS shall be triggered by the non-payment of deposits that are due and payable and where there is a statement by the supervisor that the company appears unable to repay deposits and has no current prospect of being able to do so or (2) a court order has been issued which has the effect of suspending depositors' ability to make claims against the company.

⁶ Oxera Table 2.5, pages 25 – 26, 155, 174

CEIOPS Recommendation 3

Respecting the fact that the decision to start winding up procedures is under the jurisdiction of the Member State in which the undertaking is licensed and that the existing level of harmonisation is seen as adequate in the banking sector, CEIOPS recommends that the intervention of an IGS should be triggered according to the same conditions as Deposit Guarantee Schemes.

The introduction of an IGS directive may call for the revision of the winding up procedures.

III. Coverage of the IGS (policies, claims, claimants)

III. 1. Introduction

This section concerns the types of policies to be covered by IGS, together with the level of protection and eligible claimants.

III. 2. Reference to the findings of the Oxera report evaluation of options

The Oxera report mentions⁷ that there are no particular reasons to differentiate between different classes of life insurance (p.143). For non-life insurance there may be reasons to favour liability insurance, compulsory insurance and retail policies (p.144). The Oxera report says that if the decision is to protect natural persons only, a case can be made for excluding certain policies from the scope of the IGS protection given that they cover commercial risks only. This applies in the non-life market – for example to marine⁸, aviation and transit (MAT) or credit and suretyship insurance. The Oxera report also says that for the same reasons, reinsurance policies are typically outside the scope of IGS protection. Eligible claimants should be consumers and possibly small businesses, regardless of whether they are protected as policyholders, beneficiaries or third parties (p.145). Claims for unearned premiums could be excluded, particularly for non-life insurance (p. 147).

In life insurance, the Oxera report notes (page 148) that IGS-coverage could extend beyond the main contractual commitments (including main guarantee returns and possibly attributed bonuses) to also include some features of the contract, such as future profit sharing or other benefits, depending on the life assurance policies written. The report continues "Indeed, compensation could also be provided for any pure investment losses that may be incurred by policyholders". However the Oxera report notes that such extended coverage may be rejected on the grounds of practicality and proportionality, even if in some case the relevant benefits may constitute an important part of the value of the contract over and above the contractual commitments. In addition, making the policy purchase decision 'risk-free' for policyholders was likely to exacerbate moral hazard.

Minimum limits of coverage: the Oxera report manifests no preference regarding the harmonisation approach in a future IGS EU directive on this feature. But regarding

⁷ Oxera report, pp 143-149

⁸ Oxera report, p 144, says "motor but this should presumably be marine, as in "MAT" which the report subsequently refers to.

the 'per-policy' *versus* 'per-customer' compensation question, the Oxera report considers that the future directive's approach "*tends to be*" (*sic*) 'per-customer', as in the depositor-guarantee and investors-guarantee schemes EU directives (p. 151).

Compensations could be subject to a deductible, a percentage reduction or a cap. Caps may be difficult to implement with acceptable results, but such limitations should be restricted for some classes of Non Life insurance, such as compulsory insurance and third-party liability insurance (p. 148-151 and 152).

Regarding the form of compensation limits, the Oxera report prefers (p. 181) percentage reductions to monetary caps "(...) *because of the highly skewed distribution of claims for some classes of insurance, and because of the difficulty of specifying a single absolute amount that is appropriate for all EU Member States given differences in income and insurance cover.*".

Regarding the "*de minimis*" amount of cover and deductibles, the Oxera report (also p. 181) seems to prefer the strictly national regulation: "*(Small) deductibles or minimum floors on claims could also be allowed at the level of national IGS (...)*".

III. 3. CEIOPS Recommendations

III. 3.1. Policies covered

This chapter includes alternative methods for limiting the cover of the IGS either by insurance classes or according to claimants.

CEIOPS Recommendation 4

IGS covers all classes of life insurance and non-life insurance.

Member States are, however, allowed to exclude from coverage insurance claims arising out of marine, railway, transport and aviation insurance (see points 4 to 6 and 11 to 12 in Annex A of the Non-life Directive).

However, these exemptions should not be in contradiction to CEIOPS Recommendations 5.

<u>Advantages</u>	<u>Disadvantages</u>
<p>There would be a minimum level of protection across Member States in respect of both life and non-life insurance (p.152).</p> <p>In respect of life insurance, due to the long insurance period, the insured persons are often unable to predict the failure of the insurer. Additionally, the policyholders may be unable to obtain the same level of insurance protection at the same price because of changes in their personal situation (p.143).</p>	<p>The costs of the wide cover might be too large or at least difficult to assess (p.152).</p>

As for non-life insurance, although the consequences of failure of the insurer are different, non-life insurers' failures have historically been more frequent (p.144). Additionally, in respect of non-life insurance, the claims may be of a significant value or nature, which justifies covering such claims by the guarantee scheme (p.152).

III. 3.2. Claimants

CEIOPS Recommendation 5:

Claimants should include, at the minimum, all natural persons be it policyholders and other beneficiaries covered by the insurance contract.

Member States are however allowed to exclude from coverage insurance claims by some categories of persons as defined in Annex 1 points 7 and 8 of the Deposit Guarantee Schemes directive (directors, managers, qualified shareholders of the failed undertaking etc.).

Third parties should be covered if they have a legal right to claim against the insurer under the contract.

<u>Advantages</u>	<u>Disadvantages</u>
<p>There will be a minimum level of protection across Member States for the most vulnerable claimants.</p> <p>Limiting the number of potential claimants by excluding corporate bodies (at least large ones) may also substantially reduce the costs of the scheme⁹.</p> <p>Extending the cover to all third parties who may suffer in the case of an insurance failure may be very costly and may result in extending the scheme to some entities which were not intended to be covered, e.g. large corporate bodies. Therefore, while adopting this solution, some exceptions may be advisable.</p>	<p>Limiting the scope of cover of IGS to the individuals may result in no cover for the other vulnerable claimants, such as small businesses or corporate bodies.</p> <p>Such a solution may also substantially increase the costs of IGS.</p>

⁹ Oxera report, p. 27

Reinsurance, which nature differs from the direct insurance, is excluded from IGS.

CEIOPS Recommendation 6:

Member States are allowed to extend the scope of coverage to other claimants.

<u>Advantages</u>	<u>Disadvantages</u>
<p>Member States with existing IGS would not have to reduce their cover.</p> <p>Member States would also be allowed to extend the cover for other entities or to a higher level, which might be considered more adequate or preferable for the particular Member State.</p> <p>Some insurance agreements (e.g. third party liability insurance or those set as compulsory within the EU) play an important role in the economic or social activity of the entities to be covered by IGS. Therefore, additional protection for those insurance agreements may be justifiable.</p> <p>All of the aforementioned advantages regarding the cover for individuals shall apply in this respect.</p> <p>Additionally, Member States would be allowed to extend the cover for other entities considered as vulnerable.</p>	<p>Minimum harmonisation rules with many options left may result in a variety cover within different Member States. The more options are allowed, the greater is the variance in cover across the EU. (p.152)</p> <p>Additionally, there might be a risk of forum shopping, e.g. in favour of states with minimal IGS, or vice versa, depending on consumer demand or the costs of participation in the guarantee scheme.</p> <p>The cost of wide cover could be too large or at least difficult to assess.</p> <p>There would be some difficulties regarding defining small businesses or any other corporate bodies to be covered by the scheme.</p> <p>Too many options might also result in different level playing field for the insurers or the companies depending on the place of residence (either of the insurer or the insured company, depending on the solutions regarding geographic scope of the IGS).</p>

III. 3.3. Value and Limitation of Claims

(1) Value of Claims

CEIOPS Recommendation 7:

The basic starting premise is that the value of claims is to be determined on a contractual and legal basis. There may be a case for excluding investment risk on the part of the policyholder.¹⁰ The guarantee scheme rules can provide that “excessive benefits” are excluded from cover.¹¹

<u>Advantages</u>	<u>Disadvantages</u>
To provide protection in real terms , the IGS should compensate the contractual and legal value of the policy, as this is the value that policyholders have paid for and which the beneficiaries are relying on.	Covering investment risk on the part of the policyholder may encourage insurers to provide risky or excessive terms - and customers to accept them - in reliance on the IGS to cover any shortfall leading to the failure of the insurer. It should therefore be excluded.

(2) Unearned Premiums

CEIOPS Recommendation 8

CEIOPS acknowledges the different importance of unearned premium in life vs. non-life insurance.

It should be voluntary to include unearned premiums in the cover and to differentiate between life insurance and non-life insurance¹².

<u>Advantages</u>	<u>Disadvantages</u>
For non-life insurance, excluding unearned premiums from the cover could prevent a large number of fairly small claims, with relatively small benefits to the customer. This goal could also be reached by introducing co-payments (see Par. 4.1).	For life insurance, excluding unearned premiums could have a deteriorating effect on the level of cover as premiums correspond to significant amounts over time.

¹⁰ Oxera report, p. 148.

¹¹ For example, such benefits could be excluded where no reasonable and prudent person in the position of the insurer would have decided to offer these benefits given the premiums payable and other contractual terms. There is exclusion on these lines from the Financial Services Compensation Scheme, the UK insurance guarantee scheme.

¹² Oxera report, p. 147 f.

(3) EU Compulsory Insurance

CEIOPS Recommendation 9

Insurance which is compulsory at EU level should not be subject to co-payments (i.e. fixed deductibles, minimum floors, percentage reductions or caps).

<u>Advantages</u>	<u>Disadvantages</u>
Insurance that has been made compulsory at EU-level may be of great social importance and should therefore not be subject to co-payments.	There appears to be no disadvantages to providing full cover for EU compulsory insurance, except of course increased costs for the IGS.

III. 4. Other Options

4.1. Co-payments

The measures below of (a) fixed deductibles, (b) minimum floors, (c) percentage reduction and (d) caps are collectively referred to as co-payments (in Oxera terms: co-insurance)¹³

(a) Fixed Deductible

A fixed deductible means deducting a fixed amount from a claim, e.g. €100, regardless of its value. In this example a claim for €100 or less will not be paid at all, while a claim for €200 will be paid with €100.

<u>Advantages</u>	<u>Disadvantages</u>
<p>Fixed deductibles reduce the cost of an IGS.</p> <p>Fixed deductibles bar or deter smaller claims. This reduces the administrative burden on the IGS for the benefit of larger and more important claims.</p> <p>Fixed and well-disclosed deductibles can provide moral incentive in favour of prudent insurers by establishing co-payments for all claimants.</p> <p>Fixed and well-disclosed deductibles can provide an incentive for policyholders to seek to insure with prudent insurers by establishing co-payments for all claimants.</p>	<p>For people of limited means, even a small deductible may constitute a noticeable loss on small claims.</p>

¹³ Oxera report, pp. 146 – 151.

Fixed deductibles have a relatively minor impact on larger, more important claims.	
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(b) Minimum Floor

A minimum floor means that claims below a certain amount, e.g. €100, are not paid at all, while claims meeting the minimum amount requirement will be paid in full. In this example a claim for €100 will not be paid at all while a claim for €200 will be paid with €200.

<u>Advantages</u>	<u>Disadvantages</u>
<p>Minimum floors reduce the cost of an IGS.</p> <p>Better protection for claims that meet the minimum amount requirement.</p> <p>Minimum floor will exclude minor claims, leaving resources to deal with the larger, more important claims.</p>	<p>A minimum floor reduces costs less than a fixed deductible of the same amount.</p> <p>Moral incentive is less than with a fixed deductible, as many claims will not be subject to deductions.</p> <p>For people of limited means, a minimum floor may constitute a noticeable loss on small claims.</p>

(c) Percentage Reduction

A percentage reduction means that claim values will be reduced by a percentage, e.g. 10%. The example percentage means that a claim for €500 will be paid with €450 and a claim for €1000 will be paid with €900.

The national law could also give the power of the IGS to, within the limits stated in law, casuistically determinate the concrete extent of the reduction (*ex professo* "reduction of policies").

<u>Advantages</u>	<u>Disadvantages</u>
<p>Percentage reductions are an efficient tool for reducing the cost of IGSs.</p> <p>In many cases a small percentage reduction will not have a drastic negative effect on the cover for the individual claimant.</p> <p>Percentage reductions can provide an incentive for policyholders to seek to insure with prudent insurers by establishing co-insurance equally for all claimants.</p>	<p>For some larger claims, e.g. disability claims, motor insurance claims or residential property claims, even a small percentage reduction may have a large negative effect on the cover provided, even negating the purpose of the cover.</p>

(d) Caps

A cap means that the portion of claim value which exceeds a certain amount, e.g. €100,000, will not be paid at all. The example means that a claim for €80,000 will be paid in full, while a claim for €200,000 will be paid with €100,000.

<u>Advantages</u>	<u>Disadvantages</u>
<p>Caps are effective at reducing the cost of IGSs.</p> <p>Caps can provide moral incentive for holders of large policies to seek to insure with prudent insurers.</p> <p>Existing caps in national IGSs would not have to be abolished (but may well be adjusted).</p>	<p>Caps have a much larger negative impact on large and important claims than percentage reductions, fixed deductibles or minimum floors.</p> <p>Caps can create distorting incentives by encouraging insurance customers to obtain several different policies just below the cap limit, in order to circumvent the cap. However customers may not be able to achieve this effect in the case of non-life insurance as they will be able to claim only under one policy for the same loss.</p> <p>The optimal amounts of caps may be difficult to determine and may vary between Member States.</p> <p>To avoid unfair or counterproductive results, it may be necessary to have different caps for different classes of insurance, thereby increasing the complexity and reducing the transparency of IGSs.</p>

(e) Harmonisation of Co-payments

<u>Advantages</u>	<u>Disadvantages</u>
<p>If measures of co-payments should be permitted in national IGSs, then there is a strong case for harmonising a minimum cover. If cover becomes too varied across Member States, then consumers would be uncertain of their protection, negating many of the positive effects of an IGS. Allowing a wide national scope of co-payments would in theory enable Member States to reduce their cover below meaningful levels.</p>	<p>There would appear to be no objective disadvantages to restricting the scope of national discretion with regard to co-payments (although the impact will be different in different Member States due to the very different levels of average salaries etc).</p>

III. 5. Treatment of Savings and Investment Products

III. 1. Introduction

In principle, there should be equal treatment of similar types of products and such insurance products should not be put at a disadvantage. It could be argued that savings/insurance products in insurance form should be protected to the same extent as similar banking and investment products.

III. 2. Reference to the findings of the Oxera report evaluation of options

The Oxera report only discusses the rationale for the creation of an IGS relative to the rationale for the existence of Deposit Guarantee Schemes (DGS) and Investor Compensation Schemes (ICS). The Oxera report concludes that while the existence of DGS/ICS of itself is no reason to create an IGS, the case for having a guarantee scheme in other sectors and not insurance is weak. This is particularly the case where consumer protection is a key objective. (p.143)

3. CEIOPS opinion

Some investment life products are similar to non-insurance investments. However it is unclear as a matter of law and practice how different types of life product could be distinguished and how this could be simply explained to consumers. Nor is it clear how making such complex distinctions will be compatible with an insurance guarantee scheme seeking to make compensation payments as soon as possible.

Some savings and investment products in insurance form are close substitutes for other investment products. As such, an argument can be made that they should receive the same cover as under the Investor Compensation directive or the Deposit Guarantee Scheme directive. There is, however, an extra dimension to the insurance products in that they are often purchased to provide for retirement/personal care and so a failure could place extreme hardship on policyholders. This latter characteristic would argue for the extension of coverage amounts to reflect this. These products may also be taken out as long-term investments and so can be distinguished from deposits which are often shorter term investments and can be more easily realised.

This was considered by the EC Working Group but abandoned due to a lack of clear distinction between some insurance and investment products.

<u>Advantages</u>	<u>Disadvantages</u>
Providing the same level of coverage as under the Investor Compensation directive or the Deposit Guarantee Scheme directive would generate a level playing field between banks, insurance companies and investment firms with regard to savings. It would be very clear to consumers that similar products are treated equally	There is the potential that the limits imposed in DGS may be too low to reflect the purpose of savings/investment policies purchased from insurers. There is scope for hardship to be imposed on some policyholders if the IGS had to payout subject to comparable limits imposed in Deposit Guarantee Schemes. It may be necessary to consider variable

<p>and would remove any questions as to how a policy would be treated.</p>	<p>levels of coverage dependent on the particular nature of given insurance policies. This would require a mechanism to properly allocate insurance policies to the relevant categories.</p> <p>In the case of complex combination products it will be difficult for consumers to understand the cover available.</p> <p>Communicating the scope of the scheme could be more difficult.</p> <p>It will slow up the payment time for the guarantee scheme if it has to take complex legal decisions on the terms and conditions of different insurance products.</p> <p>It is unclear how the different types of insurance products, eligible for different compensation limits, will be defined.</p>
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IV. Geographic scope of the IGS

IV. 1. Introduction

Cross-border issues play a considerable role in the creation and design of insurance guarantee schemes. When discussing the geographic scope of insurance guarantee schemes, one has to bear in mind the concept of 'insurance passport', that is insurance companies operating also via freedom of establishment and freedom to provide services. Another scenario to bear in mind when analyzing cross border issues is the business carried on by a subsidiary of a parent undertaking in another Member State. In order to effectively address cross-border issues, the geographic scope of insurance guarantee schemes would need to be structured on the basis of either the host or the home state principle. This part of the report also addresses the interaction of the home-host Member state principles with the Motor Insurance directives. In this report it is being assumed that a branch of an insurance undertaking whose head office is outside the Community will be required to become a member of the IGS of the Member State of the branch.

IV. 2. Reference to the findings of the Oxera report evaluation of options

IV. 2.1. Home State Principle

In the Oxera report, a home state IGS is defined as "one that covers all domestically authorized insurers, including their relevant business conducted via branches and freedom of services in other Member States" (p. 176).

Under the home state principle a subsidiary of another company is covered by the IGS in the State where the subsidiary is authorised, in the same way as other companies.

<u>Advantages</u>	<u>Disadvantages</u>
<p>Corresponds with the current supervisory structure, and is also in line with article 4 of directive 2001/17/EC (Reorganisation and winding-up directive) (p.176).</p> <p>Efficiency of an IGS process: The case handling of an IGS would be easier if it is in the country where the insurer is wound up (p.174).</p> <p>Acceptance by the insurance industry: Insurance undertakings would probably be more comfortable being members of a scheme within their jurisdiction as they would be familiar with the supervisory and regulatory regime within their jurisdiction (p.174).</p> <p>Approach used in directives on Deposit guarantee and investor compensation schemes (p.176).</p> <p>Equivalent protection and level playing field between subsidiaries and domestic insurers within a Member State: Equal protection for domestic consumers and a level playing field between them (p.178).</p> <p>Administrative feasibility of IGS process: Subsidiaries can in principle default while the parent remains solvent. Moreover, it is the local supervisor that takes back the control of the subsidiary solvency on a local basis in the event of a breach of the subsidiary's solvency. Therefore, from an administrative point of view and other practicality reasons, it would seem more appropriate to take an approach where the local supervisor is responsible for taking the winding-up decision and triggering the insurance guarantee scheme and where the local insurance guarantee scheme provides protection (p.178).</p> <p>Funding implications: If subsidiaries</p>	<p>Consumer protection: Due to the possible differences in the scope and level of coverage between IGSs in different countries, the level of protection of consumers in a national market may vary, unless the levels of protection will be harmonised (p.173/4).</p> <p>Competition issues: A level playing field between domestic insurers and incoming EU insurers is not maintained since business of incoming EU insurers is not protected by local IGS (p.173).</p> <p>Funding: If an insurer with headquarters in a small country and with substantial cross-border business fails, the home-state IGS may face significant problems in terms of raising the funding necessary to make the promised payments. (p.175).</p> <p>The domestic companies will be required to contribute for the losses of the cross-border business or a certain ex ante levy for cross border businesses would be necessary (<i>not from the Oxera report</i>).</p>

are members of their national IGS, in the event of insolvency, the costs and resulting funding requirements are spread across national IGS rather than concentrated in the single insurance guarantee scheme of the parent's home state (p.178).	
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IV. 2.2. Host State Principle

In the Oxera report, a host state IGS is defined as "one that covers all relevant policies sold to domestic policyholders, including policies of incoming EU insurers (branches and freedom of services)" (p. 176).

<u>Advantages</u>	<u>Disadvantages</u>
<p>Coverage of all policies issued in the host state: This may be beneficial from a consumer protection perspective (equivalent protection). (p. 173)</p> <p>Equal level of consumer protection within MS, without the need to harmonise IGSs across countries in the EU.(p. 173)</p> <p>Level playing field condition within MS, between domestic and incoming EU insurers, and would avoid competition distortion within a Member State. (p. 173).</p>	<p>Insurers with cross-border business would be required to participate in more than one IGS, which could give rise to various issues such as contribution payments as well as administration costs.(p. 174)</p> <p>Non-efficient IGS intervention because the IGS is not aligned with the supervisory framework. (p. 174)</p> <p>Acceptance by the insurance industry: Domestic insurers may be unwilling to contribute to an IGS if they perceive that their contributions will be utilised to finance the failure of incoming EU firms coming from jurisdictions which have in place a less stringent supervisory regime. (p. 174)</p> <p>Acceptance by the local supervisor: Local supervisors may have reservations about the quality of home state supervision of the insurance undertaking and may therefore be unwilling to trigger the local IGS in the event of failure of an incoming EU insurer. (p. 174)</p>

IV. 2.3. Geographic scope of an IGS in line with lead supervisory responsibilities

In this case, the subsidiaries are covered by the home IGS of the parent-company.

<u>Advantages</u>	<u>Disadvantages</u>
<p>Equal consumer protection across MS in the event of group failure, irrespective of whether the policyholder in different countries has purchased the policies from subsidiaries, branches, or freedom of services providers (p. 177).</p> <p>Neutrality with respect to market entry decision of groups (p. 177).</p> <p>It would be fairer if the lead supervisor is also responsible for delivering the IGS protection to policyholders (p.178).</p>	<p>Consumer protection: Unless the levels of protection will be harmonised between IGSs in different countries, IGS coverage will differ in one particular national market (p.178).</p> <p>Competition issue: A level playing field between domestic insurers and incoming EU insurers is not maintained since business of incoming EU insurers is not protected by local IGS (p.173).</p> <p>Funding: If an insurer with headquarters in a small country and with substantial business carried out by subsidiaries in other EU Member States fails, the home-state IGS may face significant problems in terms of raising the funding necessary to make the promised payments. The companies in the parent’s home state will be required to contribute for the losses of the subsidiaries in other EU Member States (p. 175 in relation to cross-border branch/services business).</p> <p>Assigning responsibilities for subsidiaries to the IGS in the jurisdiction of the supervisor of a parent company could also present problems and give rise to particular opposition in those MS where there are a significant number of subsidiaries of insurance companies authorized in other EU Member States.- Since these subsidiaries would no longer participate in the local IGS and share the costs in the event of domestic failure, this could lead to concerns about the ability and usefulness of running a reduced-size domestic IGS (p. 178).</p>

IV. 3. CEIOPS Recommendation

CEIOPS Recommendation 10:

CEIOPS expresses a preference for the **home** state principle so that companies are covered by the IGS in the state where the company is authorised. This includes the company's branch and services business throughout the EEA.

CEIOPS acknowledges that it would not be easy to reach an agreement on the host state principle. Host state principle does not fit well with the currently EU supervisory framework.

Even though the host state principle is not CEIOPS preferred option, an advantage for the host state principle would include similar cover for all identities operating in the same market and will reduce consumer education challenges.

IV. 4. Other Options

In the Solvency II Directive adopted by the Parliament¹⁴, there is no shift of powers from solo supervisors to group supervisors, i.e. the solo supervisor remains responsible for the enforcement of the solvency capital requirements (MCR and SCR) of solo undertakings.

Nevertheless, during the presentation on the functioning of the colleges in times of crisis during the March 2009 Members Meeting of CEIOPS, the need of a European mandate was highlighted. National mandate leads only to accountability to national institutions (and national policyholders). An extension to a European mandate for home authorities (and group supervisor authorities) might be helpful to improve the supervision of cross-border financial institutions and to ensure an equal protection of policyholders of branches and cross border entities. It is partially included in Article 27a of the Solvency II Directive.

"Without prejudice to the main objective of supervision as set out in Article 27 Member States shall ensure that, in the exercise of their general duties, supervisory authorities shall duly consider the potential impact of their decisions on the stability of the financial systems concerned in the European Union, in particular in emergency situations, taking into account the information available at the relevant time."

That conclusion also applies to the architecture of IGS. Indeed, the structure of IGS may impact incentives of group and home supervisory authorities to ensure an equal protection of all policyholders in the group independently of the location of the branch or the undertaking that is insuring them.

Within the context of insurance groups, an approach where the subsidiaries would be required to contribute to the insurance guarantee scheme in the country in which they are established and authorised would have some merits. This approach would be consistent with the preferred approach of the home state principle as explained in Part IV.3 of this part of the report.

¹⁴<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+20090422+SIT-03+DOC+WORD+V0//EN&language=EN>

If the group support regime is to be introduced according to Recital 95(e) and Article 246(2) of the SII directive, one could re-open the discussion on the group dimension to the IGS.

V. Organisational structure and funding

V.1. Organisational structure

V.1.1. Introduction

This section concerns whether or not there is a call for harmonised rules for organisational set-up of national guarantee schemes.

In its stakeholders' meeting of 8 May 2009, the EC presented the 6 following possible EU wide solutions:

- (1) 28th regime (an additional regime besides the national schemes);
- (2) A Single EU-wide IGS covering all relevant policies written and purchased in the EU replacing national schemes;
- (3) An EU-wide IGS that covers only policies that are written and sold across borders or, alternatively, that covers only those insurers that engage in cross-border business (via branches and freedom to provide services) + national schemes for domestic business;
- (4) An EU-wide IGS that covers only insurers being part of a potential future lead supervision regime (including subsidiaries) + national schemes for all other relevant policies (domestic and cross-border);
- (5) Introducing an IGS in all MS with an appropriate level of harmonisation;
- (6) Introducing an IGS in all MS with an appropriate level of harmonisation with mutual support.

V.1.2. Reference to findings in the Oxera report

The Oxera report mentions cost saving as an argument in favour of combining the administration of different schemes (p. 154).

The Oxera report sees no particular benefit in streamlining organisational set-up across Europe as no real criticism has been raised against how existing schemes are organized and the Oxera report considers that the question is irrelevant from a consumer protection perspective (pp 154-155).

The Oxera report does not consider that the need for cooperation with insolvency practitioners or the size of staff in an IGS are dependent on whether the scheme is a private or a public agency (p. 155).

V. 1.3. CEIOPS' recommendation

CEIOPS recommendation 11

The organisation of national insurance guarantee schemes is left to the individual member states.

<u>Advantages</u>	<u>Disadvantages</u>
<p>Existing guarantee schemes throughout the EEA will not have to change their structure or management.</p> <p>Allows for flexibility to fit in the market and legal system in each member state.</p>	<p>No particular disadvantages observed.</p>

V. 2. Funding

V.2.1. Introduction

The main issue related to funding of IGS is the question of ex-ante or ex-post funding. Ex-ante funding means that there will be a pre-paid fund, while ex-post funding means that there will be a call for contributions when the IGS needs funds. It is assumed that the funding of IGS in any way will be based on contributions from the insurance undertakings covered by the IGS.

An argument put forward against establishing IGS is the costs related to it. The cost issue could be adjusted through scheme design (e.g. ex-ante or ex-post funding) and establishing a system of mutual support. Furthermore, there could be a maximum level for contributions from the undertakings to the IGS each year to reduce the burden on the insurance undertakings, e.g. as a maximum percentage of the premiums (if that is the basis for calculating contributions) ("escape clause").

V.2.2. Reference to the findings of the Oxera report evaluation of options

The Oxera report suggested there was no single recommendation to make between ex ante vs. ex post financing as both would have their advantages and disadvantages and could meet the funding needs of the IGS, especially as they might be combined.

Option 1: Ex-ante financing

<u>Advantages (pp157-164)</u>	<u>Disadvantages (pp 157-164)</u>
<p>The funds will be immediately available for the IGS to use.</p> <p>Even failed companies will have contributed.</p> <p>Less pro-cyclical.</p>	<p>May require a larger administration (for capital management etc)</p> <p>The insurance undertakings will not have the possibility of having the funds at its disposal.</p> <p>If ex post financing is excluded the funds may prove to be insufficient.</p>

Option 2: Ex-post financing

<u>Advantages</u>	<u>Disadvantages</u>
<p>Reduces costs when the IGS is not in use and insurance undertakings will not have any actual cost unless there is a failure.</p> <p>Requires minimal organisation and administration in times with no activity related to failed undertakings.</p> <p>The insurance undertakings will have the funds at their disposal until the IGS makes a call for contributions.</p> <p>There will be a possibility to consider the size of the contribution from the undertakings based on the need of the IGS.</p>	<p>Could be a delay in payments to the insured while waiting for contributions to the IGS. This could however be mitigated by giving the IGS a possibility to borrow funds or establish credit facilities. Compared to the banking side there is however less need for the IGS to have immediate access to funds.</p> <p>If there are several insurance undertakings with problems at the same time, the undertakings' ability to contribute may be weakened.</p> <p>The failing undertaking does not contribute to the IGS.</p> <p>Raises pro-cyclical dimensions</p>

Option 3. Co-insurance/mutual support

This was just mentioned in the Oxera report without any particular discussion.

V.2.3. CEIOPS' opinion

Option 1 and 2

The funding principle is relevant for Member States to get clear who, at the end of the day, pays the bill in case of a winding up situation as policy holders receive the guaranteed compensation or policy continuity. For input on ex ante premium calculations, the first question is however, what is going to be harmonised and to what level the IGS provides guarantee. At a later stage the funding principle can be considered in more detail. CEIOPS has not been able to deal with the funding question extensively, so the concerns expressed in the Oxera report are still relevant

Option 3: Co-insurance / mutual support

One of the approaches presented by the European Commission was introducing an IGS in all Member States with an appropriate level of harmonisation with mutual support (aforementioned approach number 6). This means that all national IGS could be requested to support the intervention of one of the national schemes in case of lack of resources, i.e. to "raise the capacity" through reinsurance like mechanisms.

The following chapter discusses what would be the most likely effects for the recommendations in previous chapters in this report of introducing a European regime for mutually mitigating risks between national insurance guarantee schemes, be it a system in which the supranational regime comes into play once a national

scheme is unable to meet its obligation or some sort of more traditional co- or reinsurance coverage.

There could be several ways to define when and how the national IGS could rely on support from other schemes, for example only when the national IGS does not have any funds left or it could be a proportional cover. The issue of organising the mutual support or co/re-insurance between IGS would require further considerations. The analysis in this report will therefore be limited to look at the advantages and disadvantages related to such a system in general.

Preliminary thoughts

<u>Advantages</u>	<u>Disadvantages</u>
<p>Will mitigate the funding problems which may arise in small national markets if the IGS is structured based on the home state principle. In some national markets branches from other EU MS have a substantial market share, and when the branches are members of the home state IGS the remaining insurance market could be too small to finance the national IGS.</p> <p>Leads to a larger distribution of the costs related to IGS.</p>	<p>If there are national differences between the scope of coverage of the IGS, the mutual support should be limited to the scope harmonised across the EEA. This may limit the benefits from the system.</p> <p>It would not be fair if a national IGS that is <i>ex ante</i> financed supports a IGS of another Member State which is <i>ex post</i> financed , at least if the financial difficulties of the latter could be avoided if its financing was <i>ex ante</i>.</p>

Harmonisation dilemmas

Depending on how the supranational regime is constructed, it will most likely lead to a higher level of harmonisation especially as far as covered claimants and coverage levels are concerned.

If it is in the form of a proportional co-insurance cover it is unlikely that other IGSs will agree to contribute to pay claims other than at the EU minimum. However, such a design would allow individual member states to introduce cover beyond the harmonized minimum provided they find a way of financing that is not exposing other IGSs to the risk of having to contribute.

If the supranational level comes into play only after the national IGS is fully emptied, this would even stronger call for a fully harmonised coverage level, as other IGSs will not agree to participate in sharing losses if the national IGS in question has drained its resources by paying claims beyond the EU-wide coverage level. A regime where the supranational coverage is enacted once national schemes are incapable of paying its claims also calls for fully harmonised funding rules of the schemes. Such a scheme would for most practical purposes be similar to introducing a single EEA-wide guarantee scheme.

If a supranational cover is aimed at mitigating just parts of the risks born by national IGSs without the ambition to cover an unlimited amount of claims, it appears that national discretion both on coverage levels as well as financing of the national

schemes could be kept. A regime that keeps a major part of the risks in the hands of the national IGS and distributes a second (limited) tier of the risks throughout the European IGSs would be able to raise the combined level of protection for policyholders throughout the EEA.

A supranational regime of sharing of losses does not necessarily call for restricting the national choices for intervention methods, as long as there remains a least cost principle to be followed by national authorities when deciding how to best maintain the interests of the policyholders in a winding up procedure. Applying the supranational level would probably have to be subject to the precondition that the undertaking was being wound up or had met the conditions for being wound up.

CEIOPS sees no major influences on its recommendation to apply the home state principle by the addition of a supranational layer of mutual risk mitigation.

V.4. Payout timing

V.4.1. Introduction

This chapter discusses whether or not a future directive should set specific time limits for paying claims.

V.4.2. Reference to the findings of the Oxera report evaluation of options

This feature is not covered in the Oxera report.

V.4.3. CEIOPS Recommendation

CEIOPS recommendation 12:

CEIOPS recommends that IGS should be required to make payments as soon as practicable after the claim has been assessed. There may be significant variations on what is desirable for different types of product; shorter pay outs could be justified for third party liability insurance, compulsory insurance and health insurance.

For example, it may be necessary for annuities already in payment to continue to be paid (or for compensation to be paid) without delay. However there may be little detriment for policyholders if they have to wait some time for compensation where a policy was not due to mature for 25 years. The amount of compensation due will be complex to assess in some cases and the IGS may be dependent on third parties, such as the Insolvency Practitioner, for the information necessary to assess the validity and amount of the claim. This is an area where there are clear differences from deposits and in some case there will be considerable additional complexities.

<u>Advantages</u>	<u>Disadvantages</u>
<p>Too lengthy payout could undermine the idea of an IGS</p> <p>Consumers would benefit from receiving their payments as soon as a particular</p>	<p>Too short a time can add an extra burden on the IGS, particularly as it may need to provide available funds at short notice.</p> <p>In the insurance sector there are cases where the payout timing of the guarantee</p>

claim is due.

Even though speed of payment is not crucial for all types of insurance, there are cases where the payout timing of the guarantee scheme doesn't appear to have a priori the same eminent relevance as the access to the money deposited for the bank depositor¹⁵.

scheme doesn't appear to have a priori the same eminent relevance as the access to the money deposited for the bank depositor¹⁶.

The IGS will in some cases not be in control of the timetable as it will be dependent on information from others for example the Insolvency Practitioner or the court.

V.5. Topping up

Situations may arise whereby consumers in the same Member State may be protected to varying degrees depending on whether the insurance undertaking is authorised in that State or passporting from another Member State. This problem has been addressed by the Deposit Guarantee Scheme directive and the Investor Compensation directive which provide that where the level and/or scope of the scheme offered by the host Member State exceeds the coverage of the home Member State's scheme, the host Member State must provide that visiting branches may voluntarily join the host scheme (referred to as "topping-up"). Similarly to what is provided for in the other two financial sectors, branches of insurance companies operating in another Member State, can be allowed to voluntarily join in a guarantee scheme of the host Member State¹⁷ if there are differences in the amount of compensation provided by the different schemes.

<u>Advantages</u>	<u>Disadvantages</u>
<p>Beneficial for the policyholders in the host Member State.</p> <p>If it was done on a mandatory basis, it would create a level playing field for all companies operating within one Member State.</p>	<p>Especially if based on voluntary membership, it could lead to adverse selection and favour moral hazard.</p> <p>Not feasible due to the difficulty in applying it in the case of continuity of insurance portfolio and the differences between Member States in calculating insurance claims.¹⁸</p> <p>Financing – Unfair if the IGS in the MS where insurer is authorised is based on ex-post funding while the IGS in the host state is based on ex-ante financing. Furthermore, troublesome to calculate the fee for the insurer from another MS.</p>

¹⁵ Directive 2009/14/EC, on depositor-guarantee schemes, considered the payout timing as important as the limits coverage regarding such schemes.

¹⁶ Directive 2009/14/EC, on depositor-guarantee schemes, considered the payout timing as important as the limits coverage regarding such schemes.

¹⁷ European Commission, Internal Market DG, Insurance, *Working Paper on Insurance Guarantee Schemes* – Meeting on 27 of January 2005, MARKT/2529/05-EN Orig., 21/01/2005 at p.7.

¹⁸ European Commission, Internal Market DG, Insurance, *Working Paper on Insurance Guarantee Schemes* – Meeting on 1st June 2005, MARKT/2512/05-EN Orig., 31/05/05 at p.4 and Oxera report on p 177)

VI. Further Considerations

VI.1. Interaction of the home-host Member state principles with the Motor Insurance directives

The co-existence of the motor guarantee fund established under the current EU motor directives with a general IGS needs to be examined. The EU Motor directives provide that each MS is to set up or authorize a body with the task of providing compensation, at least up to the limits set out in the motor directives for damage to property or personal injuries caused by an unidentified vehicle or a vehicle for which the insurance obligation provided for in the directives has not been satisfied. They also provide for cover in the case of vehicles stolen or obtained by violence. The motor directives do not provide that these special guarantee funds should cover the insolvency risk.

In terms of the Working papers of the European Commission on IGS, there are three main options for covering claims arising from compulsory motor insurance in case of winding-up of the insurance undertaking:

(a) The first option would be that a future directive on IGS would also cover claims arising from compulsory motor insurance in the case of the winding-up of the insurance undertaking. This solution would be based on a home member state approach. It would imply that the general guarantee scheme of the home member state of the insurance undertaking would have to compensate victims of motor accidents in all Member States in the case of winding-up. Applying the scope of coverage of an insurance guarantee scheme also for compulsory motor insurance would help achieve a minimum level of harmonisation with respect to treatment of all claims of a particular insurance undertaking.

(b) A second option would be to extend the scope of the current Motor Guarantee Funds in order to cover also claims arising from compulsory motor insurance in the case of the winding-up of the insurance undertaking. This option would be based on a host Member State approach, which is the same principle under which the motor guarantee funds are functioning according to the motor directives (current motor insurance directives will have to be amended to add the insolvency of the insurance undertaking). In this case the motor guarantee fund may have a claim against the general guarantee scheme covering the insurance undertaking in the home Member State. Under this option, the motor insurance claims will be covered by the rules established for the Motor Guarantee Funds and other claims will be covered by rules established for the national general insurance guarantee scheme.

(c) Finally, a third option would be that the Motor Guarantee Funds cover claims arising from compulsory motor insurance in the case of the winding-up of the insurance undertaking on a home member state basis. This solution would involve a major change of the host principle under which motor guarantee funds have been set up according to the current motor insurance directives, and is therefore not recommended by the Commission.

Observations

A decision as to whether to apply a home state principle or a host state principle in the event of insolvency of an insurance undertaking carrying on compulsory motor insurance will be inevitably be influenced by what is currently taking place in other Member States. Even though the motor directives do not require the motor guarantee funds to cover the insolvency of an undertaking carrying on motor

business, some jurisdictions do cater for this situation. A flexible approach could be adopted such as this could be left up to the MS to decide which national fund (whether the motor guarantee funds or the IGS) should provide compensation. However, this approach would not be desirable. It could be argued that option (a) would be the preferred option as a minimum level of harmonisation would be achieved with respect to treatment of all claims, whether motor or not, of a particular insurance undertaking.

VI. 2. Information requirements

The Oxera report manifests no preference regarding the harmonisation approach in a future IGS EU directive on this feature (pp 182-183).

Minimum harmonisation of information requirements is in line both with the Deposit Guarantee Schemes Directive and the Investor Guarantee Scheme Directive (see Art. 9 of doc. MARKT/2534/12-EN, p. 18).

There seems to be a relevant consensus regarding the EU minimum harmonisation of information requirements, which is in line both with Directive 94/19/EC¹⁹ and Directive 97/9/EC, regarding deposit-guarantee schemes and investor-compensation schemes.

In "CEIOPS Reply" of 7 July 2008 (page 29), 12 Member States preferred minimum harmonisation to "Payout timing and information of the policyholder"; and Art. 9 of doc. MARKT/2534/12 (page 18), which is in line with Article 10 of Directive 94/19/EC²⁰, received general consensus in the EC Working Group on IGS Meeting of 12 December 2005.

VII. Occupational Pension sector

CEIOPS Recommendation 13:

If the EU were to introduce a European regime for insurance guarantee schemes, this should not be extended to the occupational pensions sector.

The request from the European Commission for input on its work on guarantee schemes from 5 May 2009 also includes the question whether or not, if the EU were to introduce a European regime for insurance guarantee schemes, this should be extended to the pensions sector.

This chapter includes only the conclusions of the note that has been drafted by CEIOPS Occupational Pensions Committee (OPC). The complete note is available in Annex 1 of this document. It includes a description of the main characteristics of the occupational pension system in the different Member States, the mapping of existing pension guarantee scheme, the reasons for their introduction or not. It also provides the member states' extensive statements on the benefits and disadvantages of a pension guarantee scheme.

The advantages and disadvantages that are mentioned in the responses to the OPC's questionnaire on Pension Guarantee Schemes can be summarized in two advantages

¹⁹ Directive 2009/14/EC extended the information requirements of 1994 regarding the existence and scope of deposit-guarantee schemes to the negative delimitation of the coverage by the scheme, *i.e.*, to the non coverage of deposits by the scheme.

²⁰ And Article 10 of Directive 97/9/EC, on investor-compensation schemes.

and four disadvantages. The advantages are (i) the improved protection for members and beneficiaries and (ii) the confidence in the occupational pension system. The disadvantages are (a) the costs connected to a PGS, (b) the moral hazard that people take higher risks because of the guarantees, (c) the opinion that a PGS would not be necessary as (funding) rules could deliver the same level of protection and (d) the pro-cyclicality of a PGS where the costs of one failure might play a role in another institution's insolvency.

Only six countries have considered introducing a Pension Guarantee Scheme, of which four have decided to indeed introduce such a scheme. Within the three existing Guarantee Schemes (RO is in the process of setting up a scheme), two countries (DE and UK) use the plan sponsor's insolvency as the trigger, and one country (DK) the IORP's insolvency. This highlights one of the main issues arising from the responses to the PGS questionnaire: the occupational pension systems within the EU are very different, and introducing an (even slightly) harmonised PGS will be extremely difficult as a PGS should be designed to fit in with an individual Member State's pension system.

Section III of the OPC note contains proof of this, where it provides remarks that respondents made in relation to convergence and harmonisation in the field of Pension Guarantee Schemes. The nature of these remarks causes CEIOPS to believe that both convergence and harmonisation of Pension Guarantee Schemes are not possible because the occupational pension systems significantly differ between member states. For this reason there would need to be a thorough analysis of the role that the guarantee schemes play where they do exist because they ensure delivery of the promise made to the member. This promise is secured by different mechanisms for different member states. Effective convergence and harmonisation in this field would require significant convergence as to the national pension systems any Guarantee Scheme would have to apply and may not achieve a more cost effective solution to delivery on the promise than that which already exists in member states. In this respect, it is important to note that there is a consensus also that the delicate balance between affordability and sustainability could be adversely affected where provision is voluntary.