THE SOCIETY OF ACTUARIES IN IRELAND

Response to the European Commission White Paper on Insurance Guarantee Schemes

November 2010

1 Introduction

The Society of Actuaries in Ireland is the professional body representing the actuarial profession in Ireland. Most of the Society's members work in the financial services industry, and the profession has a statutory role relating to the supervision of insurance companies and pension schemes. The Society seeks to make an impartial contribution to public debate on social policy and public interest matters where an actuarial perspective can add value.

We welcome the opportunity to provide input to the European Commission’s deliberations on Insurance Guarantee Schemes.

2 Key issues

2.1 From a consumer perspective, an Insurance Guarantee Scheme (IGS) presents two key issues, both of which are addressed by the White Paper, namely minimising moral hazard and minimising the frictional costs of the scheme. The two are not mutually exclusive.

2.2 In relation to moral hazard, again there are two issues:

- The scheme should not incentivise riskier behaviours by insurers;
- Nor should it incentivise consumers to take out policies with riskier insurers on the basis that they have a safety net.

2.3 As indicated in the White Paper, measures to mitigate moral hazard could include:

- Funding on an *ex-ante* basis, which means that any insurer that defaults will have contributed to the scheme – this may discourage excessive risk-taking;
- Calculating the funding contribution from each insurer in proportion to the riskiness of its business;
- Capping the level of compensation, such that consumers are not fully compensated for an insurance company failure.

2.4 These measures have the potential to be valid in this context, but the devil will be in the detail.

- It is not clear from the Paper how the risk level of insurers would be measured. It may be sensible to utilise Solvency II Solvency Capital Requirement (SCR) measures as a basis for this. However, this approach may need to build in some allowance for the level of available capital above the SCR. Ultimately the funding contribution should be in proportion to the risk of default and the cost of benefits payable from the IGS in the event of default.
- Limits on the level of compensation would need to be set sufficiently high to mitigate financial hardship that could be caused by a failure to meet a claim, for example, but not so high as to result in moral hazard or excessive costs.

2.5 In terms of the frictional costs issue, it is hard to avoid the fact that a scheme of this nature will come at a cost. Having an *ex-ante* scheme will increase the level of administration costs (management of Scheme assets etc), compared with an *ex-post* scheme. There will need to be a transparent mechanism in place to ensure that these costs are kept at a minimum. Some of the measures described in the paper will reduce costs by reducing the scope of the scheme or the benefit levels provided, but there are no concrete suggestions in relation to minimising frictional costs.

3 Other comments

3.1 Home country or host country approach: whichever approach is taken, it would be important to have consistency between the funding of the IGS and the benefits payable – i.e. it would be inappropriate for funding to be on a home country basis and benefits on a host country basis or *vice versa*..

3.2 The impact of an insolvent insurer will be very different according to whether it is a life or non-life insurer. Care will be needed around the point of insolvency, in particular in relation to moral hazard. For a non-life insurer insolvency, the biggest issue will be outstanding claims, rather than the issue of having paid a year of premium in advance. It will be important to treat consumers fairly where claim events arise around the time of insolvency. Consumers will need to have time to put appropriate alternative cover in place, but it would be unfair on other consumers for an IGS to pick up costs arising from a failure to do so in a prompt manner.

3.3 From a consumer perspective, it makes sense to have the IGS step in before insolvency if its actions can prevent insolvency, but this may require considerable expertise, and at what cost? The IGS in that circumstance would be more than a funding mechanism, and may have to make more difficult decisions around resource allocation.

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