Opinion of the European Economic and Social Committee on the 'White Paper: Insurance Guarantee Schemes'

COM(2010) 370 final

(2011/C 218/10)

Rapporteur: **Mr WUERMELING**

On 12 July 2010, the European Commission decided to consult the European Economic and Social Committee, under Article 304 of the Treaty on the Functioning of the European Union, on the

White Paper on Insurance Guarantee Schemes

COM(2010) 370 final.

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 5 April 2011.

At its 471st plenary session, held on 4 and 5 May 2011 (meeting of 5 May), the European Economic and Social Committee adopted the following opinion by 148 votes to seven with ten abstentions:

1. Conclusions and recommendations

1.1 The EESC welcomes the European Commission's White Paper on Insurance Guarantee Schemes. It supports the Commission's efforts to propose measures for protecting policyholders within the EU.

1.2 The EESC backs the Commission's efforts to introduce harmonised rules for insurance guarantee schemes (IGSs). It supports the Commission's intention to provide for a European Directive with a high level of protection in the form of a minimal harmonisation, so that national systems can also provide for further protection. The IGS should be used as a last resort when other instruments (e.g. supervisory instruments) have been exhausted.

1.3 Nevertheless, it should be borne in mind that, over the past few years, there has been a considerable improvement in the provisions relating to insurance company solvency as a result of supervision and capital requirements. In practice, the failure rate of insurance companies is low and these measures should further reduce it. This should be taken into account when designing IGSs so that a balance can be struck between costs and benefits. The EESC therefore favours EU requirements that achieve the goals of safeguarding consumers and employees while keeping costs for companies and policyholders to a minimum.

1.4 The EESC believes that the Commission is right to address the issue of unlimited cover for IGSs in the White Paper. Sound insurance companies should not be placed in difficulty because of unlimited guarantee obligations. The EESC therefore welcomes the fact that, in its White Paper, the Commission is considering setting limits on claims.

1.5 When preparing legislation, the Commission should pay particular attention to the question of when the IGS can be deployed. At all events, it should not be called upon until all possible supervisory options have been exhausted. Merely falling short of the Minimum Capital Requirement under Solvency II should be sufficient for triggering the IGS.

1.6 As regards the question of financial provision for the IGSs, the EESC recommends re-examining the various options on the basis of the results of the fifth quantitative impact study (QIS5) of the Solvency II directive. It would be advisable to fix a certain level of protection at EU level, but to set the specific provision in terms of the respective national risk and the risk of each business line.

1.7 With respect to the existing national guarantee schemes, European legislation should provide for a high and appropriate level of protection. The organisational questions, such as the details of the amount of contributions, the timing of the financing, the choice of portfolio transfers or awarding compensation, and the introduction of specific guarantee schemes for each business line can then be left to the Member States.

2. Introduction

2.1 Insurance companies cover basic risks for consumers such as sickness, accidents or civil liability and provide for their old age [1]. If an insurance company goes bankrupt, this can lead to the irreparable loss of all or a large part of consumers' assets and can drive them into poverty.

2.1.1 The question of the need for an IGS arises in different ways in the various insurance business lines. Whilst there is frequently a danger of losing the capital saved in life insurance, that is not the case for non-life insurance.

(1) OJ, C 48, 15.2.2011., p. 38, point 1.4.

2.1.2 Endowment life insurance policies are intended to provide long-term cover in old age or for survivors. If this is lost and there is no insolvency guarantee, a major part of private provision is lost. State social systems would have to intervene in an emergency. Thus the EESC feels that the introduction of an IGS is most urgent in this area.

2.1.3 In non-life and civil liability insurance, policyholders must be protected if there is an unresolved claim for compensation pending when the bankruptcy occurs. However, for other policyholders, the problem of a new policy from another insurer being offered under less favourable conditions because the policyholder is older or his health has deteriorated does not arise. A new policy can generally be obtained on the market on similar terms.

2.2 According to the Commission's data, 130 out of 5 200 insurance companies (2008 figures) have suspended payments since 1994. However, it should be noted in this respect that the companies are legally obliged to maintain a sufficient level of capital to fully or at least partially meet policyholders' claims in such cases.

2.3 Thus it has so far not been deemed necessary to introduce Europe-wide guarantee schemes for the rare cases of insurance company insolvencies. The Commission began preparing a directive in 2001, but the plan was shelved. Although collective guarantee schemes are not the norm in market economies, they have been set up on many occasions in the financial sector in view of the particular risks for consumers.

2.4 A Europe-wide deposit guarantee has been available in the banking sector since 1994 ([2]) because of the risk of a 'run' which would be highly destabilising for the financial markets. This is currently being updated ([3]). Nevertheless, the insurance sector is exposed to different risks from banks. In particular, the former need not fear a run nor does it require refinancing. Therefore, an effective guarantee scheme for the insurance sector must be differently structured from banking sector schemes.

2.5 To protect customers from losing their claims, the legislator has adopted extensive precautions in the insurance sector: comprehensive and proactive supervision, stringent capital requirements, strict laws on investing capital and protecting rights under bankruptcy law. Implementing the Solvency-II directive will further reduce the risk of financial difficulties for insurance companies ([4]).

2.6 Moreover, the risks arising from primary insurance will be covered by reinsurance, further reducing the risk of bankruptcy. Grouping and diversifying a wide range of risks through reinsurance creates strong links between insurers, which provides additional protection for consumers.

2.7 Moreover, the EU has placed financial supervision on a totally new European footing in the wake of the financial crisis. As regards the insurance sector, this also includes the creation of a European Insurance and Occupational Pensions Authority (EIOPA).

2.8 The insurance sector remained largely stable during the financial crisis. It was not responsible for triggering it ([5]), but was affected by the consequences. European insurance companies had to write off assets and the low interest rates resulting from the bail-outs and monetary policy are making it difficult for insurers to obtain the necessary returns from their capital investments. The spectacular instances of difficulties in the sector, such as the US company AIG or recently Ambac, were not caused by traditional insurance activities, but by bank-style financial derivatives. This may also occur in the future, particularly in the case of businesses and financial conglomerates that operate as both banking and insurance companies.

2.9 Guarantee schemes for insurance companies already exist in 12 of the 27 Member States ([6]). They are very complex: in some Member States there is only a guarantee for certain business lines. Moreover, the extent of coverage is different and there are also some state guarantees.

2.10 As a rule, insurance undertakings that operate throughout Europe work on the national markets with independent subsidiaries that pay into the respective national guarantee schemes. If a large European company were to get into difficulty, the national guarantee schemes would in general provide sufficient protection for policyholders. The EESC calls, however, for a European guarantee scheme for transnational companies in the event that national guarantee schemes prove insufficient.

2.11 The costs generated by an IGS are ultimately passed on to policyholders in the form of higher premiums. Whilst individual consumers are protected against insolvency, the body of consumers must bear the cost.

3. **Observations on the Commission's arguments in Chapter 3 of the White Paper**

3.1 *Nature of possible EU action (White Paper 3.1)*

There are big differences between the national insurance markets in terms of product and risk structure. A directive for minimum harmonisation should thus be chosen as the instrument, in order to allow Member States to take due account of specific national characteristics under the legislation governing insolvency, contracts, taxation and the social sector and in order to maintain the existing and proven guarantee schemes, where they reflect the provisions of the directive.

([2]) OJ L 135, 31.5.1994, p. 5; OJ L 84, 26.3.1997, p. 22.
([3]) COM(2010) 368 final, 2010/0207 (COD), 12.7.2010.
([4]) OJ C 224, 30.8.2008., p. 11, point 3.1.
([5]) OJ, C 48, 15.2.2011., p. 38, point 1.3.
([6]) OECD report No. DAF/AS/WD (2010)20 of 10 November 2010 provides a comprehensive overview of such systems in OECD member states.

3.2 *Level of centralisation and role of the IGS (White Paper 3.2)*

3.2.1 First and foremost, it is important to ensure that an insurer does not become insolvent. An effective supervisory system should prevent this from happening. If this does not work then the IGSs can be used.

3.3 *Geographical scope (White Paper 3.3)*

The Commission rightly favours the home country principle, which is in line with the principles of European insurance supervision. In accordance with the Solvency II directive, the supervision of all the activities of insurance companies established in the EU is carried out in the home country. This also applies to the activities carried out under the freedom of establishment via dependent branches or under the free provision of services through cross-border services.

3.4 *Policies covered (White Paper 3.4)*

3.4.1 Because of the differences between the life insurance and non-life insurance business lines, it would be wise to create separate guarantee structures for these categories. The risk within a business line is more or less the same, which justifies reciprocal assistance. However, it is difficult to justify house contents insurance policyholders, for example, having to pay into an IGS whose funds will be used to rescue a life insurer. Since this can depend on special national characteristics, such as whether there is an obligation in the market in question for a legal separation of companies in the different business lines (the separate business line principle), the European legislator should allow the Member States a degree of latitude.

3.4.2 As regards motor insurance and in line with the opinion drawn up by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), the EESC considers that this subject should be included in the future directive on IGS, for reasons of clarity, competitive balance and greater ease of understanding for consumers.

3.4.3 The Commission proposals do not cover protection for occupational pensions. Only insurance-based occupational pension schemes in the traditional sense come under the IGS. The EESC also sees the need for action with other occupational pensions and is in favour of including this question in the context of the follow-up to the Pensions Green Paper.

3.4.4 An appropriate and affordable contribution by policyholders is an effective incentive for them to find out how sound the insurer is, in so far as this is possible for consumers.

3.4.5 It would also be advisable to set upper limits or other forms for limiting the obligations of insurance schemes, such as de minimis thresholds or excesses, as CEIOPS also proposed in its opinion, whilst not overburdening policyholders with a plethora of restrictions. This would significantly reduce the burden on the IGS and would be reflected in the costs. Policyholders, who ultimately bear the costs, would also benefit.

3.5 *Eligible claimants (White Paper 3.5)*

3.5.1 The Commission rightly explains that a guarantee for all market operators would generate excessively high costs. The first sentence of the White Paper presents IGSs as a consumer protection measure. This does not mean, however, that the group of those benefitting from protection should be limited to consumers. However, entities that receive the same protection granted to consumers under the national legislation of some countries, whether they are policyholders, the insured or beneficiaries should also be covered.

3.5.2 Member States should from the outset be free to exclude purely commercial insurance covering periods of inactivity or transport, for example, from the scope of the IGSs. Similarly, they should decide whether it is sensible to include small undertakings in the scope of the directive.

3.6 When preparing legislation, the Commission should pay particular attention to the question of when the IGS can be deployed and who should take the decision. The Commission is considering not waiting for bankruptcy to occur before deploying the IGS, but rather using it to prevent bankruptcy. The EESC believes that, for reasons of efficiency and to reflect the nature of the scheme and the purpose for which it was designed, falling short of the Minimum Capital Requirement under Solvency II should be sufficient for triggering the IGS.

3.7 *Funding (White Paper 3.6)*

3.7.1 Timing of the funding (White Paper 3.6.1)

3.7.1.1 The question of whether to opt for ex-post or ex-ante funding or a combination of the two is the subject of thorny discussion. All the systems have advantages and disadvantages.

3.7.1.2 Ex-post funding removes less liquidity from the market, which reduces the premiums for policyholders because the costs are lower. It also avoids the problem of temporary investment of the funds collected. With ex-post funding, no part of the resources is used for administrative costs before a case of insolvency arises.

3.7.1.3 On the other hand, ex-post funding makes it difficult to combat the problem of moral hazard, since it is precisely the least reliable market operators that are excluded from the market because of their insolvency and can no longer share the burden of costs at the time of funding.

3.7.1.4 The advantage of ex-ante funding is above all the fact that contributions can be quantified against the risk of insolvency. Market operators with riskier commercial practices will be required to pay more. Furthermore, procyclical effects can be prevented more effectively with ex-ante funding than with ex-post funding.

3.7.1.5 The question of the timing of the funding can be crucial for the effectiveness of the IGS. The advantages of an ex nunc financing scheme far outweigh the disadvantages and it is hard to see why national characteristics and traditions mean that the decision is best left to the Member States. To ensure the scheme's efficiency, the directive should include a single ex nunc form of financing.

3.7.2 Target level (White Paper 3.6.2)

3.7.2.1 Financial contributions to the IGS should be limited, as CEIOPS has also called for in its opinion. Unlimited compulsory cover would make it impossible to calculate the risk for individual companies. It would lead to every insurer being liable for the whole market ([7]). An individual company's risk management would no longer depend on its own decisions, but to a great extent on the risk approach of its competitors.

3.7.2.2 The Commission has set a target level of 1.2 % of the gross written premiums as a starting point. The EESC would like the various options to be re-examined on the basis of the currently available figures for the Solvency II directive. In this respect it should also be borne in mind that the Solvency II directive and other intervention mechanisms have been created to give policyholders greater protection, an aspect also emphasised by CEIOPS in its opinion.

3.7.2.3 The Commission's calculations are based on an average probability of the IGS being called on of 0.1 %. However, this assumes own capital cover of 100 % of the Solvency Capital Requirements (SCR). If capital is higher than the SCR in some Member States and business lines, the bankruptcy risk diminishes correspondingly. The directive should thus make it possible for national guarantee schemes to assess capital requirements in terms of the real risk of losses on the national markets and in the various business lines.

3.7.2.4 In its White Paper the Commission does not address the question of whether a fresh contribution to the IGS should be made following a loss. Clear rules and limits are needed to rule out the possibility of unlimited liability and to enable companies to assess their obligations in advance and make the necessary provisions.

3.7.3 Contributions (White Paper 3.6.3)

3.7.3.1 The size of the contribution should be based on available data to reduce administrative costs. In the case of life insurance, this could be linked to the capital accumulated and in the case of non-life insurance, to the amount of technical provisions. Own capital in relation to the SCR could also be a criterion. The European legislator should fix the methodology and allow Member States to settle the details of the amounts of the contributions, so that they can take account of their specific national characteristics.

3.7.3.2 Before having recourse to IGSs, solvent insurers should be given the opportunity to take over endangered companies, without a financial contribution, if they wish to take on their customers.

3.8 *Portfolio transfer and/or compensation of claims (White Paper 3.7)*

3.8.1 There are two different approaches available for IGSs: a one-off payment for damages to the policyholder, or the contract can be continued through an insolvency guarantee undertaking which would take over the client portfolio. The EESC considers that portfolio transfer offers advantages to life insurance policy holders. However, compensation payments should provide sufficient protection for consumers in non-life and accident insurance. In any event, the European directive should not prevent the use of the scheme that is more advantageous for the consumer.

Brussels, 5 May 2011.

The President
of the European Economic and Social Committee
Staffan NILSSON

([7]) OJ, C 48, 15.2.2011., p. 38, point 2.7.3.1.

APPENDIX

to the Opinion of the European Economic and Social Committee

The following amendment, which received at least a quarter of the votes cast, was rejected in the course of the debate (Rule 54 (3) of the Rules of Procedure):

Point 2.10

Amend as follows:

'*2.10 As a rule, insurance undertakings that operate throughout Europe work on the national markets with independent subsidiaries that pay into the respective national guarantee schemes. If a large European company were to get into difficulty, the national guarantee schemes would in general provide sufficient protection for policyholders. The EESC calls, however, to consider at a later stage ~~for~~ a European guarantee scheme for transnational companies in the event that national guarantee schemes prove insufficient.*'

Reason

At this stage a European-wide mutual bail out of insurance companies seems to be premature.

Result of the vote:

For:	68
Against	78
Abstentions	13