EUROPEAN COMMISSION – PUBLIC CONSULTATION ON INSURANCE GUARANTEE SCHEMES IN THE EU

The ABI's Response to the consultation

Introduction

1. The Association of British Insurers (ABI) represents nearly 400 member companies, which between them provide 91% of the UK’s domestic insurance. It works on behalf of the UK insurance industry to keep standards high and to make the insurance industry’s voice heard.

2. The ABI is on the Register of Interest Representatives. Our registration number is 730137075-36.

Overall Comments

3. The UK has operated a comprehensive insurance guarantee scheme (IGS) for over 30 years. This is supported by the UK insurance industry and is an important factor in providing consumer protection and maintaining the industry’s reputation.

4. Given the UK experience the ABI believe that IGS are an essential element in consumer protection. We are also concerned that the absence, or limited nature, of such schemes in many Member States is a barrier to the development of a single market in insurance.

5. The ABI, therefore, supports, in principle, a directive mandating the setting up of IGS in all Member States. This should be on a minimum harmonisation basis.

6. The ABI fully supports the development of Solvency II and believes that when implemented this will reduce the, already small, number of insurance failures. However, Solvency II is quite explicitly a non-zero failure regime and so there remains a need for IGS to ensure that consumers are protected in, the very rare, cases of an insurer becoming insolvent. IGS are not, therefore, an alternative to a robust system of prudential regulation but are a necessary complement to it by providing a last resort mechanism for compensating policyholders.

7. Our responses to the specific questions raised in the consultation are set out in the attached annex.
Questions for Consultation

1. Have new insurance guarantee scheme arrangements been introduced in your Member State or is the situation currently under review?

The UK has operated an insurance guarantee scheme for more than 30 years. Originally operated by The Policyholder Protection Board this is now run by the Financial Services Compensation Scheme (FSCS) - which also operates the UK’s deposit and investment compensation schemes.

The FSCS has separate sub-schemes for life and non-life insurance. These schemes are funded by levies on the industry raised on a pay-as-you-go basis.

The UK insurance industry supports the FSCS and believes that it is an important factor in providing consumer protection and maintaining the industry’s reputation.

2. Given that neither the current nor the future solvency regime create a zero-failure environment and that many MS have not established IGS, which is your preferred option?

a. The status quo, i.e. adopting a caveat emptor approach possibly linked with enhanced policyholder information
b. Case-by-case intervention as and when problems arise
c. Mandating the establishment of IGS in all Member States
d. Introducing a single EU-wide IGS that covers all relevant policies written and purchased within the EU
e. Other options.

The ABI agrees, in principle, with option C as this will help ensure a level playing field across Member States for both firms and consumers and help to develop a single-market in insurance. This approach will give Member States the flexibility necessary to develop schemes appropriate for specific markets – we would not favour Option D as this would lack this flexibility.

We do not believe that either Option A or B remain credible options given that no regulatory regime can provide a zero-failure environment. The ABI fully supports the development of Solvency II and believes that when implemented this will reduce the, already small, number of insurance failures. However, we do not believe that this detracts from the need to have credible and robust compensation arrangements in place to deal with insurance insolvencies as and when they arise. We think that there must be arrangements in place to provide compensation to policyholders as a last resort in the event of the failure of a firm.
3. Do you agree with the conclusion that, costs can to a certain extent be adjusted through scheme design and that if properly designed, introducing an IGS can be pro-competitive and improve the operation of the market?

Yes. An IGS clearly imposes some costs on the industry which will in most cases be passed onto consumers. However, it is not the UK experience that the administrative costs of operating the FSCS are excessive.

The vast majority of the costs which will arise when an insurer fails will do so as a result of the failure and are independent of whether or not an IGS exists. The difference arises from how these costs are dealt with. If there is no IGS then the costs will fall directly on the policyholders of the failed firm (or on taxpayers generally if there is state intervention). In such cases individual hardship can ensue and there are likely to be industry-wide repercussions relating to the reputation of and confidence in insurers. However, where an IGS exists the costs will be spread over a much wider group of participants thereby limiting both the hardship suffered and the reputational damage to the industry.

Clearly there is a danger that the cost of compensation could result in contamination across the industry and leave other firms weaker than they otherwise would be. However, this can be guarded against by limiting the amount that can be levied in any year from the industry (this is the system adopted by the UK scheme and in practice the levy in any one year has never approached the maximum allowable).

All insurance companies operating in the UK are required to be members of the FSCS. We believe that this improves competition and the operation of the market as it provides consumers with reassurance that they will be compensated in the event of their insurance provider becoming insolvent. However, the capping of compensation, in most cases, at 90% guards against the risk of moral hazard.

4. Do you consider the presence or absence of IGS to be an important factor in the development of cross-frontier insurance business in the single market and, in your view, which aspects of the current uncoordinated situation already or potentially constitute obstacles to the further development of the single insurance market?

There are clearly many factors to be taken into account when considering the barriers to the development of cross-frontier insurance business. In our view cultural preferences, differences in national legislation, taxation and form of insurance products are all likely to be more important factors than the existence or otherwise of IGS. Nevertheless, we are concerned that the current uncoordinated position raises barriers to the development of a fully functioning single market in retail insurance.

There is anecdotal evidence that a number of our members have experienced difficulty in conducting business in other member states because they have been unable to join the local insurance guarantee scheme. On the other hand the current proposals by the UK Financial Services Authority to extend FSCS coverage to all policies sold by the EEA branches of UK insurers could, potentially, give UK insurers a competitive advantage in certain markets where there is either no scheme or the UK scheme is more generous. We believe that these inconsistencies are confusing for consumers and firms and would be alleviated by a directive which mandated minimum standards in all Member States.
5. Which are the key considerations (for and against) in the trade-off involved in the decision on whether or not to establish an IGS and what relative weight do you attach to these key considerations?

The UK has had over 30 years experience in operating an IGS and we do not believe that this has imposed an undue burden on industry. We believe that any concerns about the cost of such a scheme are heavily outweighed by the consumer protection and industry reputation benefits. We also believe that a coordinated EU-wide approach will help to encourage the development of a single market in insurance.

6. Is the case for establishing an insurance guarantee scheme in insurance weaker than in the banking and securities sectors and which lessons, if any, can be earned from the banking and securities sectors?

No. Banking and insurance are very different businesses and the compensation arrangements should recognize these differences. However, we can see no justification for a view that insurance policyholders are less deserving of protection than bank depositors or other investors.

We believe that it is, in fact, easier to provide a workable IGS than it is a credible deposit protection scheme. Recent experience from the UK has shown that in relation to banks even a relatively generous deposit protection scheme may not be sufficient to maintain consumer confidence. Funding a deposit protection scheme might also be problematical given the potentially large amounts that might be required at short notice. Such issues are unlikely to arise in respect of insurers where claims extend over many years thereby allowing compensation to be paid as claims mature thereby making the payment of such claims easier to fund.

7. What should be the geographic scope of the IGS – i.e. should the national IGS be based on the home or the host state principle?

We assume that this question relates to coverage of business sold through branches or passporting arrangements. This is a complex area and there are arguments in favour of both home and host state approaches.

The main argument in favour of the home state approach is that this ensures that the Member State responsible for the prudential supervision of the insurer is also responsible for providing compensation in the event of the insurer failing. This appears to be the best method for ensuring that regulatory authorities in the home Member State operate a strong prudential regime and that the costs of the failure of such a regime do not fall on other Member States.

However, to the extent that the purpose of IGS is to provide consumer protection and ensure a level-playing field for firms within a jurisdiction there are also substantive arguments in favour of a host state approach:

- It would ensure that consumers within the market are given equal protection.
- It would enable the existence and coverage of the scheme to be clearly explained (thereby improving consumer confidence) which would not be
possible if the level of protection varies dependent on the nationality of the insurer the consumer chooses to buy a policy from.

- It would provide a level playing field for companies operating in that market.
- It would ensure that firms operating in the market contribute proportionally to providing cover.
- It would allow the IGS to be designed to meet the particular requirements of the local market (for example with regard to the appropriate level of compensation required).
- It would be administratively more convenient for claimants to work with a scheme based in their own jurisdiction and familiar with local legal requirements. It is likely that having to claim from a foreign IGS would lead to delays in providing compensation and additional administrative cost.

Many of these potential benefits of a host state regime could be achieved under a home state model by allowing ‘top-ups’ where appropriate and providing for co-operation between IGS in different Member States.

8. Should subsidiaries participate in and be covered by the IGS of the Member State in which the group supervisor is located under the group support regime under Solvency II?

The ABI strongly supports the group supervision proposals in the Solvency II directive. However, we do not believe that there is any necessary connection between these proposals and the introduction of IGS. Both proposals make sense in their own right.

We do not agree that subsidiaries of a group should be covered by the IGS of the Member State in which the group supervisor is located. Subsidiaries should be members of the IGS of the Member State(s) in which they operate. This approach is more consistent with the regulatory structures that we understand are likely to be in place will be in place under Solvency II whereby the local supervisors rather than the group supervisor will be responsible for ensuring that the subsidiary continues to meet its Minimum Capital Requirement.

9. What degree of harmonisation across Member States would be required between national IGS and which features of IGS should be harmonised? Should they be harmonised, please indicate your preferred approach.

a. Geographic scope (home v host state principle)
b. Organisational structure (single or multiple IGS, cooperation within solvency practitioners and supervisory authority, staffing arrangements/outsourcing)
c. Funding arrangements (in particular ex ante or ex post funding, risk weighted contributions and contribution limits))
d. Policies covered - What classes of insurance should be covered by the IGS and which insurance classes could be excluded?
e. Claimant eligibility - Which claimants should benefit from the IGS, and which claimants could be excluded?
f. Protection amounts and limits (caps or maximum compensation levels, deductibles, etc.)
g. Nature of intervention (in particular the payment of compensation or portfolio transfer)

h. Payout timing and information to policyholders/beneficiaries

We favour the minimum level of harmonisation necessary.

In practical terms we believe that it will be necessary for any directive to lay down the geographic scope, minimum levels of compensation, minimum requirements as to what policies are covered, who is eligible to receive compensation and what information needs to be provided to policyholders. Member States should, however, be free to require higher levels of compensation or wider coverage if they believe that this is necessary and appropriate in their market.

We believe that issues such as the organisational structure of a scheme, funding arrangements and the nature of intervention should be left to Member States. This will enable schemes to be designed in ways appropriate to the specific market and will enable different types of policies to be covered in different ways if that is felt to be appropriate.