



EIOPA-CP-18-003
30 July 2018

DISCUSSION PAPER
ON
RESOLUTION FUNDING AND
NATIONAL INSURANCE GUARANTEE
SCHEMES

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Responding to this paper

EIOPA welcomes comments on the “Discussion paper on Resolution funding and national insurance guarantee schemes”.

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email CP-18-003@eiopa.europa.eu by **26 October 2018**.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be considered.

Publication of responses

Contributions received will be published on EIOPA’s public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA’s rules on public access to documents.¹

Contributions will be made available at the end of the public consultation period.

Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied. EIOPA, as a European Authority, will process any personal data in line with Regulation (EC) No 45/2001 on the protection of the individuals with regards to the processing of personal data by the Community institutions and bodies and on the free movement of such data. More information on data protection can be found at <https://eiopa.europa.eu/> under the heading ‘Legal notice’.

¹ Public Access to Documents (See link: [https://eiopa.europa.eu/Pages/SearchResults.aspx?k=filename:Public-Access-\(EIOPA-MB-11-051\).pdf](https://eiopa.europa.eu/Pages/SearchResults.aspx?k=filename:Public-Access-(EIOPA-MB-11-051).pdf)).

Executive summary

The aim of this Discussion paper is **to gather feedback from stakeholders** on the analysis presented in this paper. As such, the Discussion paper, which **does not constitute a formal proposal** by EIOPA, will be used to further develop its stance on two distinct but related topics – **resolution funding and national insurance guarantee schemes** (IGSs).

This Discussion paper is **a follow-up to the EIOPA Opinion** on "*The harmonisation of recovery and resolution frameworks for (re)insurers across the Member States*" published in 2017. The publication of the Opinion was an important milestone in EIOPA's work on recovery and resolution. The work on resolution funding and IGSs is a continuation of this work. Resolution funding and IGSs are **essential elements of the resolution of failing insurers**.²

(A) *Resolution funding*

Resolution funding refers to the means of financing the costs of resolving failing insurers. **EIOPA distinguishes three sources of resolution funding**: (i) the assets and liabilities (including own funds) of the failing insurer, (ii) national resolution funds and (iii) national IGSs (or other policyholder protection schemes). Public funds are not considered as a source of resolution funding, in line with the approach of the FSB "*Key Attributes of Effective Resolution Regimes for Financial Institutions*" (FSB, 2014). In the Opinion, EIOPA already proposed to harmonise the powers to restructure, limit or write down liabilities of insurers in resolution. This refers to the first source of resolution funding. The exercise of these powers should be made subject to strong safeguards and be in line with the creditor hierarchy.

Furthermore, the survey conducted by EIOPA in the first quarter of 2018 showed that there are currently only two Member States with a resolution fund for insurers in place. IGSs are much more common across the Member States, whereby the funds of some of the schemes can also be used to finance resolution actions.

An orderly resolution process might require a combination of different funding arrangements. **Member States should ensure that they have in place adequate and sufficient funding arrangements.**

² In this paper "insurer" refers to both primary insurers and reinsurers (unless otherwise stated).

(B) *National IGSs*

On the topic of IGSs, the survey showed that **20 Member States have in place one or more national IGSs (or other policyholder protection schemes)**.³ The **primary function of the IGSs is to compensate policyholders** for their losses in the event of insurance insolvency. Besides this main function, some schemes have **additional functions related to the resolution framework**. As aforementioned, some may also be used to fund resolution actions, such as the transfer of insurance policies to a third party, or may function as a bridge institution. Such use of an IGS in resolution may be grounded on the fact that the IGS would have been involved in the winding-up of the failing insurer if a resolution procedure had not been opened.

At present, there is **no harmonised approach to guarantee schemes in insurance** like the guarantee schemes in other sectors of the financial markets – Deposit Guarantee Schemes (DGS) and on Investor Compensation Schemes (ICS). Member States have therefore adopted their own approach to policyholder protection schemes, which show noticeable differences in design features, such as scope, coverage and funding. These differences in national IGSs, together with differences in insolvency laws, have led to a situation where policyholders across or even within the same Member States are not protected to the same extent in liquidation.⁴ In the context of the internal market, this situation might be regarded as not desirable.

Against this background and in accordance with Article 26 of its Regulation, **EIOPA made an assessment of the potential advantages of some degree of harmonisation in the field of IGSs**. In accordance with the EIOPA Regulation, it assessed the need for a European network of national IGSs⁵ which are adequately funded and sufficiently harmonised. The phrase “a European network of national IGSs” is used to refer to the system of national IGSs and to any potential underlying EU regime laying down rules and/or standards for national IGSs (such as their scope and funding). As such, the reference to a European network should not be regarded as a single EU-wide IGS, but as a body of Union laws harmonising the standards for national IGSs and the system of such IGSs.

³ The term IGSs is used throughout this paper to refer to IGSs or that fulfils the tasks of IGSs in relation with the protection of policyholders.

⁴ Please note that differences in national insolvency procedures might have already resulted in variations of policyholder treatment across Member States. Additionally, there are substantial differences in insurance products and insurance cover provided between Member States. The differences in national insolvency procedures as well as in insurance products/coverage are not considered in the context of this paper. The focus of this paper is on the differences in policyholder treatment caused by the differences in the national approach to IGSs.

⁵ The mandatory compensation bodies covering third-party motor insurance only are not captured here.

For the purpose of its analysis, EIOPA assessed the potential advantages of the following options:

(I) Maintaining the status quo: The current fragmented landscape where some Member States have set up IGSs while others have not and with no common set of elements at European level is maintained.

It could be argued that the current situation should be maintained, given that there are already sufficient policyholder protection mechanisms in place. Solvency II and the high ranking of policyholder claims in liquidation already provide significant protection to policyholders. Furthermore, the costs for the industry of IGSs and potential moral hazard effects (if any) might be substantial unless these are taken into account in the design features of IGSs.

(II) Establishing a European network of national IGSs: A European network of national IGSs which are adequately funded and sufficiently harmonised is created (minimum harmonisation).

It is argued that moving towards a harmonised approach to IGSs would lead to more equal and effective policyholder protection.⁶ The existence of IGSs in Member States would also ensure that the costs of insurance resolution are distributed to the industry⁷ and, hence, reliance on taxpayer money would be further minimised. The creation of a network of national IGSs might also avoid any potential distortion of the level playing field in Europe due to the differences in national IGSs, contribute to cross-border activities in the area of insurance and increase the consumer confidence in the insurance sector.

(III) Establishing a single EU-wide IGS: A single EU-wide IGS is created (maximum harmonisation).

This option would require considerable further harmonisation in many fields in the insurance sector. In particular, a single EU-wide IGS including risk-sharing would involve a higher degree of supervisory convergence and at the same time risk reduction (viz. the establishment of the Single Supervisory Mechanism). This is unlikely to happen in the near future and is therefore not further analysed in the paper by EIOPA. This option is considered out of scope.

⁶ Please note that a full equal treatment of policyholders in liquidation cannot be guaranteed even where a harmonised approach to IGSs is achieved due to differences in national legislation, such as normal insolvency procedures.

⁷ It should be noted that in some Member States the costs are distributed to policyholders as a surcharge.

Based on this analysis, EIOPA is of the view that a minimum degree of harmonisation in the field of policyholder protection in the EU would benefit policyholders, the insurance market and more broadly the financial stability in the EU. A harmonised approach should however consider the national schemes already in place and should be carefully designed taking account of the potential disadvantages of IGSs, such as the costs and potential moral hazard effects.

Therefore, EIOPA provisionally concludes that **the structure and design features of IGSs are crucial** in order to fully understand the benefits and costs of IGS protection. The way IGSs are designed (e.g. their scope, funding and coverage) will determine the actual protection provided to policyholders and the costs of the IGSs. EIOPA is therefore specifically seeking feedback from stakeholders on its assessment and the design features of IGSs. Following the consultation, the work will be continued by EIOPA.

1. Introduction

1.1 Legal basis

1. EIOPA is carrying out the current work in the context of the responsibilities laid down in the EIOPA Regulation.⁸ The following articles are of relevance in this context:
 - Article 8(1)(i) of the EIOPA Regulation sets out EIOPA's tasks and powers in the area of recovery and resolution of insurers by providing that EIOPA is responsible for "*[...] the development and coordination of recovery and resolution plans, providing a high level of protection to policy holders, to beneficiaries and throughout the Union, in accordance with Articles 21 to 26*".
 - Article 24(2) of the EIOPA Regulation provides EIOPA with the responsibility to contribute to ensuring coherent and coordinated crisis management and resolution regime in Europe.
 - Article 25(2) of the EIOPA Regulation provides that "*[EIOPA] may identify best practices aimed at facilitating the resolution of failing institutions and, in particular, cross-border groups, in ways which avoid contagion, ensuring that appropriate tools, including sufficient resources, are available and allow the institution or the group to be resolved in an orderly, cost-efficient and timely manner.*"
 - Article 26 of the EIOPA Regulation which states that "*The Authority may contribute to the assessment of the need for a European network of national insurance guarantee schemes which is adequately funded and sufficiently harmonised*".
2. Against this legal background, EIOPA is competent to issue a Discussion paper on resolution funding and insurance guarantee schemes (IGSs) as a follow-up to its Opinion on "*The harmonisation of recovery and resolution frameworks for (re)insurers across the Member States*" (EIOPA, 2017).

1.2 Background

3. Following the past financial crisis and the unprecedented public support to failing financial institutions, the adequacy of effective crisis prevention and management tools of national authorities has gained increasing attention. In 2017 EIOPA called upon the EU institutions to adopt a minimum harmonised recovery and resolution framework for (re)insurers (EIOPA, 2017).
4. EIOPA argued that a common approach to the fundamental elements of recovery and resolution will avoid the current fragmented landscape and

⁸ Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010.

facilitate cross-border cooperation and coordination between Member States. It was proposed that a harmonised recovery and resolution framework should consist of the following building blocks: preparation and planning, early intervention, resolution and cross-border cooperation and coordination.

5. However, two essential elements of recovery and resolution were not addressed in the Opinion: resolution funding and IGSs. EIOPA now continues its work on recovery and resolution by looking into the potential sources of resolution funding and IGSs as a means of resolution funding and a last-resort policyholder protection mechanism. Similar to recovery and resolution frameworks, neither the arrangements for the funding of resolution nor the IGSs are harmonised at EU level. Member States currently follow their own approach to IGSs and have different resolution funding arrangements in place (if at all).

1.3 Definitions

6. In Article 26 of the EIOPA Regulation a reference is made to "*the need for a European network of national insurance guarantee schemes which is adequately funded and sufficiently harmonised*". This does not refer to the establishment of an EU-wide, fully harmonised IGS. In fact, the option to create a fully harmonised Union-wide IGS is not considered by EIOPA and is out of scope of this Discussion paper. EIOPA is of the view that an EU-wide IGS represents an option that is currently not feasible, as it would require considerable further supervisory convergence.
7. The phrase "a European network of national IGSs" is used to refer to the system of national IGSs and to any potential underlying European regime laying down rules and/or standards for national IGSs (such as their scope and funding). As such and consistent with the above, the reference to a European network should not be regarded as a single EU-wide IGS, but as a body of Union laws harmonising the standards for national IGSs and the system of such IGSs.
8. Furthermore, for the purpose of this work, EIOPA adopts the following definition for IGSs: "*IGSs provide protection to [policyholders] when insurers are unable to fulfil their contractual commitments [...] either by paying compensation to policyholders for their claims, or by securing the continuation of their insurance contract*" (European Commission, 2010).

1.4 Scope of Discussion paper

9. The Motor Insurance Directive (MID, Directive 2009/103/EC) requires Member States "*to set up or authorise a body with the task of providing compensation, at least up to the limits of the insurance obligation for damage*

to property or personal injuries caused by an **unidentified vehicle** or a vehicle for which **the insurance obligation** provided for in [this Directive] **has not been satisfied**" (Article 10 of the MID). The MID has been under review by the European Commission who has recently finalised its review and proposed amendments to the MID (see Box 1).⁹

10. For the purpose of this paper, EIOPA decided to exclude from the scope schemes strictly covering insurance liabilities under the MID.
11. This means that schemes that cover exclusively motor third party liabilities (MTPL) under circumstances set out in Article 10 are excluded from this paper. It should be noted that in some Member States¹⁰ the circumstances under which those schemes can pay compensation for damages to property or personal injuries have been extended to include the event that the insurer bound to pay the damages is insolvent. These schemes are also out of scope in light of the proposals made by the European Commission (see Box 1).
12. Nevertheless, schemes that cover MTPL and other insurance liabilities are included in the scope. Also, schemes that exclusively cover MTPL in the event of liquidation of an insurer but not in the event laid down in Article 10 are within scope.¹¹
13. Furthermore, it should be acknowledged that there are also differences in national legislation on insolvency procedures and insurance contracts across the Member States which might have an impact on the treatment of the policyholders in the EU. These differences are however out of scope. The focus of this paper is therefore on the differences in policyholder treatment caused by the differences in the national approach to IGSSs.

Box 1: European Commission's proposal to amend EU rules on motor insurance (MID)

- The European Commission has assessed the effectiveness, efficiency and coherence of the MID legislation. The evaluation was finalised on 24 May 2018.
- The conclusion of the European Commission was that some elements of the Directive needed to be amended. The Commission therefore made a proposal to strengthen

⁹ According to the [European Commission](#), the MID enables seamless travel within the EU by EU residents with their vehicles for both business and leisure purposes. On the basis of a single premium, EU residents can travel anywhere without the need to buy additional insurance. The Directive also ensures a high protection of potential victims of motor vehicle accidents and is instrumental for the functioning of the Schengen Zone.

¹⁰ For instance, this is the case in Greece. In Greece, there is an Auxiliary Fund with a dual purpose: the compensation according to Article 10 of the MID and, in addition, the compensation of MTPL claimants in case of insolvency of an insurer.

¹¹ For instance, Hungary has established two schemes. It has a compensation guarantee fund under the MID and another scheme under the national act on MTPL which provides "*compensation to victims of accidents caused by motor vehicles with sufficient insurance cover under contract in accordance with this Act at the time of the accident at an insurance company undergoing liquidation in the Member State that has authorized the insurance company in question*".

EU rules on motor insurance to better protect victims of motor vehicle accidents and improve the rights of insurance policyholders.

- According to the Commission, the proposal will ensure that victims of motor vehicle accidents receive the full compensation they are due, even when the insurer is insolvent. The compensation in case of the insolvency of an insurer is one of the main changes proposed to the MID. The aim of this amendment is to ensure that victims are rapidly and fully compensated in their Member State of residence if the insurer of the vehicle responsible for an accident is insolvent.
- Furthermore, in cross-border situations, the European Commission proposed that the ultimate financial responsibility is borne by the insurance sector of the home Member States of the insurer. Thus, if the insurer provides cross-border insurance services, the compensation body in the victim's Member State of residence initially pays the claim of the victim, but will then be reimbursed by a compensation body from the insurer's home Member State.
- The Commission also proposed some amendments to the recognition of claims history statements, risks due to uninsured driving, harmonisation of minimum amounts of cover and added some clarifications to the scope of the Directive following a ruling of the Court of Justice.

Source: European Commission (see [link](#))

1.5 Approach

14. EIOPA has followed a pragmatic and gradual approach for developing its provisional views on resolution funding and IGSs, particularly, with respect to the potential harmonisation of national IGSs.
15. Firstly, EIOPA looked into the topic of resolution funding and examined the potential available sources of resolution funding. A brief overview of these sources in the Member States is also provided.
16. Secondly, EIOPA moved to the main topic of this Discussion paper which is IGSs. EIOPA obtained a detailed overview of the current situation and assessed the potential problems that current situation might create in the event an insurer becomes insolvent. Based on this assessment, EIOPA analysed whether there is a need for a European network of national IGSs which are adequately funded and sufficiently harmonised by comparing the potential pros and cons of harmonisation versus current situation.
17. The purpose of this Discussion paper is to seek feedback from stakeholders on EIOPA's assessment and desired features of national IGSs. At this stage, EIOPA does not reach a conclusion whether an action at the European level is needed in the field of IGSs. EIOPA will continue its analysis, taking into account the feedback from stakeholders, and draw definite conclusions where appropriate in a next stage.

1.6 Survey on national IGSs

18. In the context of this work, EIOPA conducted a survey on the existing national IGSs in Member States, including the sources of resolution funding. The outcome of the survey (hereafter, referred to as the EIOPA survey) is used throughout the paper and has served as valuable input to the different parts of the analysis.
19. The EIOPA survey was responded by 31 national supervisory authorities (NSAs) and represents the situation in the Member States as of end February 2018. However, it should be noted that not all of the questions included in the survey were answered by NSAs. NSAs provided their input to the questions as long as they were applicable and/or relevant to their situation. Consequently, the charts included in the Discussion paper might show a different sum of IGSs depending on the information illustrated in the charts.

1.7 Structure of Discussion paper

20. The Discussion paper follows the approach described above. Chapter 2 includes the sources of resolution funding and clarifies the link between resolution funding and IGSs. Chapter 3 looks into IGSs and provides arguments both in favour of maintaining the current status quo and in favour of a European network of national IGSs.
21. Throughout the Discussion paper some questions for stakeholders are included. The bulk of the questions relate to the potential features of an IGS which are discussed in Section 3.7 Design features of IGSs.

2. Sources of resolution funding

2.1 Introduction

22. An effective recovery and resolution framework should have provisions for the funding of insurance resolution. A resolution process generally involves the absorption of losses. If there are no funding arrangements in place, there is a likelihood that public authorities need to step in to ensure an orderly resolution and maintain financial stability. Over the course of the financial crisis, European insurers received a total of approximately EUR 6.5 billion from public authorities.¹²
23. The Financial Stability Board (FSB) stated the following about resolution funding in its Key Attributes: "*Jurisdictions should have in place privately-financed policyholder protection schemes or resolution funds that can assist in: (i) securing continuity of insurance coverage and payments by the transfer of insurance policies to a bridge insurer or other insurer or use of any other resolution powers; and; (ii) compensating policyholders for their losses in the event of a wind-up or liquidation*" (FSB, 2014, KA Annex II 6.1).
24. In order to avoid reliance on public funds, Member States should therefore have credible (privately-financed) arrangements in place to fund the costs of resolving failing insurers, where appropriate, including the costs for compensating the losses of policyholders.
25. Each of these sources is further analysed in this chapter. It is also examined which of the sources are currently available to national authorities across the Member States. Prior to analysing the sources of resolution funding, it is however worthwhile to look at the costs of resolution. Therefore, the chapter starts with a brief description of the concept of resolution costs based on (academic) literature, after which the three sources of funding are discussed.

2.2 Resolution costs

26. As aforementioned, the resolution of failing insurers often entails some costs which can be substantial. In this section, EIOPA examines what these costs are composed of and provides historical data on insurance resolution costs based on available literature. For a definition of resolution costs, the following definition of the International Association of Deposit Insurers can be used: "*The sum of the expenditures and obligations incurred by the Resolution Authority for a given resolution method, including any immediate or long-*

¹² European Commission: "[Note](#) for discussion by Expert Group on Banking, Payments and Insurance (EGBPI) meeting on 5 March 2015".

term obligations and any direct or contingent liabilities for future payment, less the recoveries on assets of a failed bank.” Thus resolution costs refer to present and future costs which arise from the resolution of a failing institution which cannot be recovered from the assets of the institution.

27. The ESRB provides a useful split for the resolution costs. It divides the resolution costs into three components: (i) operational costs, (ii) costs for the use of resolution powers, including the compensation of policyholders, and (iii) differences in valuation of the insurers’ assets and liabilities in post-insolvency situation versus pre-insolvency (ESRB, 2017).
28. Operational costs include all of the expenses incurred by the resolution authority, such as human resources and administration costs. The implementation of resolution powers might require some additional costs. For instance, funds might be needed to set-up and operate a bridge institution to which the liabilities of a failing insurer is transferred.
29. The third component distinguished by the ESRB refers to the fact that methodology and assumptions for valuing the assets and liabilities of an insurer under resolution might differ from those used during normal course of business. The reason for this is that the insurer moves from going-concern to gone-concern, which might impact on the valuations of the different items. Differences in valuations might be rather large on the liabilities side due to the interest rate term structure used for discounting the liabilities. In Solvency II, hence, in a going concern situation, the term structure includes the ultimate forward rate towards which the market rates are converging – a concept which might not be relevant to include in the term structure when valuing the liabilities for a gone-concern. In case there is an overall negative difference (i.e. excess of assets over liabilities under resolution is less than in pre-insolvency situation), the resulting gap needs to be funded, which can be considered as additional costs of the resolution process.

2.3 Sources of resolution funding: description

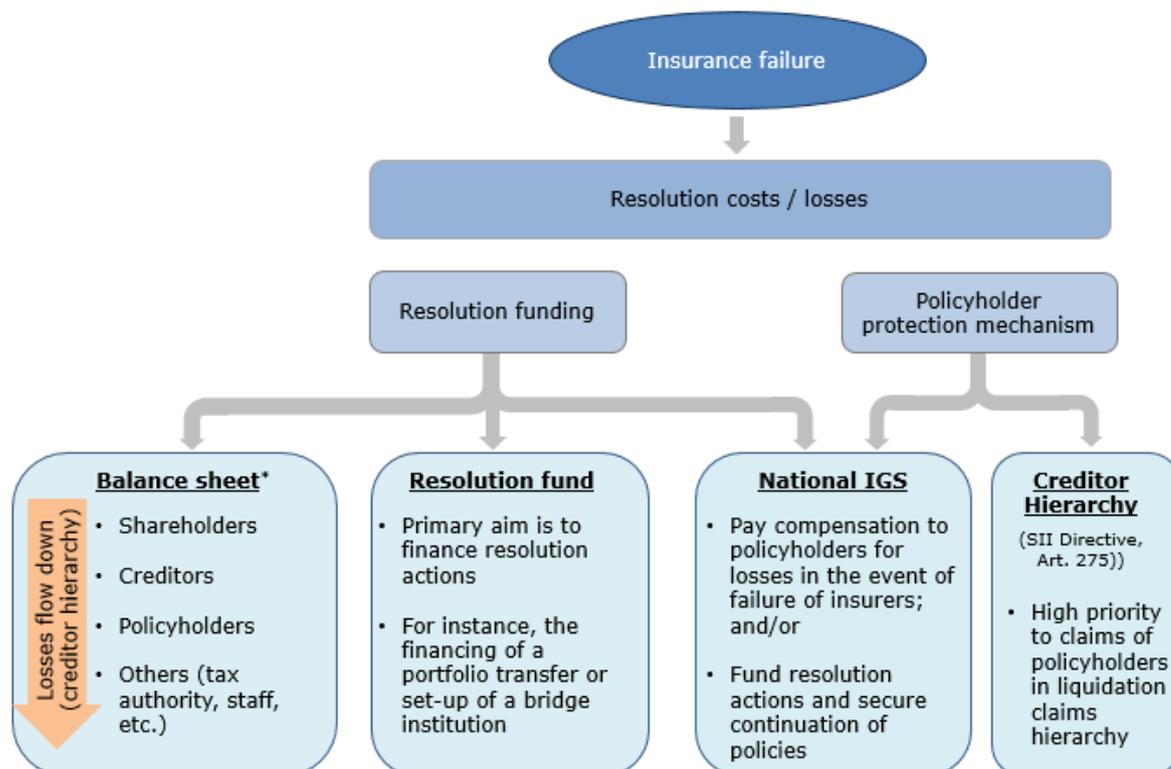
30. The components and size of the resolution costs are therefore dependent on the circumstances of the insurer and situation. These costs need to be funded in order to ensure an orderly resolution and avoid the reliance on public funds.
31. In this respect, EIOPA distinguishes three main sources:
 - (i) Assets and liabilities of insurers under resolution,
 - (ii) National resolution funds, and
 - (iii) National IGSs (or other policyholder protection schemes).

The three sources are depicted in figure 1 and further discussed in the sections below.

32. Public funds are not included in this list of sources for resolution funding. Consistent with the FSB Key Attributes, EIOPA focuses on privately financed sources, as one of the objectives of a recovery and resolution framework is to minimise the reliance on public funds. Nonetheless, in some Member States public funds might serve as a means to finance insurance resolution used under certain circumstances and in accordance with the state-aid rules.
33. The figure also shows the main policyholder protection mechanisms in liquidation and tries to explain the relationship between the sources of resolution funding and policyholder protection mechanisms.¹³ The depicted policyholder protection mechanisms are the provisions on the ranking of insurance claims in the Solvency II Directive (Article 275(1)) and the national IGSs.
34. The Solvency II Directive Article 275(1) (formerly 2001/17 Directive, Article 10) requires that "*Member States shall ensure that insurance claims take precedence over other claims against the insurance undertaking in one or both of the following ways:*
- a) with regard to assets representing the technical provisions, insurance claims shall take absolute precedence over any other claim on the insurance undertaking; or*
 - b) with regard to the whole of the assets of the insurance undertaking, insurance claims shall take precedence over any other claim on the insurance undertaking with the only possible exception of the following: claims by employees arising from employment contracts and employment relationships, claims by public bodies on taxes, claims by social security systems, claims on assets subject to rights in rem."*
35. The survey conducted by EIOPA in the context of this Discussion paper indicated that some Member States have implemented Option (a), whereas others have implemented Option (b).
36. In the event that insurance claims cannot be fully met, policyholders might be protected by a national IGS which will compensate eligible policyholders for their losses. Chapter 3 provides more information about IGSs as a policyholder protection mechanism. However as also shown in the figure, depending on the design and the functions assigned to IGSs, the funds of IGSs might also be used to finance the costs of resolution. The focus of this chapter is on this function of IGSs.

¹³ It should be noted that the first line of defence for policyholders is offered by Solvency II, as the likelihood and impact of an insurer is best avoided by an effective risk-based and forward looking prudential framework.

Figure 1: Overview of resolution funding sources and policyholder protection mechanisms



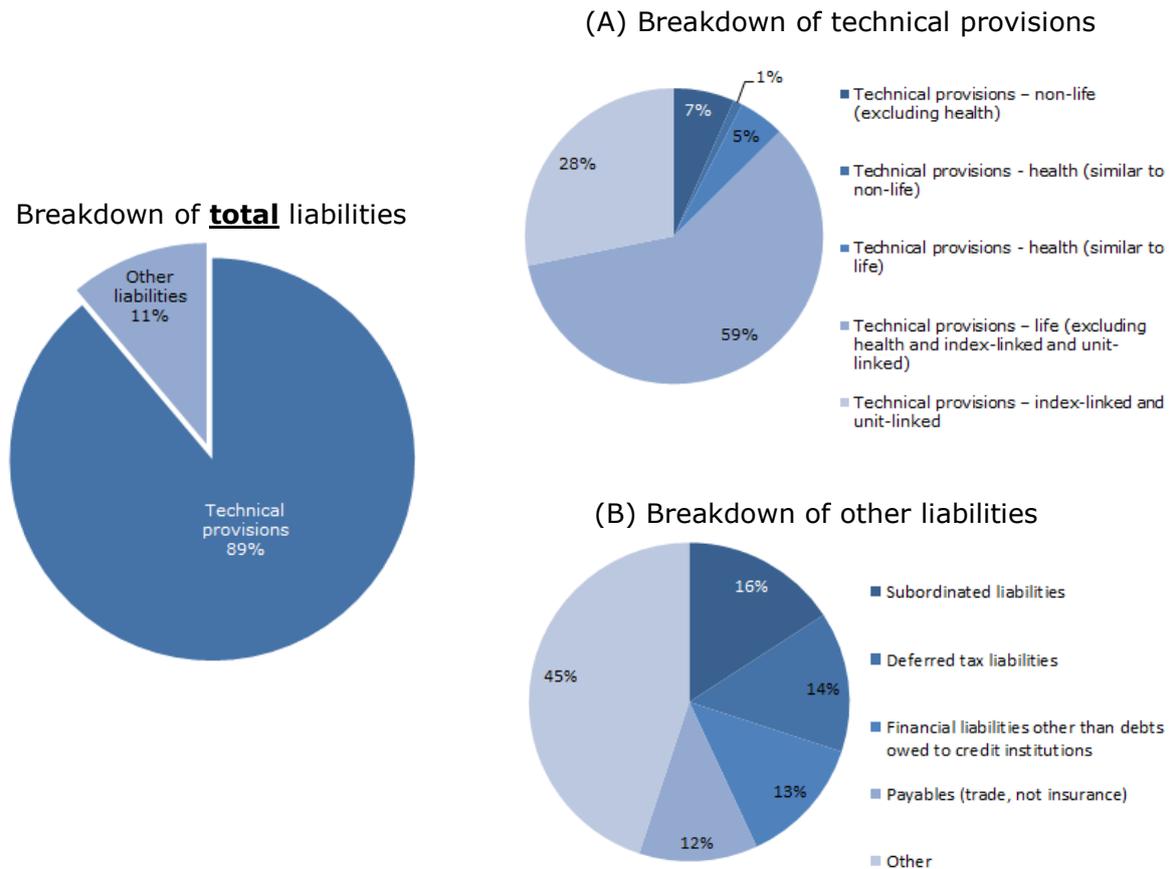
*The liability structure shown here is for illustrative purposes only and may not be representative for all Member States.

2.3.1 Assets and liabilities of insurers under resolution

37. The assets of a failing insurer should serve as the first means of funding the resolution costs. The assets might however not be sufficient to fund the liabilities and the resolution costs. Therefore, some of the costs might need to be absorbed by the creditors of the insurer, including policyholders, by allocating losses in line with the creditor hierarchy. This means that the liabilities of an insurer (including the own funds) could be used to fund the costs of resolution.
38. Figure 2 shows the liability profile of insurance groups based in the EEA. Nearly 90% of the liabilities of insurers are composed of technical provisions (insurance liabilities) and only 10% of other liabilities such as subordinated liabilities and deferred tax liabilities.¹⁴

¹⁴ The liability profile of solo insurers in the EEA is very similar to the profile of insurance groups. The breakdown of liabilities is technical provisions 88.4% and other liabilities 10.8%.

Figure 2: Liability profile of insurance groups based in the EEA

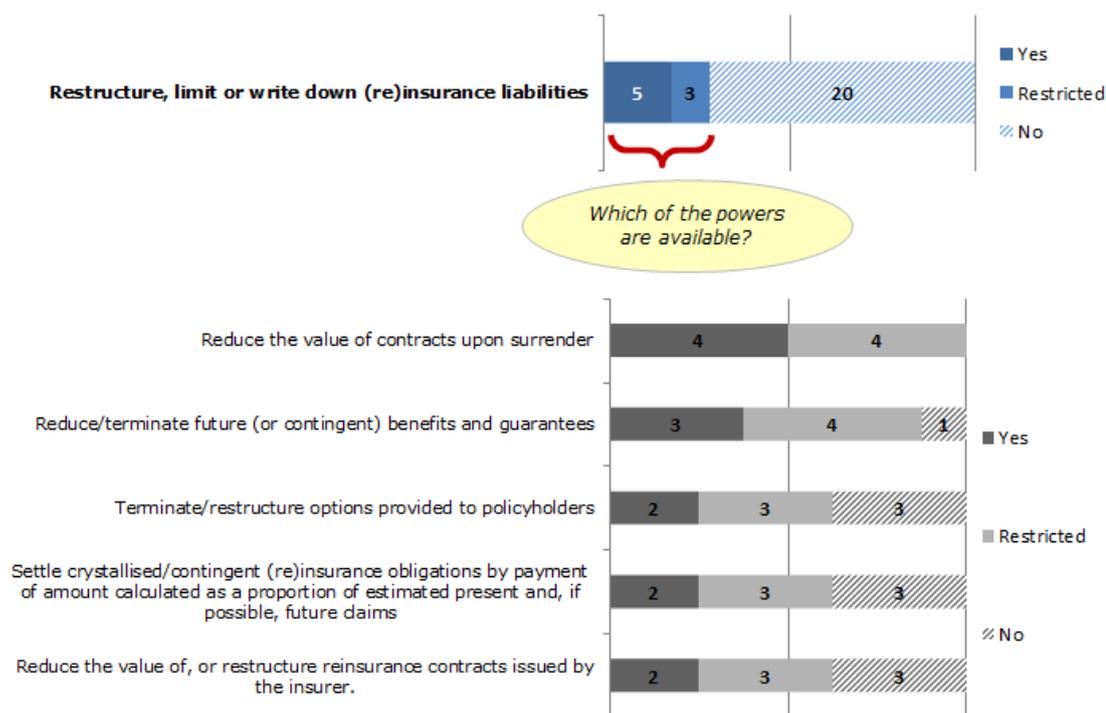


Source: Data from EIOPA insurance statistics (year-end 2016 Solvency II reporting data).

39. The extent to which the liabilities of an insurer could feasibly and credibly absorb losses in resolution depends on the type of liabilities and the powers available to the national supervisory or resolution authority. These include powers to restructure, write down or limit liabilities. For instance, the Solvency II Directive already requires that shareholder capital and other high quality own fund items, such as subordinated liabilities, should fully absorb losses on going-concern basis, as well as in the case of winding-up (Article 93 of Solvency II Directive). NSAs and/or resolution authorities could therefore use these powers to allocate some of the resolution losses to shareholders and qualifying subordinated debt holders.
40. Furthermore, the outcome of the EIOPA survey on recovery and resolution carried out in the context of the EIOPA Opinion revealed that some Member States have adopted additional powers to write down liabilities and allocate losses to shareholders, creditors and policyholders in resolution (see figure 3). The figure shows that currently in 8 Member States the national resolution authorities have – either implicitly or explicitly – the power to restructure, limit or write down (re)insurance liabilities.

41. A detailed split shows that the power to reduce the value of insurance contracts upon surrender is the most commonly available across those 8 Member States, followed by the power to reduce/terminate future or contingent benefits and guarantees embedded in the insurance liabilities.

Figure 3: Powers to restructure the liabilities of an insurer



Source: Information is based on the survey that EIOPA conducted in the context of the Opinion (EIOPA, 2017a).

42. The ability to amend the liabilities of a failing insurer and allocate losses to shareholders, creditors and policyholders could be a measure when resolving insurers. For this purpose, EIOPA advised in its Opinion that these powers should be included in the toolkit for national resolution authorities (EIOPA, 2017a). However, the exercise of these powers should be made subject to adequate safeguards, particularly, when insurance liabilities are involved. For these liabilities, EIOPA listed a set of safeguards which are summarised again in Box 2. A key safeguard for all of these powers is that the losses should be allocated in accordance with the ranking in the creditor hierarchy.

Box 2: Safeguards for the power to restructure, limit or write down insurance liabilities

- According to the EIOPA Opinion, the following safeguards should be considered by resolution authorities when they restructure, limit or write down the insurance liabilities of a failing insurer under resolution:

- a) The power should be exercised in a way that respects the hierarchy of claims;
 - b) Policyholders, should not incur a loss greater than they would have incurred in a winding-up under normal insolvency proceedings (the “no creditor worse off than in liquidation” (NCWOL) principle);
 - c) All other feasible measures and options which could have averted (further) losses for policyholders have been exhausted or have been deemed unlikely to be successful;
 - d) The allocation of losses to policyholders should only take place as a last resort option;
 - e) The exercise of the power is deemed necessary for other resolution actions to be effective, hence limiting the potential losses for policyholders (e.g. to enable a portfolio transfer);
 - f) Board members or persons who effectively run the insurer under resolution or have other key functions have been removed or dismissed if those persons can be found unfit to perform their duties pursuant to Article 42 of the Solvency II Directive;
 - g) Policyholders who are covered by an IGS or other policyholder protection mechanism should be compensated to the extent possible for their incurred losses.
- Furthermore, EIOPA is of the view that policyholders should be informed of the existence of this power. Policyholders should be made aware of the possibility that this power might be exercised in exceptional circumstances, subject to adequate safeguards; however, the possible recourse to court, against public administration’s order, could have no suspensive effect. Policyholders should be informed about the potential risks and financial consequences taking into account the possible coverage under a national IGS. This could, for instance, be achieved by including a clause in the insurance contract.

2.3.2 National resolution funds

43. National resolution funds are another source of funding. These are funds established for the purpose of funding resolution actions and typically privately financed. With the adoption of the Bank Recovery and Resolution Directive (BRRD), national resolution funds were first introduced in the banking sector.
44. In insurance, the existence of resolution funds is not very common. To date, only Romania has established a national resolution fund for insurers and the Netherlands is in the process of creating a (more limited) fund as part of its new recovery and resolution framework. The Dutch framework is expected to enter into force in 2019. Box 3 provides information on the Romanian and Dutch resolution funds for insurers.

Box 3: National resolution funds for insurers

 Romanian Resolution Fund	 Dutch Resolution Fund
Establishment	
<ul style="list-style-type: none">The resolution fund was established as part of the recovery and resolution regulation for insurers enacted in 2016.	<ul style="list-style-type: none">The resolution fund will be established as part of the recovery and resolution regulation for insurers.
Funding	
<ul style="list-style-type: none">The resolution fund is financed ex-ante by contributions collected from all insurers.Insurers make contributions according to the following rules: 0.4% of the received premiums for non-life insurance and 0.25% of the received premiums for life insurance.The fund has a ceiling of EUR 11 million beyond which contributions are halted.	<ul style="list-style-type: none">The resolution fund is financed on an ex-post basis.All insurers contribute to the fund (except for the insurer under resolution).
Purpose	
<p>The financial resources of the fund can be used for the following purposes:</p> <ul style="list-style-type: none">to guarantee the assets or liabilities of the insurer under resolution, of a bridge institution or an asset management vehicle;to make loans to these types of institutions in the transfer process of assets or insurance portfolio of the insurer under resolution;to make contributions to a bridge institution or an asset management vehicle;to pay compensation to shareholders or creditors in case they incurred greater losses than they would have incurred in a normal winding-up insolvency proceeding;to pay back loans and associated costs;to take any combination of the actions referred to above.	<p>The financial resources of the fund can only be used for the following purposes:</p> <ul style="list-style-type: none">to compensate policyholders after a potential violation of the NCWO principle;to compensate the inventory in case of excessive pay-outs to policyholders;to finance the operational costs of a resolution process; for instance, to finance the costs of establishing a bridge institution.

2.3.3 National IGSS

45. The last source of resolution funding identified here are national IGSSs (or other comparable policyholder protection schemes). Generally, the primary

purpose of IGSs is to protect policyholders in the event of insolvency by compensating them for their claims. Nevertheless, there are some national IGSs which have additional functions related to the resolution framework, meaning that the financial resources of the IGSs could be used to fund resolution actions.

46. The survey of EIOPA revealed that there are 26 IGSs in 20 Member States (see next chapter). The primary role of most IGSs is to compensate policyholders in the event of liquidation. Nevertheless, NSAs mentioned to the EIOPA survey that 11 national IGSs can be used to fund resolution actions. For instance, the IGSs can be used to enable portfolio transfer, take over and administer the insurance policies of a failing insurer and/or function as a bridge institution. The topic of IGSs is discussed in more detail in the next chapter.

2.4 Conclusions

47. The resolution of failing insurers is associated with costs which can be substantial. Resolution funding refers to the means of financing the costs of resolving failing insurers. Three sources of resolution funding can be distinguished: (i) the assets and liabilities of the failing insurer, (ii) national resolution funds and (iii) national IGSs (or other policyholder protection schemes).
48. Currently, only a small number of national supervisory or resolution authorities are empowered to restructure, limit or write down the liabilities of insurers. Only 1 Member State has a resolution fund and another Member State is in the process of adopting the required legislation to establish a resolution fund. National IGSs are more widespread, although only a few can be employed to fund resolution actions. IGSs are typically used to compensate policyholders for their losses following an insurance failure (see chapter 3).
49. In accordance with the views expressed in the Opinion, national resolution authorities should have in their toolkit the powers to restructure, limit or write down the liabilities of an insurer, including the (re)insurance liabilities. The powers should be made subject to strong and adequate safeguards, especially where insurance liabilities are involved.
50. Moreover, EIOPA advises Member States to ensure that they have in place adequate and sufficient funding arrangements for insurers in order to ensure an orderly resolution process and maintain financial stability. This might require a combination of different sources of resolution funding, depending on the national legal structure.

3. National IGSs

3.1 Introduction

51. IGSs provide last-resort protection to policyholders when insurers cannot meet their contractual commitments. There are currently 26 national IGSs in place in 20 Member States (excluding the schemes that cover exclusively MTPL under circumstances set out in Article 10 of the MID). The features of the schemes, such as scope, coverage, funding, are specific to each Member State show substantial variations.
52. Guarantee schemes also exist in other sectors of the financial system, where the rules and operation of the schemes have been harmonised at the EU level. The Directive on Deposit Guarantee Schemes (DGS) protects the depositors of banks and the Directive on Investor Compensation Schemes (ICS) protects the investors entrusting money or instruments to investment firms. According to the directive on DGS (there is also 2009 DGSD),¹⁵ Member States are required to ensure a harmonised level of protection for depositors.¹⁶ The directive on ICS ensures that investors are entitled to a minimum level of protection if an investment firm fails to return the investor's assets.¹⁷
53. In 2010 the European Commission issued a White Paper on IGSs as part of a proposal to revise the Directive on ICSs (European Commission, 2010). The European Commission argued that the lack of harmonised approach hinders the effective and equal consumer protection in the EU and proposed the creation of an IGS in each Member State.
54. The International Association of Insurance Supervisors (IAIS) published an Issues Paper on the Resolution of Cross-border Insurance Legal Entities and Groups in 2011 in which it discussed issues relating to the cross-border insolvency of insurers, including the role of policyholder protection schemes and their implication for supervisors.
55. In its Key Attributes of 2014, the FSB stated that jurisdictions should have in place privately-financed policyholder protection or resolution funds that can assist in (i) securing continuity of insurance coverage and payments by the transfer of insurance policies to a bridge insurer or other insurer or use of any other resolution powers, and (ii) compensating policyholders for their losses in the event of a wind-up or liquidation (FSB, KA 6, 2014).

¹⁵ [Directive 2014/49/EU](#). The first directive on DGS was adopted in 1994 and only required a minimum level of harmonisation between domestic DGS in the EU.

¹⁶ European Commission, [Deposit guarantee schemes](#).

¹⁷ European Commission, [Investor Compensation schemes](#).

56. In this paper, EIOPA looks into the divergences in approaches to IGSs. It assesses whether a (partially) harmonised approach to the protection of policyholders is needed by setting out the advantages and disadvantages of (partial) harmonisation versus the current situation. EIOPA also looks into the possible issues that may arise when a national IGS has to intervene in cross-border failures.
57. At this stage, EIOPA focuses on understanding the current landscape versus the alternative of a more harmonised approach. EIOPA seeks feedback from stakeholders on this assessment and potential features of an IGS. After the consultation process, EIOPA will continue its analysis and draw definite conclusions about its views on a more harmonised approach towards IGSs.

3.2 Analysis

58. The decision to establish an IGS is often influenced by the number and severity of failures, including their expected likelihood (OECD, 2013). The responses to the EIOPA survey revealed that the establishment of most guarantee schemes in the Member States across Europe was indeed prompted by insurance failures. While Solvency II has reduced the likelihood of insurers failing with the introduction of risk-based and forward looking prudential supervision, it has not fully eliminated the risk that failures might occur in the future and expose policyholders to losses.
59. In its analysis EIOPA did not examine the expected probability of defaults and potential impact of failures – this is beyond the scope of this paper. The analysis focuses on the potential problems arising from the lack of a common harmonised approach to IGSs and the potential need for harmonisation. In accordance with its Regulation, EIOPA assesses “*the need for a European network of national insurance guarantee schemes which is adequately funded and sufficiently harmonised*” (EIOPA Regulation, Article 26) and considers whether such a network of national IGSs contributes to better protecting policyholders and maintaining financial stability in the EU.
60. Furthermore, in accordance with Recital 37 and Article 26 of the EIOPA Regulation, EIOPA can contribute to the Commission’s intention to examine the possibility to introduce EU rules and/or standards protecting insurance policyholders in case of a failing insurer. Such a contribution would emerge as an EIOPA assessment of the need for a European network of national IGS, which is adequately funded and sufficiently harmonised.
61. In this context, the phrase “a European network” refers to the system of national IGSs and to any potential underlying European regime laying down rules and/or standards for national IGSs (such as their scope, funding and inter-IGS recoveries).

3.3 Brief overview of existing national IGSs

62. This section provides a brief overview of the national IGSs existing in Member States which fall within the scope of this Discussion paper (see Section 1.4 Scope of Discussion paper). The overview is based on the outcome of the survey conducted by EIOPA in Q1 2018. Across the EEA, 31 NSAs responded to the survey. A more detailed overview of the features of the national IGSs is given in Section 3.8 of this chapter.

3.3.1 Existence of IGSs

Member States with IGSs

63. Currently, 26 IGSs (or schemes that are similar to or fulfil the tasks of IGSs) are established in 20 Member States.¹⁸ Table 1 (see further down) lists the Member States that have an IGS in place, including the type of businesses covered.
64. In a majority of the Member States, the establishment of an IGS was prompted by the failure of insurers or general distress in the insurance market. A few NSAs explained that the schemes were created in order to strengthen the confidence in insurers, while some others mentioned that the scope of the mandatory bodies for MTPL was extended to cover other lines of (compulsory) non-life insurance.

¹⁸ Austria and Spain were mentioned to have schemes that fulfil the tasks of IGSs in relation with the protection of policyholders.

- In Austria insurers are required to establish a premium reserve fund (*Deckungsstock*) for life, health and accident insurance, as far as these are operated in a manner similar to life assurance. This fund is administered separately from the other assets of the insurer and constitutes a special fund in case of bankruptcy. The cover requirement corresponds to the total technical provisions established for the types of insurance. The finances of the fund cannot be used to cover losses from other insurers.
- In Spain, the policyholder protection scheme (*Consortio de Compensación de Seguros*) guarantees, in part or in full, payments made pursuant to insurance contracts in the event that an insurer fails or its licence is revoked. The scheme is funded by a surcharge on policyholders. The surcharge is a tax payable on insurance contracts. Given its nature of being a tax the principle of territoriality prevails, being the host-country principle applied for financing the system.

Member States without IGSs

65. IGSs as defined in this paper do not exist in the following EEA Member States: Croatia, Cyprus, Czech Republic, Iceland, Liechtenstein, Lithuania, Luxembourg, Netherlands¹⁹, Slovakia, Slovenia²⁰ and Sweden.
66. Three NSAs from these jurisdictions replied to the survey that they experience difficulties and/or shortcomings due to the lack of an IGS. One of these NSAs explained that the government had to step in and re-capitalise one of the largest insurers in the country because a portfolio transfer was not possible due to the size of the insurer. Therefore, intervention by the government was needed in order to avoid a disorderly resolution and losses for policyholders. The NSA added that the set-up of an IGS is being discussed at the national level but is not foreseen in the near future.
67. Another NSA reported that a report on IGS was presented to the government in the past. The report recommended creating an IGS with mandatory membership for all licensed insurers to provide protection to policyholders. However, no specific actions followed after this report.
68. None of the other NSAs mentioned any initiatives to establish an IGS in the near future.

¹⁹ In the Netherlands there is currently an early intervention arrangement in place for life insurers. This arrangement is financed by life insurers with a capacity of maximum € 135 million and can be used to enable a portfolio transfer to a bridge institution or fund a reinsurance arrangement. The arrangement could only be used in case the insurance portfolio is deemed to be viable. With the adoption of the new recovery and resolution framework (expected in 2019), this arrangement will be cancelled.

²⁰ It should be noted that the scheme established under the MID (Guarantee Fund of Slovenian Insurance Association) is intended for the payment of:

- damages caused to injured parties by drivers of uninsured and unknown motor vehicles and trailers,
- damages caused to injured parties by uninsured aircraft or other flying devices,
- damages caused to injured parties by drivers of uninsured boats,
- claims for passengers in public transport following an accident, if the owner of the means of transport does not have an insurance contract, *and*
- part of the compensation not paid from the bankruptcy estate of an insurance company bound to pay damages and against which bankruptcy proceedings have been instigated.

Table 1: Overview of existing national IGSs

Please note that the following table does not show the schemes that cover exclusively MTPL in case of damages caused by unidentified/uninsured vehicles (and in insolvency of the insurer).

Country	Name of scheme	Type of business lines covered
Austria	Deckungsstock	<ul style="list-style-type: none"> • Non-life insurance: Health and accident insurance, as far as these are operated in a manner similar to life insurance • Life insurance: All types of life insurance
Belgium	Agence fédérale des Risques professionnels / Federaal Agenschap voor Beroepsrisico's	<ul style="list-style-type: none"> • Non-life insurance: Medical expense insurance, income protection insurance and workers' compensation insurance • Life insurance: Annuities stemming from non-life insurance contracts and relating to health insurance obligations and annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations
	Fonds de garantie pour les services financiers / Garantiefonds voor financiële producten	<ul style="list-style-type: none"> • Life insurance: Insurance with profit participation
Bulgaria	Compensation Fund of the Guarantee Fund	<ul style="list-style-type: none"> • Non-life insurance: Motor vehicle liability insurance • Life insurance: Insurance with profit participation, index-linked and unit-linked insurance and other life insurance
Denmark	Guarantee Fund for non-life insurance companies	<ul style="list-style-type: none"> • Non-life insurance: Broad range of non-life insurance
Estonia	Pension Contracts Sectoral Fund of the Guarantee Fund	<ul style="list-style-type: none"> • Pension contracts which are insurance contracts for mandatory funded pensions

Finland	Joint guarantee payment system - Patient Insurance Centre	<ul style="list-style-type: none"> • Non-life insurance: General liability insurance (statutory patient insurance only)
	Joint guarantee payment system - Worker's Compensation Centre	<ul style="list-style-type: none"> • Non-life insurance: Workers' compensation insurance (statutory workers' compensation insurance only)
France	Fonds de garantie des assurances de personnes	<ul style="list-style-type: none"> • Life insurance: All types of life and health insurance
	Fonds de garantie des assurances obligatoires	<ul style="list-style-type: none"> • Non-life insurance: Motor vehicle liabilities and construction insurance
	Fonds de garantie des dommages consécutifs à des Actes de Prévention, de Diagnostic ou de Soins dispensés par des professionnels de santé	<ul style="list-style-type: none"> • Non-life insurance: Medical liabilities
Germany	Sicherungsfonds für die Lebensversicherer	<ul style="list-style-type: none"> • Life insurance: Insurance with profit participation, index-linked and unit-linked insurance and other life insurance
	Sicherungsfonds für die Krankenversicherer	<ul style="list-style-type: none"> • Life insurance: Health insurance
Greece	Private Life Insurance Guarantee Fund	<ul style="list-style-type: none"> • Life insurance: Insurance with profit participation and index-linked and unit-linked insurance
Hungary	Kártalanítási Alap	<ul style="list-style-type: none"> • Non-life insurance: Motor vehicle liabilities in the event of insolvency of motor insurers
Ireland	Insurance Compensation Fund	<ul style="list-style-type: none"> • Non-life insurance: Broad range of non-life insurance
Italy	Fondo di garanzia per le vittime della strada	<ul style="list-style-type: none"> • Non-life insurance: Motor vehicle and craft liabilities
	Fondo di garanzia per le vittime della caccia	<ul style="list-style-type: none"> • Non-life insurance: General liability insurance for hunting victims

Latvia	Fund for the Protection of the Insured	<ul style="list-style-type: none"> • Non-life insurance: Accident, health (insurance against illnesses), motor transport (except railway transport), property insurance against damage by fire and natural disasters, property insurance against other damage, motor vehicle owner third party liability insurance, general third party liability insurance and assistance insurance • Life insurance: Life, marriage and child birth, tontine, capital redemption transactions and annuity
Malta	Protection and Compensation Fund	<ul style="list-style-type: none"> • Non-life insurance: Broad range of non-life insurance • Life insurance: Life and annuity, marriage and birth, permanent health insurance, pension fund management, social insurance
Norway	Garantiordningen for Skadeforsikring	<ul style="list-style-type: none"> • Non-life insurance: Broad range of non-life insurance • Life insurance: Annuities stemming from non-life insurance contracts and relating to health insurance obligations and annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations
Poland	Ubezpieczeniowy Fundusz Gwarancyjny ²¹	<ul style="list-style-type: none"> • Non-life insurance: Compulsory motor TPL and farmers TPL insurance, compulsory insurance of the farm buildings being

²¹ Ubezpieczeniowy Fundusz Gwarancyjny (UFG) is responsible for payment compensations and benefits to the injured parties in traffic accidents and collisions caused by uninsured motor vehicles' owners and uninsured farmers (each of these groups is obliged to have valid third party liability insurance (TPL)) and is also responsible for making payments to the injured parties in traffic accidents when the person liable has not been identified.

Additionally only in case of the bankruptcy of insurance undertaking, UFG satisfies the claims of the entitled persons from:

- compulsory motor TPL and farmers TPL insurance,
- compulsory insurance of the farm buildings being the part of the agricultural farm,
- compulsory insurance resulting from separate acts or international agreements ratified by the Republic of Poland, imposing on certain entities (persons) the obligation to be insured and life insurance contracts in the amount of 50% of eligible receivables to an amount not exceeding in PLN equivalent of 30,000 EUR at the average exchange rate published by the National Bank of Poland (NBP) as valid on the date of declaration of bankruptcy, dismissal the motion of the bankruptcy declaration or discontinuance of bankruptcy proceedings or ordering of compulsive liquidation.

		<p>the part of the agricultural farm, other compulsory insurance contracts</p> <p>Life insurance: Life insurance contracts</p>
Portugal	Fundo de Acidentes de Trabalho	<ul style="list-style-type: none"> • Non-life insurance: Workers' compensation
Romania	Policyholder Guarantee Fund	<ul style="list-style-type: none"> • Non-life insurance: All types of non-life insurance • Life insurance: All types of life insurance • Reinsurance: All types of reinsurance
Spain	Consortio de Compensación de Seguros	<ul style="list-style-type: none"> • Non-life insurance: All types of non-life insurance • Life insurance: All types of life insurance
United Kingdom	Financial Services Compensation Scheme	<ul style="list-style-type: none"> • Non-life insurance: Broad range of non-life insurance • Life insurance: All types of life insurance

3.3.2 Past experiences

69. Eleven schemes have been reported to have dealt with insurance failures in the past. One additional NSA mentioned the last intervention by the IGS was in the nineties and hence no further details were provided.
70. The size of insurers having caused an intervention of IGSs ranges from small to large insurers with both life and non-life insurers included. While the intervention experience of some IGSs is limited to a few cases, others were reported to have dealt with a relatively high number of cases. In almost all cases of intervention, the funds of the IGS were used to pay compensation to policyholders for their losses.
71. Depending on the circumstances of the situation as well as the features of the IGSs, the total costs borne by the IGSs were reported to range from a few million up to EUR 1.3 billion. In one case, the NSA reported that the IGS was able to recover all payments made from the winding-up proceeds and therefore did not incur any costs in the end.
72. NSAs argued that one of the main benefits of an IGS intervention over a winding-up procedure was the quick payment of the insurance claims to policyholders. It was mentioned that without an IGS, policyholders would have had to wait for the liquidator dealing with the winding-up process. Furthermore, one NSA mentioned that the IGS reported some problems in gaining access to information relating to the domestic policyholders of a failed insurer with cross-border activities.

3.4 Potential problems of existing situation

73. The lack of a harmonised approach to IGSs has led to a patchwork of different approaches across the Member States in Europe. These differences in IGS protection, together with differences in winding-up proceedings and, in particular, in creditors' hierarchies, have led to differences in policyholder treatment of a EU wound-up insurer.
74. In 2014 EIOPA commenced to create a dynamic database with the objective to gather information from NSAs on relevant cases of insurance failures and near misses occurred in the EEA. In fact, EIOPA's database on failures and near misses in insurance contains a sample of 180 cases of affected insurers in 31 European countries²², dating back from 1999 to 2016 (EIOPA, 2018b).
75. Of all the cases collected in the database, 73 cases or 41% of the total sample are insurers that fully recovered and managed to restore their financial position (i.e. near misses). On the other hand, 87 cases or 48% of the total sample are failures, where the outcome resulted in partial or total resolution.

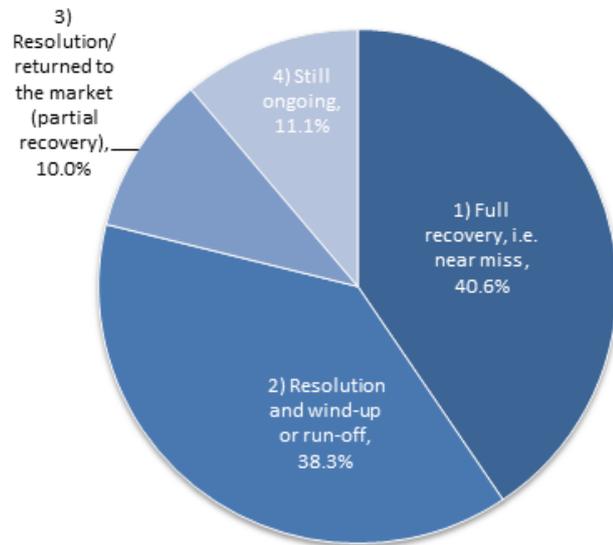
²² The EU-28 Member States plus Norway, Iceland and Liechtenstein.

The remaining 20 cases (11%) are ongoing cases where the outcome of the process was still not final (see figure 4).

76. With regard to the reported outcomes, the majority of resolution cases (i.e. failures) that were reported refer to distressed non-life insurers. This is consistent with the fact that the database displays an abundance of affected non-life companies.

77. As documented in different cases of the database, policyholders might bear or have borne losses following the failure of insurers. In the current situation, this could mean that policyholders across Member States as well as within the same Member State might be protected to a different level. This difference of level in protection will generally first result from differences in insolvency laws, but can be markedly increased by (not harmonised) intervention of national IGSs. Examples of these scenarios are described below.

Figure 4: Outcome of cases



Source: EIOPA, 2018b.

Examples of these scenarios are described below.

3.4.1 Policyholder protection across Member States

78. Differences in policyholder protection across Member States may be increased simply because of the fact that IGSs do not exist in all Member States. Across Europe, 20 Member States have in place one or more IGSs, whereas 11 Member States do not have an IGS. This leads to a situation where some policyholders would get compensated for their losses in liquidation by a protection scheme while others residing in another Member State would be (only partially) compensated by the normal insolvency procedures.

79. Where Member States have established an IGS, the differences in design features of the national IGS could still lead to differences in level of policyholder protection or increase those differences resulting from differences in insolvency laws. The EIOPA survey showed that Member States have made different choices regarding (i) eligible classes of insurance policies and policyholders and (ii) compensation limits. The outcome of these differences in the design of the IGS is that policyholders, while holding the

same type of insurance policy, benefit from a different level of protection in the event of insolvency.

80. The geographical coverage of the national IGS might, for instance, result in the situation where policyholders of an insurer are treated differently depending on where they live. This could happen if the IGS is operated on the basis of the *host-country principle* in contrast to the *home-country principle* (see Box 4 for a description of what these principles mean).
81. Currently, there are 8 IGSs operating on the basis of the host-country principle, 8 operating on the home-country principle and 8 schemes with a combination of both (see Section 3.7.1 for further information).²³
82. When IGSs are operated on the basis of the host-country principle, the funding of the IGSs requires special consideration. Reason for this is that policyholders who buy insurance from a foreign insurer (through branches or FoS) are protected by the IGS of their country. If a foreign insurer fails, the domestic IGS operating on the host-country principle would compensate the domestic policyholders who bought insurance from the foreign insurer's (through branch or FoS). Without a right of claim against the IGS of the defaulting insurer, the financial burden on domestic insurers will increase, especially, where there are frequent failures of foreign insurers, as has been recently the case in at least one country, as is illustrated below in Box 6. Eventually, this can result in a situation where a country decides to limit the coverage provided by the IGS and, hence, resulting in a situation where policyholders are less protected (see example in Box 6).
83. Furthermore, where the host-country principle is adopted, inappropriate incentives may arise from the separation of supervisory responsibilities (which fall on the "home" jurisdiction) from the "fiscal" responsibilities (which fall on the "host" jurisdiction which bears the cost of reimbursing the policyholders); especially, in situations where the primary place of business of the insurer is the host-country itself.

Box 4: Home- versus host-country principle

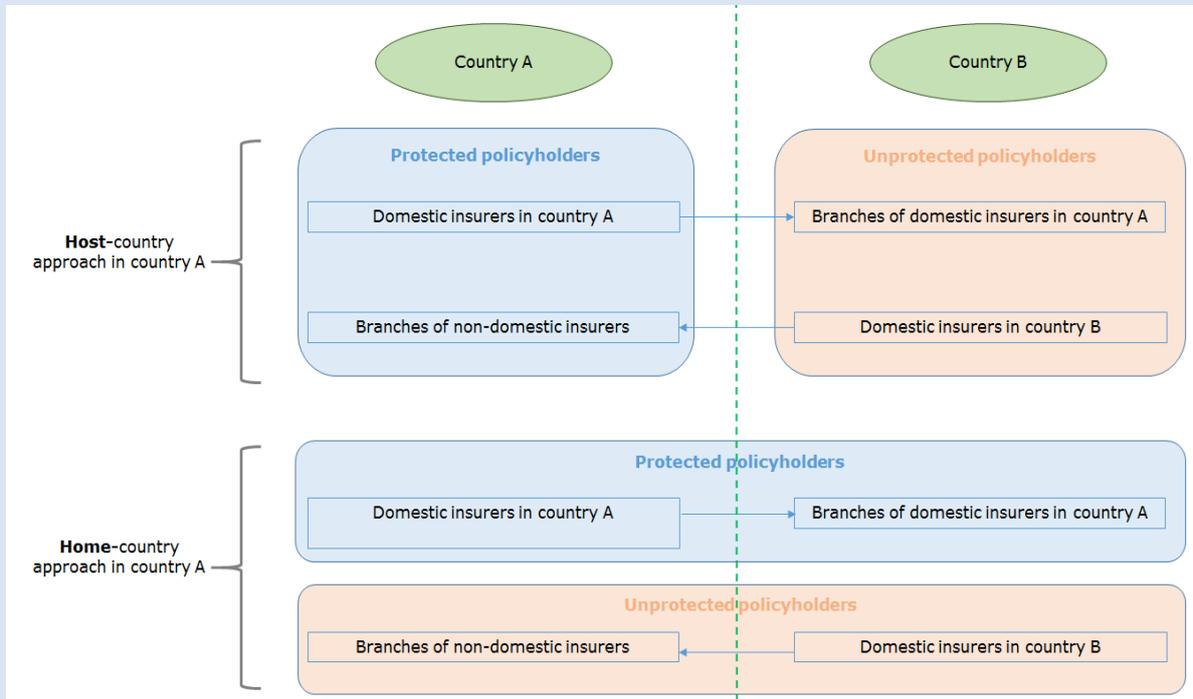
Concept

- **Host-country principle** applies when the domestic IGS covers policies issued by domestic insurers at national level and does not cover those sold in a cross-border context via branches or freedom of services (FoS) – outward FoS. It also covers those policies issued via branches or FoS (inward FoS) of incoming insurers from other Member States.
- **Home-country principle** applies when the domestic IGS covers policies issued by domestic insurers both at national level and abroad via branches or FoS (outward

²³ For reference purpose, in banking, the creation of an EU-wide network of deposits guarantee schemes by Directive 2014/49/EU generalised the home-country principle with the inclusion in the home guarantee of FPS and all EEA-branches.

FoS). The home-country principle does not require incoming insurers which operate via branches or FoS (inward FoS) to participate in the IGS.

- The following illustration provides an overview of both approaches, from the perspective of country A.



Case study - Sweden

- A non-life insurer with its head office in another EEA Member State sold insurance policies to Swedish policyholders via its branch. Recently, the Swedish NSA received a warning about potential distress at the insurer from the NSA of the Member State where the insurer is headquartered.
- Although there was no actual failure of the insurer or damage to policyholders, the inquiries of the Swedish NSA into the effects of a potential failure of the insurer would have effect on Swedish policyholders revealed some interesting facts.
- Firstly, it turned out that there are differences between the Member States about the ranking of Swedish policyholders in liquidation. According to the home Member State, Swedish policyholders would only have general priority rights to the registered assets covering the technical provisions (Article 275(1)(a) of the Solvency II Directive), whereas in case of the liquidation of a Swedish insurer, priority rights would be on the whole of the assets (Article 275(1)(b) of the Solvency II Directive).*
- Secondly, it appeared that Swedish policyholders would not be covered by the IGS under which citizen-policyholders of that Member State would be protected, i.e. the IGS did not cover policies of insurers sold via branches of domestic insurers in other countries.

* It should be noted that there might be other examples and/or other types of differences in the ranking of policyholder across Member States.

3.4.2 Policyholder protection within Member States

84. Policyholders within the same Member State could benefit from a different level of protection for the same type of insurance contract depending on which insurer they contract with. This would depend on whether policyholders buy insurance from domestic or foreign insurers.
85. Under a home-country approach, policyholders in the same Member State are not treated equally if the policyholders buy policies from a foreign insurer branch or incoming FoS. In the event of insolvency of a foreign insurer, the policyholders of this foreign insurer would not be protected by their home IGS whereas they might have been protected by their domestic IGS if they had bought the policy from a domestic insurer.
86. Even where there is an IGS within a Member State it might not be exactly clear which policies fall within its scope. This might lead to delays in policyholder compensation as clearance will have to be sought first. The case study of Ireland proves the importance of transparency and clear rules (see Box 5).

Box 5: Case study - Ireland

Please note that this case study relates to motor insurance and is included for the purpose that lessons might be learned from the case.

- In June 2016, the Irish Government completed a Review of the Framework for Motor Insurance Compensation in Ireland, which sought to improve the current compensation framework in Ireland. One of the proposals in the revised legislation is that coverage of ICF will be extended to include third party motor insurance claims in full rather than being only covered up to 65% of the claim with the MIBI to contribute the additional amount to ensure third party motor claims are compensated in full.
- This was prompted by the following case: Insurer ABC was authorised by its home NSA in 2007 and wrote business exclusively in Ireland on a FoS basis. It wrote motor (class 10) business, providing private and commercial cover to some 75,000 policyholders. The Central Bank of Ireland supervised the company from a consumer protection (conduct of business) perspective.
- In 2013, the Central Bank of Ireland became aware of issues in relation to the financial position of the insurer– the reserves were insufficient to meet their written business. The Central Bank of Ireland contacted the home supervisor and raised these issues. The Central Bank commenced a consumer protection led review of reserve adequacy in association with the home supervisor.
- It found that the firm was under reserved. Early in 2014, the home directed the insurer to cease writing new business. Later in 2014, it was resolved that the insurer would be wound up and a liquidator was appointed. Subsequently, all policies were cancelled and Irish policyholders were informed of this and advised to arrange alternative cover.

- There are two frameworks for insurance compensation in Ireland. The first is an insurance guarantee scheme, the Insurance Compensation Fund (the ICF) which is designed to facilitate payments to policyholders in relation to risks where an insurer is in liquidation or administration. The second scheme compensates victims of road traffic accidents caused by uninsured and unidentified/untraceable drivers, the Motor Insurers' Bureau of Ireland (MIBI).
- In the case of this insurer that was entering into the liquidation process in the home Member State, the initial assumption was that the ICF would compensate policyholders (in line with the limits set out) and that the balance could potentially be recovered through the liquidation process in accordance with the rights of policyholders as unsecured creditors of the insurer now in liquidation.
- However, there was a legal challenge in Ireland that argued that the MIBI should be liable to pay compensation for policyholders' losses in this case. The legal challenge prevented the ICF paying out on claims in scope. There was a protracted legal challenge through the Courts in Ireland, resulting in a decision in May 2017 that the ICF should indeed be responsible for compensation, rather than MIBI.

87. Furthermore, the different levels of policyholder protection might also raise concerns about the level playing field for both policyholders and insurers across Member States in Europe. It could be sustained that different IGS coverage of policyholders of domestic insurers versus policyholders of foreign insurers operating via branches or under FoS, may amount to a restriction of free provision of services. However, it could also be sustained that the funding by the industry of a Member State, and in the end potentially by the policyholders of this Member State, of the failures of foreign insurers, may result in a distortion of the level playing field. Box 6 includes a case study regarding an alleged infringement of EU competition rules, and the potential consequences of a host-country system where there is no compensation mechanism between IGSs of different Member States.

Box 6: Case study - France

Situation

- In year 2000 the coverage of the French non-life IGS (*Fonds de garantie des assurances obligatoires*, FGAO), beforehand limited to motor liability insurance, was extended to all other mandatory non-life insurance provided by insurers headquartered in France.
- French FGAO did not cover the insolvency of insurers headquartered in other EU countries, which did not either contribute to the IGS's financing.
- In 2015 the European Commission asked France to change the rules of the FGAO, taking the view that FGAO only covering insurers headquartered in France discriminated against insurers based in other EU countries (see link below to the summary of the case).

Responses and actions

- In response to the Commission's 'reasoned opinion', the French authorities amended their legislation by extending the coverage of the French IGS to incoming EU providers. Simultaneously, they restricted its scope to the following lines of business (LoBs): third party motor liability, *dommage ouvrage* (a LoB within construction insurance) and mandatory medical liability insurance.
- ACPR reported that in the past two years, 5 EU insurers active in France through FoS in the LoBs covered by FGAO, of which 4 were active in *dommage-ouvrage**, had to stop their business; during the same period, only 1 insurer that ACPR supervised failed.
- A concern was that if the scope of the French IGS was not limited, there was the possibility that French industry, and in the end French policyholders, might in the future have to pay for the failure of insurers that ACPR did not supervise. A former bill even limited the scope to the French IGS to third party motor liability.
- As a result of this, since 1st July 2018 French policyholders are no longer covered for all mandatory policies: the protection was reduced to 3 mandatory LoBs.

Conclusions

- This case study illustrates that introducing a host-country principle without a right of claim against the IGS of the country of the defaulting insurer may lead to a situation where the country's regulator reduces the coverage of its IGS. Therefore, it highlights the importance of the funding feature of IGSs and raises the question of the necessity to introduce rules around reimbursement where IGSs are operated on the basis of a host-country principle.
- Furthermore, the case study demonstrates that policyholders within one Member State may not be protected equally, depending on whether the insolvency incurs with a domestic or a foreign insurer. Differences stemming from IGS coverage may here add to differences in insolvency laws.

**In a dedicated [study](#) published on ACPR's website, the market ratio for the LoB *dommage ouvrage* is about 78% on a 10-year period.*

Source: Summary of the case: http://europa.eu/rapid/press-release_MEMO-15-5162_EN.htm and information provided by French NSA (ACPR). [The case 20144028 was closed.](#)

Stakeholder questions:

- Q1) Do you have any comments to the analysis on the potential problems of the existing situation?
- 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?

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 aim of ensuring more protection to policyholders?

3.5 Potential need for harmonisation

88. The survey has shown that there are many Member States with some form of policyholder protection scheme, although the design features are quite different among the Member States. In the previous section, EIOPA described the potential issues that could arise from the divergent national approaches to policyholder protection schemes.
89. In this section, EIOPA assesses the need for some degree of harmonisation in the field of policyholder protection schemes. In accordance with the EIOPA Regulation, it assesses the need for a European network of national IGSs which are adequately funded and sufficiently harmonised. This analysis requires the consideration of the potential advantages and disadvantages of a harmonised approach towards IGSs. For the purpose of its analysis, EIOPA assessed the potential advantages of the following options:
- **Maintaining the status quo:** This option represents the current fragmented landscape where some Member States have set up an IGS while others have not and with no common set of elements at European level is maintained.
 - **Establishing a European network of national IGSs (minimum harmonisation):** This option represents the situation where a European network of national IGSs which are adequately funded and sufficiently harmonised is created.
 - **Establishing a single EU-wide IGS (maximum harmonisation):** This option would require considerable further harmonisation in many fields in the insurance sector, since the situation in insurance is far more diverse compared to banking. Such a situation is unlikely to happen in the near future and is therefore not further analysed in the paper by EIOPA.

Table 2: Overview of arguments

Arguments...	
...in favour of maintaining the status quo	(A) Risk of contagion in insurance industry is less pronounced
	(B) Sufficient protection mechanisms already in place
	(C) Potential costs of IGSs
	(D) Moral hazard effects
...in favour of a European network of national IGSs	(A) More equal and effective policyholder protection ²⁴
	(B) Distribution of insurance failure costs to the industry
	(C) Increase in consumer confidence and choice
	(D) Level playing field across Member States

3.5.1 Arguments in favour of maintaining status quo

(A) Risk of contagion in insurance industry is less pronounced

90. One of the main reasons for the introduction of guarantee schemes in the banking sector was the prevention of potential contagion risk; the risk of a large number of consumers withdrawing their money from a troubled bank which could result in a loss of consumer confidence and harm other banks and financial stability as a whole.
91. Although a run on insurers in the form of mass lapses by policyholders is a possibility²⁵, it is far less likely to occur. Even if a run on the insurer does occur, the impact would be dampened by the existence of penalties on early termination and lengthier cancellation procedures. These safeguards materially reduce the liquidity pressures on insurers compared to banks.

(B) Sufficient protection mechanisms already in place

92. The strong supervisory framework, the high ranking of policyholder claims in the creditor hierarchy and potential other (national) protection mechanisms

²⁴ Please note that a full equal treatment of policyholders in liquidation cannot be guaranteed even where a harmonised approach to IGSs is achieved due to differences in national legislation, such as normal insolvency procedures: see case study of Sweden in Box 4.

²⁵ The case of the Belgian insurer Ethias shows that insurance runs can occur. Ethias suffered a significant number of cancellation of policies and withdrawals of savings during the 2008 crisis, which ended up in a capital injection by the Belgian Federal State and the Flemish and Walloon regions of EUR 1.5 billion (European Commission [press release](#)).

in combination with the low frequency of insurance failures provide another argument against the establishment of national IGSs across Europe.

93. The protection of policyholders is, for instance, at the heart of Solvency II with financial stability and fair and stable markets being other objectives being pursued as long as they do not undermine the main objective of policyholder protection. Solvency II has introduced a risk-based, forward looking approach to insurance supervision requiring insurers to hold technical provisions in order to ensure that insurance claims can be met. The requirements on technical provisions, capital, system of governance, own risk and solvency assessments and disclosure all aim to ensure that policyholders are adequately protected.
94. Another policyholder protection mechanism in place is the provisions on the ranking of insurance claims in liquidation (Solvency II Directive, Article 275(1)). These provisions determine that policyholders are given a high priority over other creditors in winding-up proceedings.
95. Furthermore, the EIOPA survey of 2016 showed that there are initiatives by Member States to establish or reinforce the national recovery and resolution framework for insurers (EIOPA, 2017a). A comprehensive and effective recovery and resolution framework helps to increase awareness of and preparedness for stress scenarios and grants resolution authorities with a set of powers to orderly resolve failing insurers, including the powers to transfer insurance portfolios to a solvent third party.
96. IGSs can therefore not be regarded in isolation and should be considered within the broader framework of recovery and resolution. This means that in some Member States the need for a national IGS might be less stringent than in others.
97. Finally, the survey of EIOPA revealed that there are already a number of national IGSs existing in Member States. Any initiative for establishing a network of national IGSs which are sufficiently harmonised will therefore need to consider the current landscape while assuring that the existing IGSs are not negatively affected and hence will be a complicated task.

(C) Potential costs of IGSs

98. The potential costs of an IGS might be another reason for not wanting to establish an IGS. After all, the introduction of an IGS is associated with costs which can be split into direct and indirect costs. The direct costs of an IGS include operational/administration and guarantee costs. Indirect costs relate to the potential adverse effects of having an IGS in place, such as moral hazard behaviour. The indirect costs are discussed below under argument (D).
99. Operational/administration costs include the initial set-up costs and the costs of operating the scheme, such as the costs for the staff and investment costs

if the scheme is funded on an ex-ante basis (i.e. where the contributions are collected before the event of a failure). The total size of the costs could be fairly low in some situations, especially where the IGS is funded ex-post.²⁶

100. Guarantee costs are the costs for compensating policyholders and the costs for the use of powers to enable the continuation of insurance policies.
101. These costs are usually borne by the industry but in some cases might be passed on to policyholders. The survey of EIOPA revealed that most IGSs are indeed funded by contributions from insurers, although there are cases where policyholders (directly or indirectly) contribute to the funding of the IGSs (see Section 3.7.4 for more information).
102. The amount of the costs largely depends on the design features of the IGS (such as scope, coverage limits and funding approach) and the amount of shortage in the event of a failure (i.e. the total amount of loss). Where the features of an IGS are quite favourable for policyholders (i.e. providing more protection) and/or where the failure of an insurer, due to its size or the size and concentration of the market where it operates, has a large impact, the costs for the industry could be significant. Section 3.3.4 includes some information about the past experiences of IGSs with failures. It mentions that the reported costs of IGSs in past interventions ranged from a few million up to EUR 1.3 billion.
103. Especially in highly concentrated markets, the failure of a large insurer could put the remaining insurers under considerable financial strain to cover for the costs of failing insurers. This could eventually threaten the financial stability and, hence, should be carefully considered.

(D) Moral hazard effects

104. The indirect costs of an IGS include the risk of moral hazard behaviour – the potential adverse effects that an IGS could have on the behaviour of consumers and potentially insurers. The potential adverse effect on the side of consumers is that they would be more inclined to buy insurance from an insurer covered by an IGS irrespective of its financial strength. As aforementioned, this risk would only materialise if consumers are well-informed and act upon this information which might only be true for professional policyholders (i.e. financial and non-financial companies).
105. The potential adverse effect on the side of insurers refers to changes in risk and/or investment behaviour. Some sustain that insurers would be incentivised to take on excessive risks given that the costs of a potential failure would be borne by the whole industry and/or policyholders, instead of being borne by the sole policyholders of the failed insurers.

²⁶ One NSA mentioned in the survey that the IGS for life insurance (created in 2000), was never used so far. In year 2016, the IGS expenses amounted to EUR 173,000, or 0.040% of managed assets.

106. Although the arguments are theoretically sensible, there has not been so far hard evidence that the existence of IGSs might lead to adverse behaviour on the side of policyholders and/or insurers. In fact, NSAs responded to the survey of EIOPA that they have not observed any (evident) adverse behaviour.

3.5.2 Arguments in favour of European network of national IGSs

(A) More equal and effective policyholder protection

107. Adequate protection of policyholders is at the core of the Solvency II regulation and, where they exist, at the core of national insurance resolution frameworks. The main argument in favour of a European network of national IGSs is therefore the protection of policyholders against the negative consequences of an insurer's failure. This, however, does not mean that policyholders should be fully protected under all circumstances, neither does it exclude the possibility that policyholders may absorb losses as a last-resort option and to the extent that they are not covered by an IGS.
108. The previous section showed that currently policyholders holding similar insurance contracts are not provided with the same degree of protection if an insurer fails.²⁷ This is an undesirable situation. The risk of insurance failures occurring in the future cannot be fully eliminated which means that the scenario where policyholders across Member States are treated unequally in insolvency remains real without some level of harmonisation in the field of policyholder protection. Policyholders – and, in particular, those residing in the same country or having the same insurer – should ideally enjoy a comparable level of protection²⁸ irrespective of their or their insurer's residence.
109. Some degree of harmonisation such as the establishment of a network of national IGSs would also contribute to a more effective protection of policyholders and avoid the situation where policies sold via branches or FoS are not covered by the home or host-country IGS. The creation of IGSs across the Member States is likely to increase the speed of claims payments to policyholders in the event of failure compared to normal insolvency procedures (OECD, 2013). Although the losses of policyholders are minimised because of their priority ranking in the creditor hierarchy, the process to recover the losses from the estate of the failed insurer could be relatively long in normal insolvency procedures.

²⁷ It should be reiterated that differences in policyholder treatment already exist due to different national insolvency procedures and the ranking of policyholders in the creditor hierarchy.

²⁸ A full equal treatment of policyholders cannot be achieved given the differences in other legislation, such as insolvency frameworks.

110. However, it should be noted that different level of protection also arise from differences in insolvency laws (as earlier mentioned), but also affect policyholders of a solvent insurer. For instance, in motor insurance, in some countries the cover provided in case of bodily injury is unlimited whereas in others it is limited up to EUR 5 million as per Article 9.1(a) of Directive 2009/103.
111. A long recovery process, on the contrary, generally has harmful effects on policyholders and may put them in a situation similar to that where they had no insurance protection at all. The impact will ultimately depend on the extent to which policyholders rely on the pay-out on their insurance policies which could be relatively high on some contracts, such as policies with a savings element or social protection element.
112. Additionally, a harmonised approach to IGSs might also facilitate cooperation and coordination between national IGSs in the event of an insurance failure with cross-border activities. The case study of Romania (see Box 7) showed that there might be obstacles for compensation payments across Member States, which might be avoided if there is a harmonised approach, including cross-border cooperation and coordination agreements, between national IGSs.

Box 7: Case study - Romania

- In February 2014, the Romanian NSA (ASF) decided to open a financial recovery through special administration for insurer XYZ following the deterioration of its financial situation. This deterioration prompted ASF to withdraw the insurer's license and to request the initiation of a winding-up procedure in August 2015. Before the withdrawal of its license, insurer XYZ pursued insurance business through branches in other Member States.
- Romania has an IGS where any person with a right of claim against the failed insurer as a result of the occurrence of the risks covered by a valid insurance policy is entitled to request the opening of a loss file between the date of the financial recovery procedure and the termination of their insurance contract, but not later than 90 days from the decision to initiate bankruptcy proceedings.
- In January 2016, a Memorandum of Understanding (MoU) was concluded between the Romanian IGS and the IGS of Member State A. Additionally, a common procedure on the operational aspects of the claim files handling was agreed between the national IGSs, such as the legal framework, scope, activity work flow and payment issues.
- There were discussions towards concluding a similar MoU between the Romanian IGS and the IGS in Member State B. The MoU was meant to address some of the challenges that hindered the payment of compensations to policyholders in Member State B, such as compensation sharing, language of the documentation and banking transfer costs. Although there is no agreement yet, the Romanian IGS has been able to meet most of the payment requests from customers of the branch in Member State B.

113. The current market environment as well as the relatively high degree of internationalisation in insurance makes the need for harmonisation and coordination in this area particularly evident (see Box 8). The prolonged low interest rates environment combined with the risk of sharp reversal in asset prices poses a risk to insurers and threatens the sector or significant parts of it (EIOPA, 2018a).
114. The high degree of cross-border activity in insurance emphasises the importance of a harmonised approach to consumer protection in order to avoid a situation where some of the policyholders of a failed cross-border insurance group are protected by a national IGS, whereas others are not due to their residence and IGS features. Box 8 shows that nearly 27% of the insurers in the EEA have cross-border activities. Additionally, the Opinion of EIOPA reported that the degree of internationalisation in the insurance sector is relatively higher than in the banking sector (EIOPA, 2017a). In the insurance sector, 29% of the business is written by subsidiaries or branches controlled by foreign entities located in the EU (measured as gross written premiums), whereas in the banking sector this is only 17% (measured as the amount of foreign lending).

Box 8: Low interest environment and cross-border business in insurance

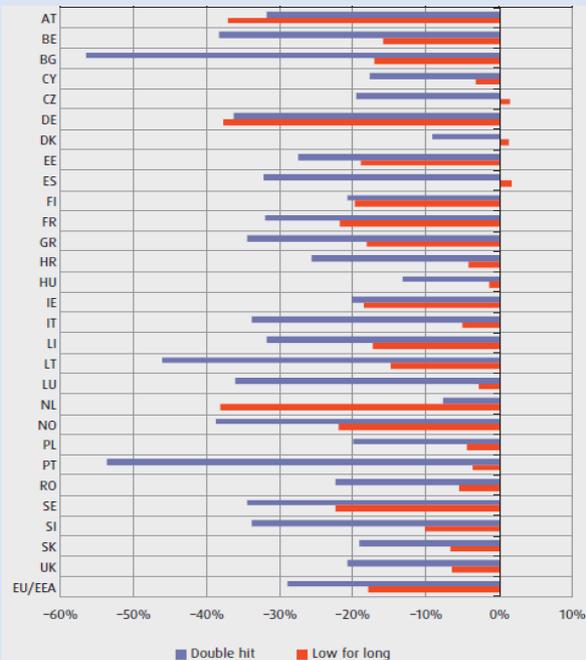
Current market environment

- The current environment remains challenging for insurers. EIOPA (EIOPA, 2013 and 2016) and the ESRB (ESRB, 2015) have identified the low interest rate environment combined with the risk of a sharp reversal in asset prices (double-hit) as a source of systemic risk.
- In 2016, the EIOPA stress showed the impact of a potential double-hit scenario: a negative impact on the insurers' balance sheets of approximately EUR 160 billion (-28.9% of the total excess of assets over liabilities) with more than 40% of the sample losing more than a third of their excess of assets over liabilities.
- ESRB points out the risk of collective failures of life insurers in such a scenario and argues that *"an insurance recovery and resolution directive and an insurance guarantee scheme directive would form a holistic framework for dealing with insurer failures"* (ESRB, 2015).

Cross-border business in the EEA

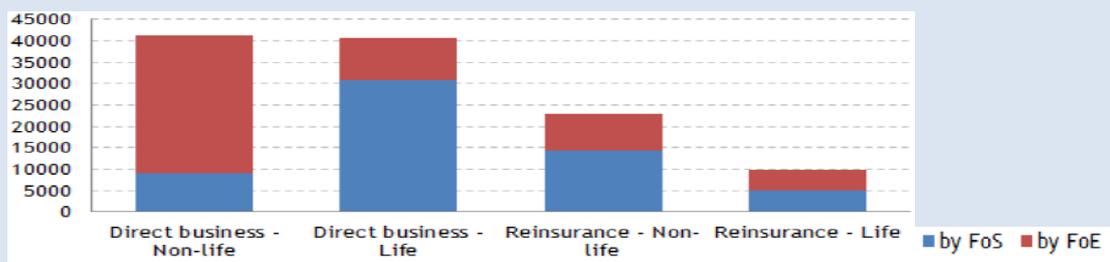
- Cross-border business is a material part of European insurance business.
- Insurers authorised in an EEA country may carry out insurance activities in another EEA country ("host country") via Freedom of Establishment (FoE, i.e. branches) or via Freedom of Services (FoS). FoE requires the establishment of a branch, while FoS can be done without physical presence in the host country.
- In the EEA, EUR 59 billion gross written premiums (GWP) are reported via FoS and EUR 56 billion via FoE, accounting together for more than 8% of all GWP in the EEA. For direct business life, the share is 6%. For direct business non-life and reinsurance the share is 9% and 12% respectively.
- Of 2800 (re)insurers under Solvency II, 750 reported cross-border business within the EEA in 2016.

Figure B7.1: Changes in excess of assets over liabilities (in %)



Source: EIOPA (2016)

Figure B7.2: Cross-border business for 2800 solo insurers (EUR million, YE2016)



Source: EIOPA (2017b)

(B) Distribution of insurance failure costs to the industry

115. The establishment of IGSs would minimise the potential exposure of taxpayers to insurance failures and would distribute the costs of failures to the insurance industry. The extent to which the costs of an insurance failure are actually absorbed by the industry depends largely on the design of a protection scheme.
116. The past financial crisis has shown that public intervention cannot be ruled out, especially when such an intervention is expected by the public (EIOPA, 2017a). Over the course of the financial crisis, European insurers received a total of approximately EUR 6.5 billion from public authorities in order to maintain the financial stability in the affected countries.
117. An IGS could help to minimise the reliance on public funds and, hence, decrease taxpayer exposure to insurance failures by ensuring that the costs are borne by the industry and, to the extent the costs are passed on, by all policyholders.
118. The involvement of the industry in the failure of insurers also gives them a direct financial stake in the behaviour of other insurers as well as the quality of the frameworks governing the supervision and resolution of insurers (OECD, 2013). This could eventually have a positive impact on the industry monitoring and may lead to improvements in regulation.
119. Finally, harmonised rules with respect to the funding of IGSs could avoid the risk of double burdening insurers with cross-border activities which participate in IGSs located in their home-jurisdiction and host-jurisdiction(s).

(C) Increase in consumer confidence and choice

120. A potential increase in consumer confidence and financial stability reinforces the arguments in favour of a network of national IGSs. A well-functioning protection scheme limits the losses for policyholders in the event of insolvency by acting as a pay-box or ensuring the continuation of the policies. The additional layer of protection offered by an IGS could therefore increase confidence in the insurance industry and further promote consumer demand. An important condition for this is that the schemes are adequately funded

and have sufficient capacity to provide compensation on eligible contracts. On the contrary, the existence of an IGS is unlikely to enhance consumer confidence and financial stability if the IGS is deemed to have insufficient (financial) resources.

121. Establishment of national IGSs might be further motivated by a potential increase in the choice of consumers insofar as the differences between domestic and foreign insurers would be eliminated. Similar to previous arguments, this argument relies on the assumption that consumers are aware and well-informed of the different levels of protection in insolvency and make rational decisions based on this information. The information flow to consumers is captured in Solvency II that requires that "*consumers should be provided with whatever information is necessary before the conclusion of the contract and throughout the term of the contract to enable them to choose the contract best suited to their needs*" (Recital 79 of Solvency II Directive).
122. There might therefore be clear arguments in favour of setting up an IGS from the perspectives of distributing resolution cost to the industry and providing an additional layer of protection to policyholders and, as a result, increasing consumer confidence and choice.

(D) Level playing field across Member States

123. Level playing field considerations provide additional rationales for establishing of a network of national IGSs. The current landscape of different national approaches may raise concerns about the level playing field within the insurance market as well as between different sectors of the financial market.
124. A harmonised approach towards IGSs might be required in order to ensure that policyholders do perceive they have a comparable degree of protection in insolvency across the Member States. As described above, policyholders across but also within Member States could be protected differently. It then may be sustained that this could induce a competitive advantage for insurers covered by an (beneficial) IGS²⁹, assuming that policyholders are aware of the existence and design features of an IGS. Potential negative impacts to the level playing field across the Member States in Europe due to these reasons is not desirable or in the interest of the internal market.
125. Additionally, considerations about the level playing field between insurers on the one hand and banks and investment firms on the other hand might provide another basis for the establishment of a network of harmonised national guarantee schemes in insurance. Non-insurance financial products, such as deposit insurance and investment protection funds, are to some

²⁹ A beneficial IGS refers to a protection scheme that provides the utmost protection to policyholders.

degree protected by the directives on DGS and ICS respectively. Sectorial differences in consumer protection arrangements may negatively affect and potentially distort the level playing field for competing financial products. This is particularly valid for life insurance products for which more competing alternatives are offered by other financial sectors. This argument is perceived to be less pronounced for non-life insurance.

3.6 Preliminary conclusions

126. Without reaching a definite conclusion on the potential need for a European network of national IGSs which are adequately funded and sufficiently harmonised, EIOPA arrives at the following preliminary conclusions:

- There are differences in the national assessment of the need for and approaches towards an IGS which led to the establishment of IGSs in most but not all Member States and, where IGSs were established, to differences in the coverage provided;
- The establishment of an IGS is often prompted by the failure of insurer(s) or distress in the insurance market;
- The primary role of existing national IGSs is to compensate policyholders for their losses in the event of insurance failures, hence, providing an additional level of protection for policyholders;
- The variations in national approaches have resulted in policyholders in the EU being protected differently in insolvency, especially in case of cross-border failures, even though this difference in protection also results from differences in claim hierarchy across Member States;
- A more equal and effective protection of policyholders is a fundamental argument in favour of a more harmonised approach towards IGSs. Other considerations include the involvement of insurers in case of failures, level playing field and improvement of consumer confidence and choice;
- Nonetheless, arguments against the establishment of a network of national IGSs include lower probability of contagion risk in insurance and existing policyholder protection mechanisms such as enhanced supervision which make the need for IGSs less compelling. Also, the need for IGS protection should in any case be seen within a broader context of the recovery and resolution framework. Finally, the potential costs of an IGS, which would also result in additional pressure on the insurer, as well as potential moral hazard effects, do not argue in favour of IGSs.

- The design of an IGS (such as the scope, funding and coverage) is crucial and will ultimately determine to what extent the potential negative effects of an IGS can be mitigated.

127. Taking into account the problems arising from the current situation and the potential advantages of a harmonised approach towards IGSs, EIOPA is of the view that a minimum degree of harmonisation in the field of policyholder protection in the EU would benefit policyholders, the insurance market and more broadly the financial stability in the EU. A harmonised approach should however consider the national schemes already in place and should be carefully designed.

Stakeholder questions:

- Q4) Do you have any comments on the arguments in favour of maintaining the status quo? Are any relevant aspects missing?
- Q5) Do you have any comments on the 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?

3.7 Design features of IGSs

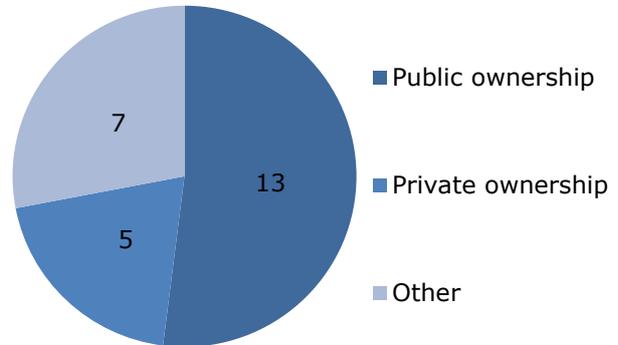
128. As aforementioned, the design of an IGS will be essential in EIOPA's assessment of the need for and approach towards a network of national IGS which is adequately funded and sufficiently harmonised. Reason for this is that the way that IGSs are designed (such as their scope, funding and inter-IGS recoveries) will determine the actual protection provided to policyholders and the costs of the IGS.

129. For this purpose, EIOPA looks into the design features of the currently existing national IGSs and then poses some questions to stakeholders to gather feedback on the potential costs and benefits of the alternative options.

3.7.1 Ownership structure

130. The survey showed that the institutional structure of the national IGSs differs across Member States. A majority of the Member States have chosen to operate the schemes as a public body, while others have opted for a private or other type of ownership (see Figure 5).

Figure 5: Ownership national IGSs



131. Two NSAs added that the schemes are operated by or from within the NSA. Eight other NSAs clarified that the IGSs are regulated and/or supervised by the NSA. In one case it was reported that the schemes are supervised by the relevant ministry.

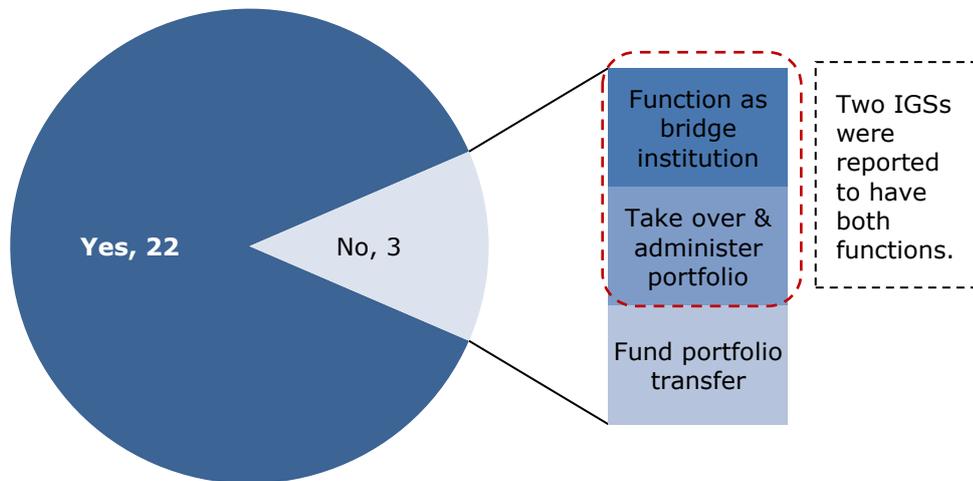
3.7.2 Role of national IGSs

132. The primary function of the existing IGSs is to compensate policyholders for their losses in the event of liquidation. This is true for all existing IGSs except for those established in 2 Member States. In these Member States, the IGSs are used for purposes other than paying compensation to policyholders. In one of the Member States, the national IGSs are in place to ensure the continuation of the insurance policies by taking over and administering the policies and/or to function as a bridge institution. In the other Member State the financial resources of the IGS can be used to fund a portfolio transfer.

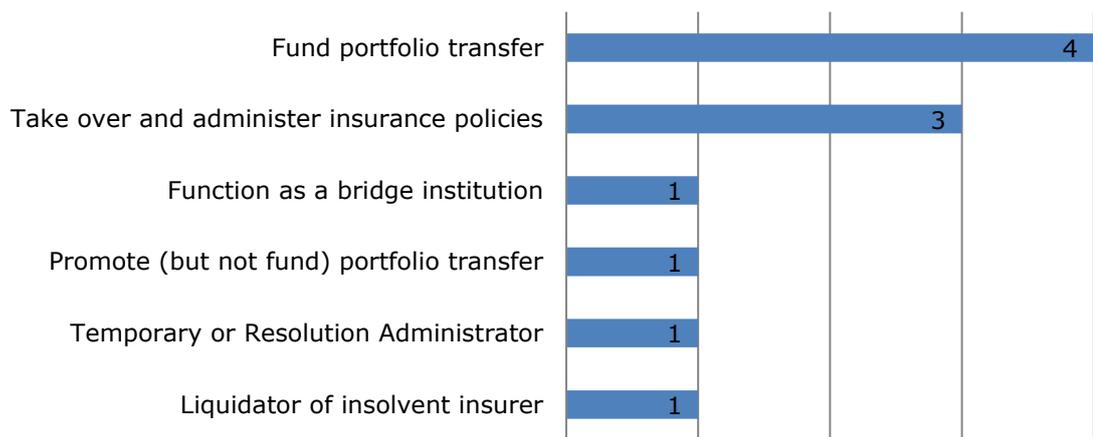
133. In all other cases, IGSs are used to compensate policyholders for their losses. Furthermore, the survey revealed that 8 IGSs have been tasked with additional roles, such as functioning as a bridge institution, funding or promoting a portfolio transfer, taking over and administering insurance policies and acting as a temporary or resolution administrator (figure 6).

Figure 6: Role of national IGSs

a) Compensation to policyholders



b) Additional roles of IGSs compensating policyholders (8 out of 22 IGSs)



Stakeholder questions:

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 insurance policies?

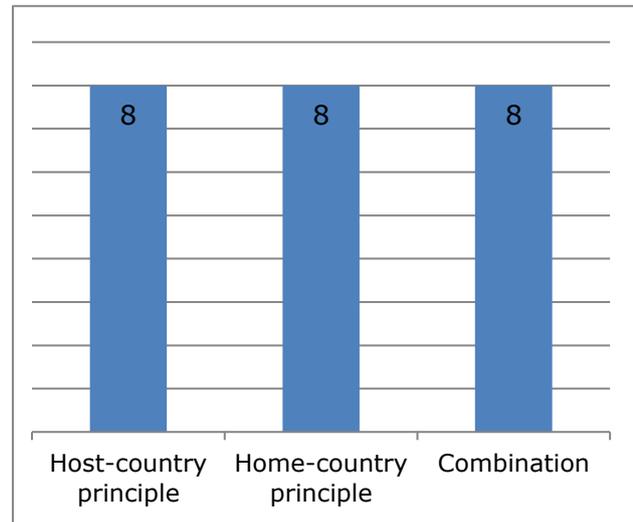
Q8) In relation to this, what are your views regarding the potential benefits and costs of merging the functions of the IGS with those of a potential resolution fund?

Please describe the potential advantages and disadvantages of your choice.

3.7.3 Geographical scope

134. The geographical scope of the IGS protection determines whether policies sold via branches or under Fo8 are covered. Understanding the geographical scope of IGSs is therefore important in a cross-border context. The geographical scope of the IGSs can be shown using the home-versus host-country principle explained in box 4.

Figure 7: Geographical scope of existing IGSs



135. IGSs based on the host-country principle cover policies issued by domestic insurers but do not cover policies sold abroad via branches or FoS. Figure 7 shows that 8 IGSs currently operate under the host-country principle. These IGSs also require EU branches active in their Member States to participate in the IGS.

136. On the other hand, 8 IGSs are operated on the basis of the home-country principle and, hence, cover all policies sold by domestic insurers, directly in the Member State, where the insurer is headquartered, or abroad via FoS or by branches. However they do not require incoming EU branches or FoS insurers to participate in the IGS.

137. Finally, 8 IGSs show a combination of both home- and host-country principles. In 3 of these cases, the EU branches are required to participate in the IGS unless they are covered by a home state IGS that provides (equivalent) protection. For another IGS that is largely operated on a host-country principle, it was explained that the branches of domestic insurers are only covered depending on the location of the insurer's branch and the location of the risk.

Stakeholder questions:

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-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?

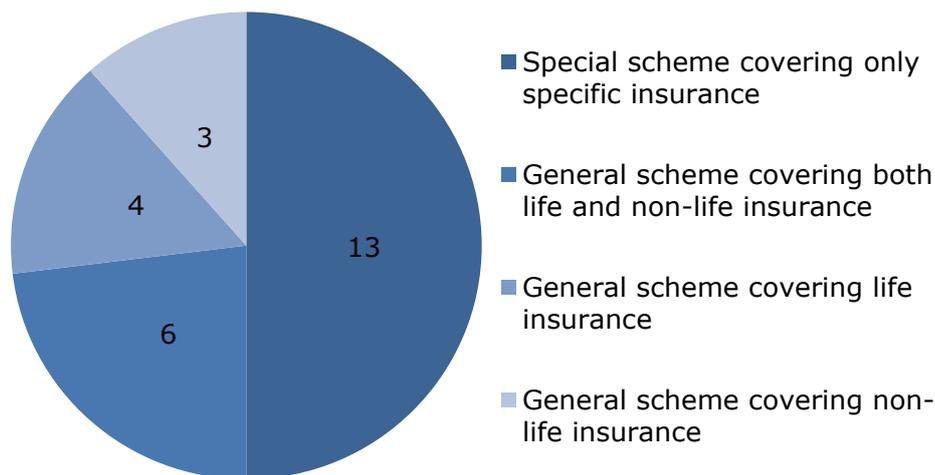
Please describe the potential advantages and disadvantages of your choice.

3.7.4 Policies covered

138. Table 1 already showed the type of policies covered by the national IGSs across the Member States. Figure 8 shows a categorisation of the existing IGSs split into general schemes covering a broad range of life and/or non-life insurance and schemes set up specially for certain insurance types.

139. Half of the existing national IGSs cover selected (mandatory) life and/or non-life insurance policies only and therefore are classified as special schemes. The remainder of the IGSs are general schemes which cover a combination of both life and non-life insurance or only one of the two.

Figure 8: Policies covered by existing IGSs



Stakeholder questions:

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

Q13) Should the IGSs be required to cover, at a minimum, all mandatory insurance 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. unearned premiums and premiums owned by insurers

as a result of the non-conclusion or cancellation of insurance contracts and operations)?

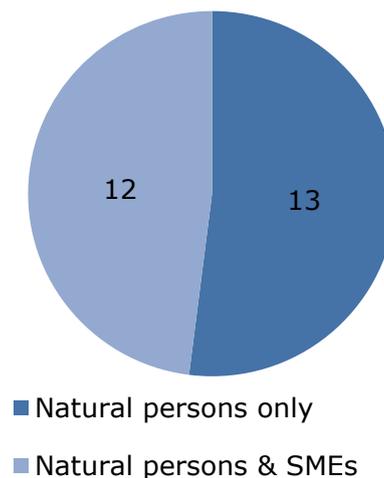
Please describe the potential advantages and disadvantages of your choice.

3.7.5 Eligible policyholders

140. The main question with respect to eligible policyholders is whether the IGS protection is extended to legal entities. The survey demonstrated that 12 of the existing schemes also provide protection to small or medium-sized legal entities (see figure 9); in one case all types of legal entities are protected by the scheme. However, one of the NSAs clarified that the protection to these entities is limited to the compulsory insurance lines covered by the IGS. The other 13 schemes were reported to provide protection to private individuals solely.

141. Furthermore, a number of NSAs explained that there are some restrictions on policyholder eligibility. For instance, it was mentioned that individuals or entities connected to the failed insurer are excluded from the scope. This may include individuals who served in the insurer during a certain number of years preceding the failure as members of its board, directors, managers, including their spouses and relatives up to second grade. Also mentioned were individuals holding more than 5% of the share capital of the insurance undertaking including their spouses and relatives up to second grade and those responsible for auditing the financial statements of the insurer. In one case, it was mentioned that, for compulsory motor insurance, claimants needed to be citizens from the EU/EEA or a country that has reciprocity agreement with Member State.

Figure 9: Eligible policyholders



142. Finally, 13 NSAs reported that their IGSs have limits to the amount of compensation paid per claim or per policyholder. Some NSAs mentioned that the IGS coverage is capped meaning that the compensation paid per claim is limited to a maximum amount which in some cases varies from life to non-life insurance.

Stakeholder questions:

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 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?

Please describe the potential advantages and disadvantages of your choices.

3.7.6 Funding

143. The EIOPA Regulation speaks about “a European network of national IGSs which is *adequately funded* and sufficiently harmonised” (Article 26 of EIOPA Regulation 2010). The article highlights the importance of the need to structure the funding of IGSs in an adequate manner, as the funding structure determines the level of protection to policyholders, as well as the costs for the industry, policyholders and/or public authorities depending on who bears the costs of the IGSs.

Contributors

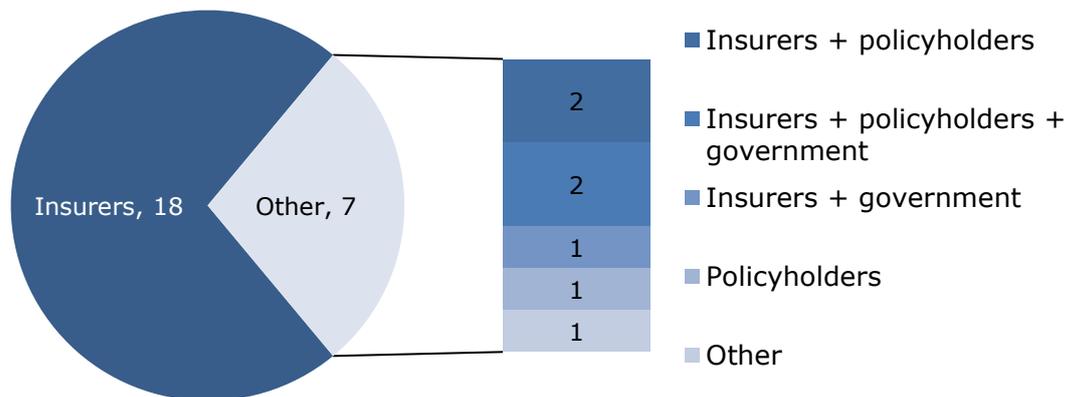
144. Figure 10 shows that most of the IGSs are predominantly funded by contributions from insurers. For 4 IGSs it was reported that the contributions are also raised from policyholders in addition to insurers. In some cases this is based on the provisions in the law which allows for the insurance premiums to be increased with the contribution levels. In other cases, the NSAs clarified that in practice the levies on insurers are passed on to policyholders. Another NSA responded to the survey that the IGS is fully funded by a surcharge on policyholders.

145. Three NSAs also selected government funding as a way to fund the IGSs. One NSA mentioned that an integral part of the funding structure of the IGS is that the government can issue loans to the IGS in order to allow that payments to policyholders are made without delay. The loans are paid back in due course through the industry contributions to the IGS. Another NSA

reported that the IGS is able to take loans guaranteed by the government in case of shortfalls.

146. Finally, one NSA reported that the IGS is funded through a special system of financing by national social security schemes.

Figure 10: Contributors to the existing IGSs³⁰



Timing of funding and contributions

147. Another important aspect of the funding is the timing. In an ex-ante funded IGS, the funds are raised before the occurrence of a failure which means that the funds need to be managed by the IGS until a failure happens. In an ex-post funded IGS, the funds are not raised until a failure occurs. Ex-ante financing does not preclude ex-post contributions to complement financing needs after an intervention.

148. Figure 11 shows the timing of the funding of the existing IGSs. As can be observed from the figure, all alternatives are captured by the IGSs. There are schemes funded on an ex-ante basis, ex-post basis or on the basis of ex-ante funding complemented with ex-post funding.

149. Figures 12 and 13 illustrate the bases for the contributions from the industry to the IGSs. A majority of the schemes use the (gross or net) technical provisions as a basis to calculate the contributions, followed by the (gross or net) written premiums. A small number of IGSs use another basis for the calculation of contributions, such as gross earned premiums.

150. Figure 13 reveals that these contributions are based on a fixed rate or percentage. Only in one case it was reported that the contributions are risk-weighted, i.e. the contributions are calculated according to the risks of the insurers. The respective NSA explained that the contributions amount to a

³⁰ Other sources of funding not shown in the figure include: the issuance of certificates of association, loans, investment returns and amounts received from the property of the bankrupt insurer.

certain percentage of the net technical provisions (recognised in the previous year) multiplied by an individual risk factor which is determined based on the risk measures in accordance with the relevant legislations.

151. Finally, figure 14 gives some other relevant information about the funding structure of the existing IGSs. The figure makes clear that some schemes have upper limits on the annual level of contribution that can be raised from an individual insurer or from the industry as a whole. Additionally, 10 IGSs are equipped with the power to raise additional funding in case of shortfalls. Examples of ways to raise additional funding include: issuance of debt securities, payment of advance annual contributions by the insurers, increase of the amount of the annual contribution.

Figure 11: Timing of funding

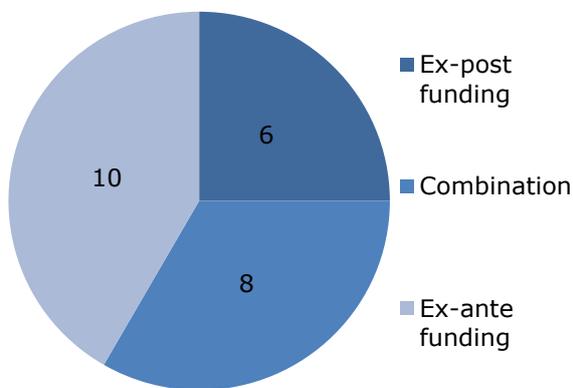


Figure 12: Calculation base

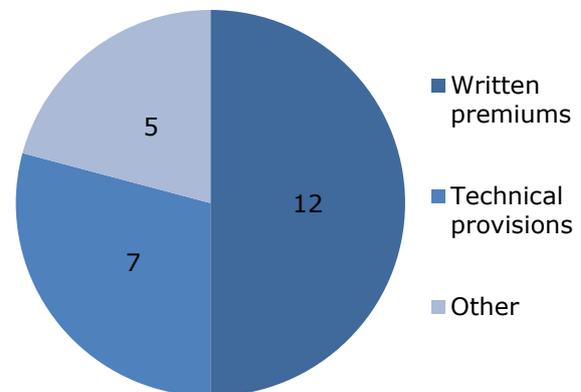


Figure 13: Contribution base

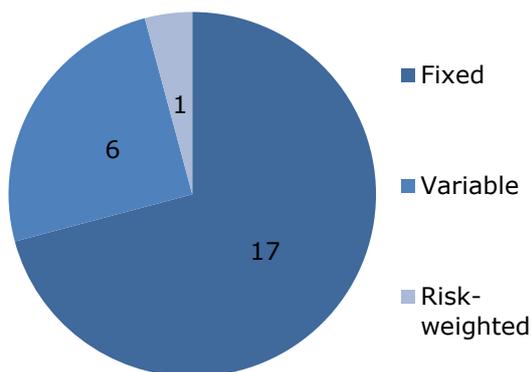
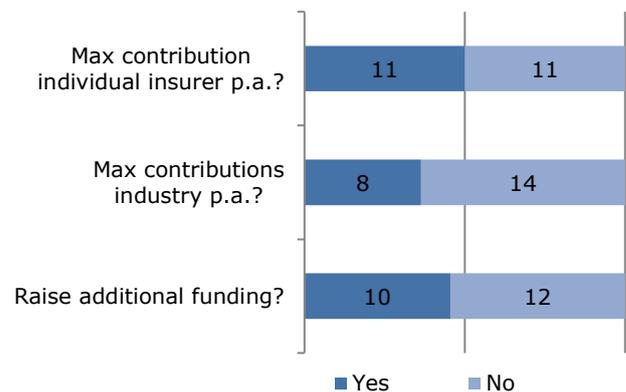


Figure 14: Other information



Minimum level of funding

152. In the survey NSAs were also asked whether the IGS is required to maintain a minimum level of funding. The responses showed that 5 schemes need to have a minimum level of capital which in some cases is defined as an absolute number laid down in the legislation or the level of capital required fulfilling its tasks.

153. One NSA mentioned that the IGS is not required to maintain a minimum level of capital, but in case of resolution it may become the shareholder of the bridge institution and, hence, needs to comply with the capital requirements set out for bridge institutions.

Stakeholder questions:

Q20)What are your views regarding the timing of the funding of IGSs, i.e. funding on an ex-ante basis, ex-post basis or a combination of both?

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 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 IGSs?

Q25)What are your views regarding the power of IGSs to require additional contributions from insurers or raise additional capital in case of shortfalls?

Please describe the potential advantages and disadvantages of your choices.

3.7.7 Disclosure

154. The responses to the survey revealed that for 11 IGSs insurers are required to disclose to policyholders whether their insurance policy is covered by an IGS protection. In most cases this means that the insurance contracts are required to include adequate information about the policyholder protection scheme, such as its coverage and the procedure for obtaining compensation for losses in liquidation. In one Member State, it was explained that the IGS coverage was laid down in the national regulation.
155. Where such a requirement does not exist, insurers are permitted to disclose information to policyholders. However, some NSAs mentioned that this is usually not done due to the possibility of amendments in the policyholder protection rules or due to other reasons.

Stakeholder questions:

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

Please describe the potential advantages and disadvantages of your choice.

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