Contribution of the
German Insurance Association (GDV)
to the European Commission’s consultation
on Insurance Guarantee Schemes and the OXERA study
(MARKT 2508/08)

GDV represents the German insurance industry and would like to express its gratefulness for the opportunity to contribute to the ongoing process of evaluation and clarification about the usefulness (or not) of introducing insurance guarantee schemes (IGS) on a European level via juridical acts of the Union.

Please find our answers to the questions put forward in the consultation document below:

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

No new IGS have been introduced since the research of OXERA was done in 2007 in Germany. There are no proposals for introducing any IGS due to the fact that according to common consensus in the German market there is no need to introduce any IGS outside the field of life and private health insurance.

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

We can clearly rule out alternative d. (EU-wide IGS) on several grounds:

Insurance markets in the EU differ largely from each other, even though the supervisory legal framework has been harmonised to a large extent (but not completely). Contract law has not been harmonised at all. IGS have to fit into the market and the legal surroundings in the market. Insurance contract law sets the frame within which the claims of policyholders are determined. It is hard to imagine that a European super-IGS would be able to handle 28 regimes of contract law properly. Moreover, installing and handling IGS are an issue of insurance supervisory law. According to the home Member State rule established in the EU this falls under the competence of the home Member State. A European IGS would above all not render customers and the industry a great service: it would be too far removed from local...
practices and would probably not respect well-established local traditions like the unique German system of continuing contracts in life and private health insurance rather than indemnifying them.

**Alternative c.**: We acknowledge that on grounds of consumer protection there is a desire to care for policyholders (or their relatives) in the case of insolvency of the insurer in life and private health insurance as these branches are highly sensitive in respect of fundamental needs of people (i.e. securing financial security of aged or ill persons, caring for the families of policyholders etc.). For these reasons we think the EU legislator could in fact ensure that a minimum cover is provided for in the case of insolvency in all EU Member States in life and private health insurance. There is no need, however, in non-life, as an insolvency in this sector will not affect many people (only a few having unsettled claims at that particular time), as claims will be generally lower (for example 95% of claims below 1000 € in private general liability) and as there is no savings component in non-life contracts.

**Alternative a.** could be a wise choice in the field of non-life insurance, because in this field the situation differs from that in life and private health insurance, as stated above. Due to the lack of a savings component, the rather small proportion of policyholders affected in the case of insolvency (i.e. those having an unsettled claim), the generally lower level of claims and the lack of importance for the social security of policyholders (old-aged and ill persons) in non-life there are not the same pressing needs for action as in life and private health insurance. Nevertheless, the idea of enhanced information for policyholders is a good one. If a scheme exists, policyholders should be expressly informed already when concluding a contract about the existence of the scheme, exact coverage and the way how to access and benefit from the scheme. There is, however, no need to expressly inform about the non-existence of a scheme as that would be the case to be expected and thus to be considered normal in the absence of any information.

**Alternative b**. is closely linked to alternative a. in so far as in fact in the past the industry has usually acted on its own in avoiding the insolvency of individual insurers by transferring the portofolios of weaker market participants to strong ones. This has worked well in the past but cannot be regulated by the legislator as the merits of the case have to be taken into consideration to find a solution fully appropriate to the needs of policyholders, the market, the insurer threatened by insolvency and the one(s) taking over portofolio. No two cases have been alike so far. A legal regulation would probably tend to sacrifice the necessary flexibility and could thus harm the willingness of the industry to act.

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?**

The design of an IGS is of course crucial for the cost it generates. A design with retroactive financing and a small permanent staff will incur less cost than the opposite.

Another factor limiting cost could be reasonable caps and excess for policyholders as well as limiting the scheme to indemnifying policyholders that are consumers and excluding certain types of insurance which usually are not taken out by consumers (like transport).

What we cannot see is how the existence of an IGS could be pro-competitive and improve the operation of the market. There are strong indications that even in the absence of IGS policyholders do not care about (or cannot properly assess) the financial soundness of an insurer (although in their own interest they should do so!). Under that precondition, assuming that all market participants would have to join an IGS promising the same cover to
policyholders, the effect on competition would be neutral. On the assumption that policyholders would in the absence of an IGS in fact care about and could assess the financial soundness of an insurer properly, the introduction of IGS would even have an anti-competitive effect: Policyholders would not have to care about the financial soundness of an insurer because they could be sure that they would not incur a loss in case it went bankrupt. That would mean they would not care about the quality of a product they buy but only about the price. Competition in that way would be destructive and in the end would neither serve the consumer nor the industry.

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?

The absence of IGS does not constitute a relevant obstacle to the further development of the single insurance market. The fact that we do not see more cross-border business today has reasons which are completely different: The incoherencies and differences in national civil (especially contractual) law make it nearly impossible to sell products across borders. They have to be redesigned according to the market they are aimed at. Often the business expected does not justify the costs. This can only be addressed effectively by further harmonising contract law (e.g. installing a so-called Optional Instrument or 28th regime as an opt-in solution).

The existence of IGS, on the other hand, does not seem to have a real effect as the OXERA study (p. 128) clearly could prove:

“The interviews conducted with market participants supported the view that factors such as “brand”, “price” and a whole range of other factors are more significant than protection by IGS... Again, based on the interviews conducted with insurance providers and intermediaries, there is no evidence available to suggest that IGS coverage has played a significant role in the advice and sales process.” “Overall there is little direct evidence available to support the view that the impact on cross-border competition through demand-side-related factors has been, or is, of general significance...there is no evidence to support the view that consumers understand, or indeed act upon, the information available to them. ….”

Of course insurers based in another Member State doing cross-border business might nevertheless have the feeling they should offer their customers some kind of IGS protection when doing business in a market where a local scheme exists, so that local policyholders contracts are covered. On the basis of a rule of home Member State supervision there could be a justification for community lawmakers clearing the path for these insurers to have an opportunity to join an IGS in their home Member State that covers cross-border activity in the EU.

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?

While the establishment of IGS clearly has a consumer-protective effect in the case of insolvency, several other points have to be taken into consideration:

- Insolvency of an insurer is not very probable today due to all-encompassing supervision and a strict solvency regime and will become even less probable in the future as a result of clearly improved solvency rules (Solvency II). The question may be asked whether it is

\[1\] IGS = Insurance Guarantee Scheme (Insolvenzsicherungssystem)
worthwhile to incur tremendous organizational and financial effort for a case that will only happen with a probability that can be neglected. A zero-failure policy may be quite excessive. Its cost would finally increase premiums.

- There is already substantial protection for policyholders in case of insolvency of the insurer according to Art. 10 of the directive on the restructuring and winding-up of insurance undertakings (2001/17/EC).

- IGS have an aspect of unfairness towards the majority of policyholders and insurers behaving responsibly. They are in the end those who will pay for the cost incurred by those not behaving responsibly. Of course it could be tried to contravene this by risk-weighted contributions but this only works in combination with an ex ante financing. Financing the system ex ante poses the problem of a larger permanent staff and of managing the assets, which increases cost and deprives undertakings of the possibility of working with the money even though no insolvency has as yet occurred.

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 learned from the banking and securities sectors?

The banking and the insurance sector cannot be directly compared to each other as to IGS. While savings are the core of the banking business with the public, they are not with insurance. There is a savings effect in endowment insurance and to a certain degree in private health insurance (reserves for aged people). There is no savings effect in other insurance (non-life) sold to consumers. So there is at least basically nothing to be indemnified in the case of insolvency, except for a small minority of contracts just having an unsettled claim at the moment of insolvency.

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 deem the field of IGS to be an integral part of insurance supervision or at least an annex thereof closely related. According to the well-established rule of home Member State supervision of the insurance industry in the EU IGS should clearly work on the basis of the home Member State principle. We would like to point out here that after lengthy discussions the working group of the Council which delivered a draft directive on IGS late in 2005 has favoured exactly that for the same reason (see Art. 2 (2) (d) and the reasoning of the draft published at http://ec.europa.eu/internal_market/insurance/docs/2005-markt-docs/2534-05-draft-proposal_en.pdf;).

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?

Subsidiaries should generally – according to the home Member State rule – participate in the IGS of the Member State where they are licensed. The group support regime (and therefore the situation of the group supervisor) is relevant before an insolvency occurs, e.g. it should serve to avoid an insolvency. If this has not been achieved even though group support was given, the subsidiary will become insolvent isolately (the parent may continue its operations). We think the local scheme would be best suited to deal with such a case. This would ensure that all policyholders within the market where the subsidiary operated enjoy the same level of protection and that there is a level playing field for all market participants within
the market. This would clearly not be the case if the subsidiary belonged to the IGS of the parent undertaking (unless the systems were completely harmonised which is otherwise not desirable). In markets that are dominated by foreign subsidiaries (clearly not the German market) the question would necessarily arise which role the local IGS could still play, whether it would find sufficient funds and whether it could be acceptable that coverage for consumers is largely fragmented if the subsidiary does not want to join the IGS in the Member State where it is licensed.

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)

As already stated above, IGS should operate on the basis of the home Member State principle, i.e. they should cover the complete business of a member, be it national or cross-border, within the EU.

b. Organisational structure (single or multiple IGS, cooperation with insolvency practitioners and supervisory authority, staffing arrangements/outsourcing)

The European lawmaker should refrain from regulating structural, financial and operational details of the IGS. This should be left to Member States. What the European legislature should take care of is to ensure minimum standards for safeguarding the interests of policyholders and beneficiaries, that is to say, it should restrict itself to regulating

- the obligation to create a scheme,
- obligatory coverage of all operations within the scope of the branches covered within the EU,
- equal treatment of policyholders regardless of whether they live within or without the Member State of the scheme,
- minimum indemnification or continuation of contracts as equivalent ways of operation, caps and excess,
- the obligation to have transparent, sound and lasting financing and administrative processes installed,
- the definition of the triggering point and who is to decide when it has been reached (probably the supervisor),
- the obligation to inform the person seeking insurance about applicable schemes and the policyholder about the possibility to recover losses in the case of insolvency.

c. Funding arrangements (in particular ex ante or ex post funding, risk weighted contributions and contribution limits))

Although we

- prefer ex post funding because it would not curtail the financial possibilities of insurers without necessity and would probably make the system cheaper,
- prefer risk-weighted contributions to contravene moral-hazard problems,
- prefer contribution limits to make the system calculable for the participants,
- we strongly suggest that the EU legislator should leave details of funding to the national lawmaker so he can adjust details to the individual structure of the market and the operational details of the scheme envisaged.

d. Policies covered - What classes of insurance should be covered by the IGS and which insurance classes could be excluded?

As already stated, there is no need to cover non-life insurance due to the different situation in the non-life classes (see answer to question 2).

Should non-life nevertheless be included, we plead for limiting the system to classes that are of importance for consumer policyholders, such as third party liability, fire, accident, legal expenses and car insurance. Classes which usually do not involve consumers as policyholders should be generally excluded (like transport, credit and surety, aviation, recall cost and loss of profits insurance).

e. Claimant eligibility - Which claimants should benefit from the IGS, and which claimants could be excluded?

Eligibility should generally be limited to claimants that are consumers (policyholder, beneficiary or insured person).

f. Protection amounts and limits (caps or maximum compensation levels, deductibles, etc.)

We consider limitation of the indemnification to 90 % of the claim and a deductible of 1.000 € to be necessary and reasonable to contain the risk of moral hazard on the side of the policyholders.

g. Nature of intervention (in particular the payment of compensation or portfolio transfer)

The EU legislator should leave the exact way of intervention to Member States and refrain from regulating too much details. A possible directive should limit itself to allowing either payment of compensation or portfolio transfer as perfectly equivalent methods.

h. Payout timing and information to policyholders/beneficiaries

We think the directive should not deal with the topic of payout timing as this depends strongly on the exact way the system will operate. For example, in the case of portfolio transfer, there is no general moment for payout. Contracts will rather be paid out according to the initial agreement between policyholder and insurer. We suggest that the EU legislator should leave details like this to the national legislator only obliging him to ensure compensation (if relevant) within a reasonable and fair time span.

Of course the policyholder should be informed in the case of portfolio transfer or the takeover of proceedings by an indemnisation scheme. Here as well we suggest that the EU legislator should leave details to the national legislator who will be in a much better position to do the necessary fine-tuning with the system envisaged.