INSURANCE GUARANTEE SCHEME

European Commission Consultation

BEUC Position Paper

Contact: Financial Services Team – financialservices@beuc.eu
Ref.: X/2011/012 - 08/02/11

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Summary

BEUC welcomes the publication of the White Paper on Insurance Guarantee Schemes by the European Commission.

BEUC supports the Commission proposition establishing an Insurance Guarantee Scheme in each Member State.

The main comments of the BEUC are:

- Although guarantee schemes for bad advice exist in some Member State, the White Paper doesn't tackle this question. The responsibility of the advisor should be better covered than nowadays;
- All insurance categories should be protected by an IGS, motor vehicle insurances included;
- In case of failure, the transfer of policies to another undertaking is essential for health insurance and protection life insurance policyholders. A payout will not help them to find a new insurance if their health is worse than at the beginning of their policy;
- A harmonized limited ex-ante funding, if needed completed by ex-post contributions, seems the better funding to achieve a level-playing field among companies from different member States;
- Compensation limits are not appropriate, nor for risk insurances, nor for investment life insurances.

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General remarks

1. **BEUC, the European Consumers' Organisation, welcomes and supports the initiative of the Commission regarding the creation of an Insurance Guarantee Scheme for all life and non-life policies.**

Having certainty to be compensated is the reason why consumers take out insurance policies. It is essential to consumers – as policyholder or as victim to be compensated – to have full confidence that insurance undertakings will be able to compensate them or to pay them the capital or the life annuity they saved for – sometimes for whole their life.

As mentioned in the Commission White paper, the future Solvency II regime, which will be applicable by 31/12/2012, can not create a zero-failure environment for insurance companies. And it would be too costly to set solvency requirements at a level sufficiently high to absorb all unexpected losses.

Insurance Guarantee Schemes (IGS) do exist within the EU, but not in all Member States. Existing IGS are not harmonized and there are important loopholes in the protection.

There are some important protection mechanisms independent of IGS, but none of them is fully satisfactory:

- <u>Prudential regulation and risk management</u> (Solvency II), which can not guarantee that there will not be any failure.
- <u>Preferential treatment of policy holders in winding-up proceedings</u>

  This essential policyholder's protection system must remain in place. But during the winding up proceedings, policyholders with outstanding claims at the time of insolvency (or with claims emerging during the proceedings) will suffer from a shortage of liquidity if claims cannot be paid for many months or even years.
- <u>Ex-post government interventions</u>

  Government interventions are not satisfactory: decisions to intervene are taken on an ad-hoc basis so policyholders can never be sure that the government will intervene, in particular for risks located in another Member State than the country in which the insurance company is located. Larger companies (too big to fail companies) make more chances to be rescued than small ones. In ex-post schemes it is always a third party who pays for the failing company. At least, if the government has to rescue a company during a general crisis - like the current financial and economic crisis - it will not be able to force other companies who are not in capacity to contribute, to reimburse the state intervention. The taxpayer will remain the payer.

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2. Guarantee scheme for bad advice

Although guarantee schemes for bad advice exist in some Member State (like the U.K.), the White Paper doesn't tackle this question.

The consequence of bad advice can be higher than the financial capacity of the advisor and the damage can appear years after the initial policy subscription.

The professional indemnity insurance minimum level of € 1 500 000 for insurance intermediaries is inadequate if a lot of consumers undergo the consequences of the bad advice. The responsibility of the advisor must be covered by a guarantee scheme that could face the consequence of bad advice even if the advisor is no longer active.

BEUC supports the creation of a compulsory Guarantee Scheme regime that covers the liability of intermediaries when their professional liability insurance is not sufficient to cover the consequences of bad advice.

An alternative to the suggested guarantee scheme could be a professional indemnity with a higher protection level, linked to the amount of premiums generated by the intermediary.

BEUC comments on the approach proposed by the Commission

The Commission proposes to establish at EU level a coherent and legally binding framework on IGS protection, applicable to all policyholders and beneficiaries, by means of a directive as defined in Article 288 TFEU.

To achieve a minimum harmonization with high level of consumer protection in all Member States by a fixed term, there is no other efficient mean than a legally binding instrument.

The Commission advocates the establishment of an IGS as a last-resort mechanism in each Member State.

BEUC agrees that the IGS should be a last resort mechanism. However, the IGS mechanism should also be made available to prevent, under strict rules to preserve the competition with other companies, the failure of a company or to facilitate the transfer of policies to another company (see below).

BEUC considers a pan-European IGS to be a better, more efficient system than multiple micro IGS.

Other existing protection mechanisms, like the preferential treatment of policy holders in winding-up proceedings, are essential elements of policyholder protection and must remain.

The Commission advocates harmonising the geographical scope of IGSs on the basis of the 'home country' principle.

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If the IGSs are organized at national level, the 'home country' principle should, like for the Deposit Guarantee (DGS) and Investor Compensation Schemes (ICS), be the reference.

But BEUC considers that the claimant located in another Member State than the IGS in charge of the repayment should be entitled to contact the IGS of his own national IGS to get information and to claim repayment.

One single point of contact for all Financial Guarantee or Compensation Schemes (DGS, ICS and IGS) would simplify consumer access to information and facilitate the eventual contacts and payments between consumers and the Guarantee or Compensation Schemes.

The Commission advocates that IGSs should cover both life and non-life insurance policies.

BEUC agrees that there is no reason to leave a category of insurances, life or non-life, unprotected.

About motor vehicle insurances

It is unclear if motor vehicle liability insurances would be in the scope of the advocated IGSs. The White Paper does not mention it. In the FAQ[1], the Commission considers that insurance policies are sufficiently protected. A guarantee scheme for motor insurance is required in every Member State by Directive 2009/103 (and earlier by directive 84/5/EEC), but only for damage caused by an unidentified or an uninsured vehicle. The Impact Assessment mentions that "*Member States have nonetheless voluntarily extended over time to the case of defaulted insurance undertakings their already compulsory guarantee schemes for motor insurance. In conclusion, as IGS are today already present almost in every EU-EEA country and do not create substantial loopholes in the protection of policyholders, there is no apparent necessity to intervene at the EU level*." [2]

It is clear that not all Member States have set up an IGS for failing motor insurances companies and that there are loopholes – considered as not substantial – in the protection of policyholders. It is also clear that there is neither obligation for Member States nor commitment from all Member State to set up an IGS to protect policyholders or victims in case of motor insurance company insolvency. This is not the good way to protect and reassure consumers. Travelling European citizens are more exposed to the failure of a motor insurance company than to other risk

[1] Insurance Guarantee Schemes (IGS) - Frequently Asked Questions, MEMO/10/320, p. 4: *10) Who should be covered by an IGS? The Commission believes that both life and non-life insurance policies, except motor insurance policies which are already sufficiently protected under EU and national legislation, should be covered by a comprehensive framework on IGS protection in the European Union and that this should be for the benefit of all natural persons.*
http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/320&format=HTML&aged=0&language=EN&guiLanguage=en

[2] Commission Staff Working Document; Impact Assessment; Accompanying document to the White Paper on Insurance Guarantee Schemes, page 224, footnote 34.
http://ec.europa.eu/internal_market/consultations/docs/2010/whitepaper-on-igs/impact-assessment_en.pdf

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insurances. Making IGS for motor insurance compulsory would not be too costly and would offer the legal certainty the consumer needs.

The Commission advocates that IGSs should cover natural persons and selected legal persons.

Natural persons and associations with natural person members, like condominium, should be protected.

The Commission advocates that IGSs should be funded on the basis of ex-ante contributions by insurers, possibly complemented by ex-post funding arrangements in case of lack of funds, which should be calculated according to the individual risk profiles of the contributors. An appropriate target level for funding should be set, with a suitable transition period. The Commission is ready to consider harmonized compensation limits and other reductions in benefits, provided that appropriate coverage of policyholders and beneficiaries is guaranteed for all relevant classes of insurance and in all Member States.

IGS's funding

A harmonized funding mechanism achieves a level-playing field among the companies from different member States.
An ex-post funding has a pro-cyclical impact if companies have to contribute in a crisis time; it also stimulates moral hazard in this sense that the failing company will never contribute for the losses it caused.

On the other side, the policyholder is entitled to a preferential treatment in winding up proceedings. The IGS will have (or should have) the right of subrogation to the rights of the policyholder for an amount equal to their payments. Due to this subrogation, the intervention of the Guarantee Scheme will be limited in comparison with a Guarantee Scheme for bank deposits.
The ex-ante financing should be limited and, if needed, be completed by ex-post contributions.

Compensation limits

BEUC considers that compensation limits are not appropriate for risk insurances. Limiting the compensation, e.g. for a burnt house, is not really reassuring for the consumer and it remains an argument for them to choose insurance companies who are considered to be “too big to fail”. This is not a high level of consumer protection. It would have a negative impact on competition and the risk would remain, in last resort, on the taxpayer.

BEUC considers also that compensation limits are not appropriate for investment life insurances. The context is quite different from the banks deposits guarantee which would be limited to € 100,000 according to the DGS Directive Proposal. Deposits are quite more liquid assets than life insurance policies; the depositor can easily transfer a part of his deposit to another credit institution without any penalty which is not the case for life insurance policies. Life insurance policies are generally long term contracts and when reaching their term, individual investment life insurance policies are regularly higher than € 100,000. Further, a common limit among all Member State doesn't seem to be defined: the level of individual pension initiatives depends of the legal and employment pension schemes (first and second pillars), and those differ from one Member State to another.

The Commission advocates that IGS should at least and within a pre-defined period of time compensate policyholders and beneficiaries for losses when an insurer becomes insolvent.

Compensations are not the only way to protect the consumer when a company becomes insolvent.

BEUC considers that early intervention facilitating the transfer of policies to other companies should be preferred to the payout of compensation. The IGS should be allowed to initiate interventions.

Protection life insurance and health insurance policyholders may suffer more than other policyholders if their company is bankrupt. A payout will not help those that could not succeed in finding a new insurance because their health is worse than at the beginning of their policy. The best way to protect consumers when a company becomes insolvent is to facilitate the transfer of policies to another company.

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