

EIOPA Consultation Paper on proposals for Solvency II 2020 review

Harmonisation of National Insurance Guarantee Schemes across EU Member states



This is one of five briefing notes that Milliman has produced summarising the consultation papers produced by EIOPA in June 2019 in relation to the Solvency II 2020 review. EIOPA has requested stakeholders to provide feedback on these papers by 18 October 2019.

Overview

On 11 February 2019, the European Commission (**EC**) issued a formal Call for Advice¹ to the European Insurance and Occupational Pensions Authority (**EIOPA**) on the review of the Solvency II Directive. This relates to the full review of the Solvency II rules required by the end of 2020 (**2020 Review**) as required by the Solvency II Directive.

As part of the 2020 Review, EIOPA is assessing the need for minimum harmonising rules for national insurance guarantee schemes (**IGS**).

In response to this, EIOPA drafted a Consultation Paper (**CP**) advising on IGS. The advice in this paper will be amended with the input of the consultation process before being submitted to the EC in the form of an EIOPA Opinion, the Solvency II opinion, which will also include a holistic impact assessment. The Solvency II Opinion will be published for consultation in Q4 2019.

EIOPA has requested stakeholders to provide their feedback on the proposals set out in the CP by **18 October 2019**. The result of this consultation will be included in an EIOPA Opinion to be submitted to the EC by June 2020. The actual implementation date for changes to the Solvency II rules following the 2020 Review remains unclear.

Recovery and resolution is also part of the 2020 Review. EIOPA advises considering the harmonisation of national IGSs within the broader context of recovery and resolution of insurers.

In this CP, EIOPA did not consider the compensation bodies established under the Motor Insurance Directive². Furthermore, it does not analyse the differences in national insolvency laws and other potential relevant national laws, such as insurance contract law. The CP only considers differences in treatment of policyholders due to differences in national IGSs.

We provide more detail on some of the main areas of the CP in this briefing note.

¹ Formal request to EIOPA for technical advice on the review of the Solvency II Directive

² Directive relating to insurance against civil liability in respect of the use of motor vehicles

Background

An IGS provides protection, partially or in full, to policyholders when insurers cannot meet their contractual commitments. Several EU Member States have some sort of IGS in place. However, at present, there are no harmonised EU rules for this. The approaches followed by Member States for the design of the IGSs therefore diverge quite substantially from each other.

In 2010, the European Commission issued a White Paper on insurance guarantee schemes³ and argued that the lack of a harmonised approach hinders the effective and equal consumer protection in the EU. The variation in national approaches towards IGSs has two main consequences:

- Policyholders across the EU could have a different level of protection in the event of liquidation of an insurer. Not all Member States have an IGS in place and there are differences in the design of the IGSs, such as their geographical coverage, eligible policies and compensation limits.
- The level playing field in insurance can be distorted because insurers covered by an IGS can have a competitive advantage over insurers without access to an IGS. Moreover, the level playing field between the insurance sector and competing financial markets can be distorted because firms such as banks and investment firms are protected by harmonised EU rules for guarantee schemes whereas insurers are not.

Regulation (EU) No 1094/2010 sets out the responsibilities of EIOPA regarding IGSs and recovery and resolution. It states among others that EIOPA may contribute to the assessment of the need for a European network of national IGSs which is adequately funded and sufficiently harmonised.

As part of this, EIOPA published an initial stance on 30 July 2018⁴ through a Discussion Paper and conducted a survey among National Competent Authorities (NCA). The outcomes and feedback received on this work is also included in the current Call for Advice.

³ White paper on insurance Guarantee Schemes

⁴ EIOPA Discussion Paper on resolution funding and National Insurance Guarantee Schemes

Advice

EIOPA advises that every Member State should have a national IGS in place for the protection of policyholders in the event of insurance failures. The national IGSs should meet a minimum set of harmonised features, outlined in the following section.

BENEFITS

Introducing national IGSs for every Member State which meet a minimum set of harmonised features is likely to result in several benefits, the main ones being summarised by EIOPA as follows:

- Policyholders are provided a more even level of protection in the event of liquidation of an insurer. This especially holds true in cases of cross-border failures where currently only policyholders who are residents of the country hosting the insurer are protected by the IGS.
- Reliance on public funds is minimised in case of insolvency because typically, the costs of an IGS are distributed to the industry and, to the extent these costs are incorporated into the premiums, the cost of protection is borne by all policyholders.
- A well-functioning IGS limits the losses for policyholders in the event of insolvency. This additional layer of protection is expected to strengthen the confidence in the insurance industry as well as the EU single market.
- Cross-border cooperation and coordination between national IGSs increases and facilitates an orderly resolution process which is particularly relevant in case of cross-border failures.
- The creation of a European network of harmonised IGSs would further contribute to the level playing field across the Member States and to the proper functioning of the internal market.

DRAWBACKS

The main drawbacks of creating and managing IGSs with the minimum set of harmonised features identified by EIOPA, are as follows:

- Costs of insurance failure will be borne by the insurance sector which might lead to higher costs, especially if currently no IGS is in place. These costs might be passed on to policyholders. Furthermore, the minimum harmonisation proposed by EIOPA implies that these costs might differ per Member State.
- Member States will have to establish a scheme or make amendments to their existing schemes, resulting in additional costs.
- The existence of IGSs as additional layers of protection could lead to insurers and policyholders becoming less prudent in their risk management and insurer's selection process, respectively.

In order to avoid excessive burdens on insurers and Member States, the proportionality principle should be taken into

account when introducing a harmonised approach. As such, EIOPA advises that the exact legal structure of the schemes should be left to the discretion of Member States. This could be a separate national IGS or mechanism that will deliver a similar outcome provided that it meets the harmonised minimum requirements set out below.

Furthermore, EIOPA advises considering the harmonisation of national IGSs within the broader context of recovery and resolution of insurers.

Minimum set of harmonising principles

In the Call for Advice, EIOPA is asked to advise on whether there is a need for minimum harmonising rules for national IGSs to ensure their functioning and effectiveness in the event of failures. Where EIOPA identifies a need to harmonise rules, it is asked to advise which principles should apply. Several areas in scope for harmonisation are identified in the Call for Advice. EIOPA advises the following principles for each area.

ROLE AND FUNCTIONING

EIOPA advises that an IGS should be set up with the primary aim to protect policyholders in case of insolvency of an insurer. The first role of an IGS is to pay compensation swiftly to policyholders and beneficiaries for their losses in case of such an insolvency. If the funds allow for it, a second role of an IGS is to ensure the continuation of insurance policies, for instance, by funding or promoting a portfolio transfer or taking over and administering the portfolio as a temporary or resolution administrator. Although this second role would require less funding, the first role is considered more beneficial from a policyholder perspective.

EIOPA is of the view that an IGS should be considered as a final step in the insolvency process. The role of an IGS is not to prevent insurance failures and it therefore shouldn't intervene with the supervisory process. Additionally, EIOPA thinks it would not be fair to require from insurers that they pay for the costs of rescuing a competitor. Finally, the continuation of policies should be preferred for life and for some long-term non-life insurance policies, where reasonably practicable and justified in terms of costs and benefits.

GEOGRAPHICAL COVERAGE

EIOPA advises that the geographical coverage of national IGSs should be harmonised on the basis of the home-country principle. This means that the IGS of a Member State covers all policies issued by its domestic insurers, both at a national level and abroad via Freedom-of-Services (**FoS**) or Freedom-of-Establishment (**FoE**). Insurers who operate outside of the Member State but issue policies using FoS or FoE in the Member State, are not required to participate in the IGS.

An alternative is the host-country principle. In this case the domestic IGS would only covers policies (1) issued by domestic insurers at national level and (2) issued via branches

or FoS (inward) of incoming insurers from other Member States. Policies sold by domestic insurers in other Member States in a cross-border context via branches or FoS (outward) would not be covered by the domestic IGS.

ELIGIBLE POLICIES

EIOPA advises that national IGSs should cover at a minimum the following lines of business for specific life- and non-life policies:

- Policies where the failure of an insurer could lead to considerable financial or social hardship for policyholders and beneficiaries. Examples of life policies are policies involving pensions and annuities. For non-life policies these are for instance policies with an outstanding claim to the insurer.
- Lines of business with a high market share in cross-border business in Europe.

The exact criteria for selecting the range of life and non-life policies need to be carefully designed. Member States could extend coverage to other lines of business relevant in their jurisdiction.

ELIGIBLE CLAIMANTS

EIOPA advises that national IGSs should cover both natural persons and selected legal persons. The legal persons in scope of an IGS needs to be further defined but it most likely will cover retail or retail-like consumers. Large corporate policyholders should have the means to assess the financial soundness of insurers and should therefore not be covered.

Additionally, EIOPA advises introducing restrictions to exclude certain natural and legal persons connected to the failed insurer from the coverage such as the Board of directors and managers of the failed insurer.

COVERAGE LEVEL

EIOPA advises introducing a harmonised coverage level for claimants. The coverage level should be set so that it does not leave policyholders and beneficiaries exposed to considerable financial or social hardship, while bearing in mind the cost of funding of IGSs. Member States could increase the level of coverage in their jurisdiction.

FUNDING

Member States should ensure that IGSs have adequate systems in place to determine their potential liabilities. Using these, the funding aspects of the IGS should be determined proportionate to the size and risk of the insurance industry in the Member State.

EIOPA is of the view 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 should be preferred. However, to avoid the risk of contagion, the ex-post fund raising should be constrained.

Furthermore, in the context of this ex-ante funding, the introduction of potential harmonised principle on the

governance, supervision and investment and risk management of IGSs should be considered.

An appropriate target level for the funding of IGSs should be defined across Member States, taking into account the national market specificities. This target level should be accompanied by a suitable transition period to ensure that the target level can be achieved without major disruptions to the industry.

In addition to this transition period, EIOPA advises considering upper limits to the annual contributions made by an individual insurer or from the industry as a whole into IGSs.

DISCLOSURE

EIOPA advises establishing requirements for the adequate, clear and comprehensive disclosure to consumers and policyholders about the existence of IGSs and the rules governing the entitlement to coverage under such schemes. These requirements should apply to both insurers and IGSs. The disclosure requirements should be in accordance with, but not limited to, the requirements set out in Article 8(3)(e) of the PRIIPs Regulation.

CROSS-BORDER COOPERATION AND COORDINATION

EIOPA advises establishing cross-border cooperation and coordination arrangements between national IGSs. This should also include arrangements for the exchange of information and dealing with compensation claims at national level on behalf of other IGSs. EIOPA should have a leading role in ensuring the consistent and coherent functioning of these cross-border arrangements across the EU.

REVIEW CLAUSE

EIOPA should conduct a review of the adequacy of the harmonised principles. This should be done at least every five years after the harmonised framework becomes effective.

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CONTACT

DUBLIN

Rik van Beers

rik.vanbeers@milliman.com



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