

Comments Template on EIOPA-CP-18-003
Discussion Paper on Resolution funding and national
Insurance Guarantee Schemes

EIOPA-IRSG-18-26

12/11/2018

Name:	EIOPA Insurance and Reinsurance Stakeholder Group	
Reference	Comment	
General comments	<p><u>IRSG general comments:</u></p> <p>The IRSG finds the EIOPA Discussion Paper on Resolution funding and national IGSS well structured, containing good background data and findings that are presented clearly. The paper also complements EIOPA’s 2017 Opinion on “the harmonization of recovery and resolution frameworks for (re)insurers across the Member States”. The IRSG is of the opinion that, since Solvency II (SII) implementation, policyholder protection has significantly improved as both governance requirements and quantitative risk measures have forced insurers to better understand risks and risk based decision-making. The IRSG considers that a move toward an even higher degree of consumer protection should be built step-by-step to avoid any unwanted consequences, as new regulation might change market practice and policyholder behaviour. In addition, any such further increase in policyholder protection needs to be seen in the context of the SII review and the envisaged introduction of the “group support” regime. The IRSG considers that recovery and resolution frameworks are clearly a possible first step to a higher degree of consumer protection, but that their effectiveness will be highly dependent on the nature, scope and quality of such frameworks.</p> <p><u>On the resolution funding part of the discussion paper</u>, the IRSG generally supports most of EIOPA’s ideas. In particular, the safeguards for the power to restructure, limit</p>	

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or write down insurance liabilities (Box 2) appears a constructive approach. EIOPA brings out concerns about the valuation method used for insurers under resolution (gone-concern valuation); this is a complex topic which needs to be further examined.

On the issue of resolution funding, the IRSG considers that a well-designed arrangement would ensure the effectiveness of the NCWOL (no creditor worse off than in liquidation) principle. It might be that an arrangement which is funded purely on an ex-post basis may not deliver the funds required at the time required. There is a risk associated with this funding approach that the conditions which cause one insurer to be distressed would also cause stress in the wider market, which would cause difficulty for companies in providing funding at the time when it was required. Anyway, the IRSG does not have consensus on whether an ex ante, ex post or a mix of these would be the best alternative as these all have their own difficulties which needs to be taken into account. Whichever the solution, a risk-based approach (taking into account the contribution of contributors to the overall level of market risk using an appropriate proxy) could provide a more appropriate and sustainable funding mechanism.

The IRSG considers that it is important for EIOPA to provide principles and possibly also some minimum requirements as to how resolution funds should work. It considers that policyholders in one country should not be significantly disadvantaged in the protection which is available to them relative to those in other countries, e.g. due to lack of resolution mechanism or similar regulation. Some members of the IRSG are of the opinion that there is a lack of justification on the ideas presented on resolution funding and that the decision on the implementation and the actual need should be left to member states to a large extent as this is connected to national legislation and supervisory practice.

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The IRSG continues to consider, as noted in its contribution to EIOPA’s 2017 Opinion, that “in practice portfolio run-off and transfer are likely to be the most effective powers in the event of insurance company failure” and that “for cross border firms, co-operation and co-ordination between supervisors will be essential in facilitating insurance company resolution in order to implement a resolution strategy which maximises policyholder protection across the insurance firm or group”.

The IRSG considers that EIOPA should clarify that its Discussion Paper is specifically relevant to direct insurance and not to the customers of pure reinsurers. The IRSG had already noted, in agreement with EIOPA and as a comment on EIOPA’s 2017 Opinion, that “for most insurance firms which are not systemic and do not offer critical functions, policyholder protection will be the key objective” of a resolution framework. EIOPA should remain consistent with its view by avoiding ambiguity such as the one implied by its footnote 2, which seems to suggest that its Discussion Paper applies also to reinsurers. In practice, the rest of its Discussion Paper is indeed targeted at direct insurance, including when referring to relevant existing regulatory provisions (e.g. SII provisions on assets and liabilities under resolution, which are a source of resolution funding as noted by EIOPA, are specific to direct insurance).

On the question of **insurance guarantee schemes (IGSs)**, some of the members of IRSG considers that keeping the status quo is the most feasible option and others that minimum protection would be required. However, the IRSG does consider that there should be some consistency in the level of protection afforded to customers in different member states, and that this might lead to some basic requirements which would apply to resolution and IGS regimes across member states.

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The IRSG makes the following additional observations, some in favour of keeping the status quo, some opting for the minimum harmonization:

1. SII, fully implemented in the EU, has reduced the risk of insurers ending up in liquidation. It incorporates an enormous amount of requirements relating to the understanding, processing and managing of insurance and other risks being run; insurers complying with these requirements can be considered to have good risk management standards already in place. Solvency II provides a much enhanced level of consumer protection over previous prudential requirements, and it is premature at this time to consider bolting on additional levels of prudence without any evidence of deficiency in the current Solvency II framework. Also it might be possible in future, by making changes to Solvency II legislation, to even further increase the way it helps to protect policyholders.
2. It is not appropriate to consider discuss IGS's as a stand-alone theme, as it is very much intertwined with effective supervision and cooperation between supervisors, use of member state options and consistent implementation and application of SII across member states. Rather than considering new rules for IGS, steps should be taken to ensure that these existing tools and powers are fully used and that resources are adequately assigned towards their proper enforcement. For instance to ensure the efficient information-sharing between NCAs and to establish collaboration platforms that would already safeguard policyholder protection.
3. A minimum harmonisation would be required to increase policyholder protection and to reduce the current patchwork approach. The positive influence that this measure should not be underestimated. By increasing

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consumer confidence in the sector could generate on the market, in particular in relation to long-term policies. Anyway even within the minimum harmonization option, certain questions are difficult to resolve, e.g.

- a. Different insurance policies have different characteristics, insurance market backgrounds and risk profiles and it would be difficult to fully reflect these differences in a uniform set of requirements relating to policyholder protection.
- b. Funding of IGSs is a complex issue. An ex-ante basis, funded by insurers, could significantly change the market pricing and offering and might favour some jurisdictions more than others. An ex-post basis may create unanticipated and unhelpful market reaction and potentially lead to change in policyholder (after shock) behaviour.
- c. Any moral hazard must be avoided if introducing IGSs, e.g. existing national insurance guarantee schemes only applying for insolvencies of insurers who have already paid into the system.

4. For cross border firms, policyholders may be treated differently depending on whether the home- or host-country principle is applied in operation of an IGS. Some further remarks to take into account regarding the cross border issue:
- a. It does not seem appropriate that policyholders should be at a disadvantage in terms of coverage under IGSs as a result of their insurer not being based in the home country.
 - b. In order to ensure the needed customer protection and equality in case of cross border settlements some principals based guidance might be needed in future.
 - c. Some IRSG members believe that the decision on the implementation and actual need should be left to a large extent to member states as this

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	<p>is connected to national legislation.</p> <p>d. Disclosure of different home and host-country arrangements will not be sufficient in this case as the policyholder is unlikely to have much focus on insurer failure when making a purchase decision.</p> <p>e. Other IRSG members believe that the current, completely fragmented landscape of national IGS warrants some EU action to provide more equal cover for all EU citizens in case of (cross-border) insolvencies.</p> <p>The IRSG gives also answers to the specific questions (Q1 to Q26). The answers needs to be read so that questions are answered even though it doesn't represent the unanimous opinion of the IRSG. Anyway, the IRSG feels it's important to give input to as many questions as possible in order to give the most support for EIOPA on this important topic.</p>	
<p>Q1 Do you have any comments to the analysis on the potential problems of the existing situation?</p>	<p>The French example featured on page 37 (box 6) is well known and has been <u>reported at national level</u> by French risk management association AMRAE.</p> <ul style="list-style-type: none"> • The French IGS (FGAO) does not include professional clients in its scope. • For professional clients, there are serious consequences. Mandatory construction insurance with 10 years liability is a long-tail liability and the losses will be supported by the own funds of the insureds. • The financial impacts for the insureds are very difficult to measure and quantify for now and will only be visible within the next 5 years. • As an alternative solution, some professional clients had to purchase an additional new policy with a French insurer but there is no guarantee that 	

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	<p>French insurers will accept to cover for the past liabilities.</p>	
<p>Q2 In case where a host-country principle is adopted, what are your views on who should pay the final costs of policyholder compensation in case of failures of incoming insurers? Should the costs be borne by the IGS of the country of the defaulting insurer, as proposed by the European Commission for motor insurance (see Box 1)? Or should there be a difference between motor insurance and other LoBs?</p>	<p>For cross border firms, policholders may be treated differently depending on whether home- or host-country principle is applied in operation of an IGS. It seems appropriate that home country policyholders should not be at a disadvantage in terms of coverage under IGS as a result of their insurer not being based in the home country. Anyway, the decision on the implementation and actual need should be left to a large extent to member states as this is connected to national legislation. In order to ensure the needed customer protection and equality in case of cross border settlements some principals based guidance might be needed in future. Disclosure of different home and host-country arrangements will not be sufficient in this case as the policyholder is unlikely to have much focus on insurer failure when making a purchase decision.</p> <p>In case of cross-border insurance activities, one solution could be that a possible guarantee scheme of the host country pays the policyholders who are residents there. Then, this scheme claims the corresponding amount to the guarantee scheme of the home country, i.e. where the insolvent insurer is based. As the contribution to the guarantee scheme depends on the country where the insurer is based, it means the policyholders of the host country will be beneficiary of a more or less favourable guarantee than the guarantee provided in their country, because it depends on the contribution rules of the home country. Nonetheless, they have contributed the guarantee scheme of the same amount the policyholders of the home country.</p> <p>In case of failures of incoming insurers, the choice of the relevant IGS should take into</p>	

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	<p>account the differences between LoBs. The situation of small insurers that are defaulting can be connected to a misunderstanding of the complexity of the local insurance rules and their implication for their solvency. Any mandatory insurance with long-tail liability has the potential to raise similar issues. Freedom of Service works fine for cross-border small insurers when they commit for shorter period of time. For longer commitment a stronger supervision is required as it is a matter of supervision by the home country, which should be reflected in the choice of the relevant IGS in case of failure.</p> <p>To support efficient supervision by the home country and prevent similar cases of failures, EIOPA has a key role to structure the exchange of information between national supervisors about:</p> <ul style="list-style-type: none"> - their local insurance market specificities - how to supervise correctly the insurers involved in a specific line of insurance business insurance (long-tail liability, provisions needed...) 	
<p>Q3 Do you think that a potential harmonised approach towards IGSs should also trigger a discussion about the potential need for the harmonisation of national insolvency regimes, with the</p>	<p>Some of the ideas on resolution funding and the safeguards for the power to restructure, limit or write down insurance liabilities could be incorporated in measures to harmonise national insolvency regimes. Particularly in relation to resolution funding, a well-designed arrangement could ensure the effectiveness of the NCWOL (no creditor worse off than in liquidation) principle.</p>	

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aim of ensuring more protection to policyholders?

Q4
Do you have any comments on the arguments in favour of maintaining the status quo? Are any relevant aspects missing?

SII, fully implemented in the EU, has reduced the risk of insurers ending up in liquidation. It incorporates an enormous amount of requirements relating to the understanding, processing and managing of insurance and other risks being run; insurers complying with these requirements can be considered to have good risk management standards already in place. Solvency II provides a much enhanced level of consumer protection over previous prudential requirements, and it is premature at this time to consider bolting on additional levels of prudence without any evidence of deficiency in the current Solvency II framework. Also it might be possible in future, by making changes to Solvency II legislation, to even further increase the way it helps to protect policyholders.

It is not appropriate to consider discuss IGS's as a stand-alone theme, as it is very much intertwined with effective supervision and cooperation between supervisors, use of member state options and consistent implementation and application of SII across member states. Rather than considering new rules for IGS, steps should be taken to ensure that these existing tools and powers are fully used and that resources are adequately assigned towards their proper enforcement. For instance to ensure the efficient information-sharing between NCAs and to establish collaboration platforms that would already safeguard policyholder protection.

Q5
Do you have any comments on the

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arguments in favour of a European network of national IGSs? Are any relevant aspects missing?

Q6
Do you have any comments on the conclusions of EIOPA?

A minimum harmonisation would be required to increase policyholder protection and to reduce the current patchwork approach. The positive influence that this measure should not be underestimated. By increasing consumer confidence in the sector could generate on the market, in particular in relation to long-term policies. Anyway even within the minimum harmonization option, certain questions are difficult to resolve, e.g.

- a. Different insurance policies have different characteristics, insurance market backgrounds and risk profiles and it would be difficult to fully reflect these differences in a uniform set of requirements relating to policyholder protection.
- b. Funding of IGSs is a complex issue. An ex-ante basis, funded by insurers, could significantly change the market pricing and offering and might favour some jurisdictions more than others. An ex-post basis may create unanticipated and unhelpful market reaction and potentially lead to change in policyholder (after shock) behaviour.
- c. Any moral hazard must be avoided if introducing IGSs, e.g. existing national insurance guarantee schemes only applying for insolvencies of insurers who have already paid into the system.

Should some level of harmonisation nevertheless be pursued, member states should

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be allowed a degree of national flexibility on the geographical scope. They should take the following elements into account when making this choice:

- Because the financial supervision of insurance and reinsurance undertakings, including business under FoS and FoE, is the sole responsibility of the home Member State (Article 30 of Solvency II), it must therefore also be the responsibility of the home Member State to deal with the consequences of an insolvent insurer, wherever its activities are located. Therefore, opting for a home-country principle would seem to make the most sense.
- But under the home-country principle, national IGS would certainly need to cooperate with each other to provide information to consumers in their own languages.
- In some cases, member states may decide that a combination of both the home and host-country principles could better deliver equal protection to policyholders affected by the same insolvency event, regardless of the location of the insurer/risk.
- In some other cases, a Member State could favour a host-country principle, but it needs to be pointed out that:
 - This may result in coverage duplication or gaps in coverage, if other member states opt primarily for the home-country principle (in a context in which this is not harmonised).
 - The host-country should not be the final debtor, as it would be unfair for host-country companies (and thus host-country policyholders) to fund the failure of a home-country company.

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- Even if the final debtor is the home-country and despite minimum harmonisation, the rules for intervention will never be completely identical. It seems unrealistic to assume that the host-country IGS will know and apply exactly the rules of operation and compensation of the home-country IGS.
- Any harmonised approach should take into account already existing national schemes to avoid incurring additional costs on insurers and policyholders. A certain variety between IGS across Europe should be accepted under minimum harmonisation.

Q7
 What are your views regarding the role of national IGSs? Should national IGSs be solely designed to provide compensation to policyholders for their losses in liquidation? Or should they be used in resolution to ensure the continuation of the

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insurance policies?

Q8
In relation to this, what are your views regarding the potential benefits and costs of merging the functions of the IGS with those of a potential resolution fund?

Q9
What are your views regarding the geographical scope of IGSs?

Q10
Should the geographical scope of potential harmonised national IGSs be set at the home-country principle, the host-

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country principle or a combination of both?

Q11
Is your view on the host-country principle dependent on the final body that bears the cost of a cross-border failure?

Q12
What are your views regarding the type of policies that potential harmonised national IGSSs should cover at a minimum?

Q13
Should the IGSSs be required to cover, at a minimum, all mandatory insurance

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liabilities? Should there be any limits to the amounts covered for these liabilities?

Q14
Should the IGSs cover (selected) life, non-life insurance, reinsurance contracts or all?

Q15
Should there be any limits to the amounts covered for life insurance liabilities and/or other liabilities?

Q16
Should the IGSs cover non-compensatory credits of insurance creditors (i.e.

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unearned premiums and premiums owned by insurers as a result of the non-conclusion or cancellation of insurance contracts and operations)?

Q17
 What are your views regarding the eligible policyholders that should be covered by an IGS? Should potential harmonised national IGSs cover (i) natural persons only, (ii) natural and selected legal persons or (iii) all types of legal persons?

Q18
 What are your views

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regarding the inclusion of restrictions on policyholders eligibility?

Q19
 What are your views regarding the introduction of limits to the amount of compensation paid per claim/policyholder? What type of limits should be introduced? Should the limits for life and saving policies be equal to the limit set in Directive 2014/49/EU to avoid arbitrage between financial institutions?

Q20
 What are your views

Where an IGS is in place or contemplated, it might be that an arrangement which is funded purely on an ex-post basis may not deliver the funds required at the time

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regarding the timing of the funding of IGSs, i.e. funding on an ex-ante basis, ex-post basis or a combination of both?

required. There is a risk associated with this funding approach that the conditions which cause one insurer to be distressed would also cause stress in the wider market, which would cause difficulty for companies in providing funding at the time when it was required. All funding options have their own difficulties which need to be taken into account. In addition, some evidence could be collected from how different solutions that have been in place have been working, e.g. in the US there has been a post funded solution for 40 years and still more insurance failures. Whichever the solution, a risk-based approach (taking into account the contribution of contributors to the overall level of market risk using an appropriate proxy) could provide a more appropriate and sustainable funding mechanism..

Q21
 What are your views regarding the contributors to the IGSs, i.e. should the IGS be funded by insurers, policyholders or otherwise?

Q22
 What are your views regarding the calculation basis

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when the IGS is (partially or fully) funded by contributions from insurers, i.e. (gross or net) technical provisions, written premiums or other?

Q23
What are your views regarding the contribution basis, i.e. fixed, variable or risk-weighted contributions?

Q24
What are your views regarding the introduction of upper limits to the annual level of contributions from insurers to the IGSSs?

Q25

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What are your views regarding the power of IGSs to require additional contributions from insurers or raise additional capital in case of shortfalls?

Q26
What are your views regarding the inclusion of a requirement for disclosure to policyholders?