ASSOCIATION OF INTERNATIONAL LIFE OFFICES

European Commission,

Internal Market H2

November 23 2010

Dear Sir,

The Association of International Life Offices[1] ("AILO") represents the interests of a number of EU/EEA and other life insurance companies, many of which are members of internationally recognised groups. AILO members market life insurance contracts in the EU/EEA and in other regions of the world. The customer base encompasses residents in EU/EEA States, international and European expatriates and also the international business community. For further details: www.ailo.org.

AILO is grateful for the opportunity to comment on the European Commission's White Paper on Insurance Guarantee Schemes ("IGS").

Objectives of the White Paper

Whilst the risk-based approach of Solvency II, once implemented, should reduce the risk of an insurance insolvency, AILO recognises that harmonising national rules on IGS in the EU could indeed achieve the objectives set forth in the White Paper such as improving policyholder protection, and promoting cross-border insurance.

AILO particularly supports the key objective of avoiding competitive distortion.

For cross-border insurers, it is also essential that improved policyholder protection does not incur disproportionate cost for the industry. If it did, this cost would ultimately be passed on to policyholders. Assuming that IGS do not encourage moral hazard, then they should also enhance market confidence.

Nature of proposed approach

AILO does not favour a "soft law" instrument. A legally binding act is required in order to achieve the objectives noted above.

A directive is one possible approach. We recognise that a directive is a suitable form of legislation for reducing the current fragmented situation which will otherwise continue to exist within the EU. However, AILO is mindful of the inherent difficulties of legislating through directives. AILO recalls that the de Larosière Report specifically counsels (in Recommendation 10) that Member States and the European Parliament refrain from putting in place legislation that leaves room for inconsistent transposition and application. The group of wise men was concerned that any national exceptions or options should not disrupt the functioning of the single financial market, particularly the efficiency of cross-border financial activity in the EU, distort competition or provide opportunities for regulatory arbitrage. We therefore urge the Commission also to consider the merits of proposing a regulation – even though the corresponding protection in the banking and investment services sectors is based on directives.

[1] AILO's registration number on the European Commission's register of Interest Representatives is 61392612625-67

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Level of centralisation and role of an IGS

AILO concurs that IGS should be established in each Member State and that it should be a last resort mechanism. This approach is particularly relevant for life insurance where, in our opinion, the primary objective, when an insurer is in financial difficulty, should be the continuity of cover for affected policyholders. Transfer of a portfolio to another insurer may or may not require funding support from the IGS. The policyholder may no longer be in a position to obtain similar cover to his or her existing policy due to changes in age and health and the fact that the contract's value will reflect the payment of premiums which have not yet been earned.

Geographical scope

To our mind this represents the most difficult aspect of the proposal for we can see clear benefits and disadvantages of both the home and host State approaches. On balance, as explained below, we retain a preference for the home State approach. However, if the Commission takes a minimum harmonisation approach, we make an important caveat regarding competition/unfair commercial practices as also explained below.

It seems to us that the only comprehensive way forward would be to permit a hybrid solution. Thus a cross-border insurer could either elect to opt out of their lower benefit, Home State scheme and voluntarily join the host State scheme, or contribute to both. However, this is unlikely to appeal to Regulators and would probably require an ex-ante funding mechanism. This mechanism would also require clear rules as to the share of compensation provided by each. In addition, if this were to be permitted then logically a cross-border insurer should be able to opt out of a higher benefit scheme and join a lower benefit scheme in another State, so that the whole purpose is effectively destroyed. In order to avoid this perverse result, it seems to us that we are left with a prohibition on the amount of compensation from a scheme being relevant to an intermediary's advice and advertising. We discuss this point further below.

Host State basis

Pros

At first sight, we recognise the attractions of this basis to a cross-border insurer, as the result would be that domestic and cross-border insurers from within the EEA compete on the same footing to provide the same amount of protection.

Cons

However, the advantages of host State coverage will be outweighed by the cost and administrative burden to insurers of maintaining membership in multiple IGS schemes. For example, the UK scheme already requires cross-border insurers based in, say, Ireland to make contributions and to report regularly. If this were to become the general rule, the insurer would be subject to considerable IT and other compliance costs as systems would need to be amended to reflect the requirements of each host State scheme.

Assuming an ex-ante funding basis was adopted, then we would expect that different levy rates will apply in each host State. Each contribution would need to reflect the actual amount of business the insurer writes in the State rather than total business written.

We are also concerned about how the schemes would function for migrant policyholders. Given that labour mobility is a priority within the EU, managing IGS coverage for migrant policyholders would impose a further administrative burden and cost on insurers. Depending on definitions, if a policyholder moved from host State A to host State B, then it is most likely that IGS levies and benefits would alter to reflect that fact.

In addition, there could be practical difficulties in an insolvency – under the Directive on the reorganisation and winding-up of insurance undertakings[2] - since the State operating the IGS would not be the State responsible for winding up.

Home State basis

Pros

A home State approach would be consistent with current legislative and supervisory trends and would make operating the IGS and handling re-organisation or winding-up more consistent. It would also be in line with rules for other protection schemes such as deposit guarantees. All domestic insurers would be treated the same, irrespective of where business is written in the EU.

Cons

As we understand the intention is to develop a minimum harmonisation Directive, providing guaranteed minimum protection, then taking a home State approach would lead to variable coverage for policyholders across the EU as cover would probably differ, depending on the domicile of the insurer. This variation would create a risk of regulatory arbitrage. It could also cause difficulties for intermediaries when they provide advice pursuant to obligations under the Insurance Mediation Directive ("IMD"). Insurance brokers may be concerned that, if they recommend a cross-border insurance undertaking which is not a member of a local IGS, they may be open to criticism from their clients, or, even, incur liability in the event of subsequent insolvency of the undertaking. Similarly, certain domestic insurers subject to the IGS of the host State in question may be tempted to play upon this broker concern in order to discourage the broker from placing the business with the cross-border insurer.

These are major concerns for cross-border insurers and AILO has anecdotal evidence of intermediaries currently providing advice on the basis set out above – to the detriment of cross-border insurers which are authorised in a home State which does not have an IGS, or whose IGS provides lower protection than the scheme in operation in the host State. There is also anecdotal evidence of insurers actively pointing to the risk of taking insurance with a cross-border insurer on the basis that policyholders of this cross-border insurer will not benefit from the local IGS.

We are also concerned that, if the new legislation were to result in significant differentiation between national schemes, insurers and brokers could be tempted to advertise these differences in order to gain market share. It is our view that this could breach EU unfair commercial practices rules that prohibit the advertising of benefits that apply as a matter of law. Annex I of the Unfair Commercial Practices Directive[3] sets out a "blacklist" of misleading commercial practices which are always considered unfair and, therefore, prohibited. Point 10 of Annex I includes the following misleading commercial practice: "*Presenting rights given to the consumer in law as a distinctive feature of the trader's offer*".

Our comments above focus on advertising and advice and so we submit that any proposed Directive (including a revised IMD) include a provision reflecting the following high-level considerations:

- Nothing in an IGS directive or revised IMD shall affect the right or obligation under national law of an insurance undertaking to refer to membership of an IGS in its documentation, i.e. as a factual reference in its "corporate stationery".

- As a general principle, an insurance undertaking's membership of an IGS shall not be a factor in an insurance intermediary's consideration of an insurance contract.

[2] Directive 2001/17/EC, in particular Articles 10 and 11. Article 10 sets out the precedence of insurance claims over other claims, while Article 11 provides "The home Member State may provide that, where the rights of insurance creditors have been subrogated to a guarantee scheme established in that Member State, claims by that scheme shall not benefit from the provisions of Article 10(1)." (our emphasis)

[3] Directive 2005/29/EC.

- Insurance intermediaries (tied insurance intermediaries) acting for undertakings which are members of an IGS must not refer to such membership (or the minimum IGS guarantee level of another undertaking) as a distinctive feature when advertising or proposing a contract to a customer, or when comparing a contract from a competing undertaking with the contract advertised or proposed. Similarly, insurance undertakings must not, for example in the context of direct sales or in dealings with intermediaries, themselves refer to membership or absence of membership when advertising or proposing a contract or comparing a contract from a competing undertaking.

- The subsequent insolvency of an insurance undertaking which offers the minimum level of IGS benefit shall not give rise to liability of the intermediary towards the policyholder based on the fact that the insurance undertaking did not offer enhanced protection.

- Finally, restricting any reference to IGS to a factual reference in corporate stationery would ensure compliance with the prohibition in the Unfair Commercial Practices Directive against presenting rights given to the consumer in law as a distinctive feature of the undertaking's offer (whether direct or through an intermediary).

The above considerations also reflect and develop the current position under EU law; the Deposit Guarantee Schemes Directive expressly refers to factual references and limitations on advertising[4].

Policies covered

AILO concurs that IGS should cover both life and general insurance. However, it is essential that any ex-ante funding should only be used for insolvencies within the relevant classes of insurance. In the same way that life and general insurance business has to be segregated, two separate schemes might be more appropriate. (We have no comment as to whether it would be practical to split general insurance into more sub-classes).

Eligible claimants

We believe that an IGS should include all natural persons and beneficiaries, whether as nominees or beneficiaries under a legal arrangement such as a trust or foundation and include individual pension policies which are effected with the employer as policyholder but with the employee as beneficiary as is common in some States such as Germany and Sweden

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[4] See Article 9(3) of the Directive which provides, "1. Member States shall ensure that credit institutions make available to actual and intending depositors the information necessary for the identification of the deposit guarantee scheme of which the institution and its branches are members within the Community or any alternative arrangement provided for in the second subparagraph of Article 3(1) or in Article 3(4). The depositors shall be informed of the provisions of the deposit-guarantee scheme or any alternative arrangement applicable, including the amount and scope of the cover offered by the deposit guarantee scheme. When a deposit is not guaranteed by a deposit guarantee scheme in accordance with Article 7(2), the credit institution shall inform the depositor accordingly. All information shall be made available in a readily comprehensible manner.

Information about the conditions for compensation and the formalities which must be completed to obtain compensation shall be given on request.

2. The information provided for in paragraph 1 shall be made available in the manner prescribed by national law in the official language or languages of the Member State in which the branch is established.

3. **Member States shall establish rules limiting the use in advertising of the information referred to in paragraph 1 in order to prevent such use from affecting the stability of the banking system or depositor confidence. In particular, Member States may restrict such advertising to a factual reference to the scheme to which a credit institution belongs.**" (our emphasis)

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Funding

Again, it is possible to argue either way for both an ex-ante and an ex-post approach. Solvency II should mean that insolvencies are less likely, and so it could be argued that the need for ex-ante funding is reduced. However, on balance, we conclude that an approach which includes at least an element of ex-ante funding is preferable because all insurers contribute, including any who may subsequently become insolvent. We make no comment on target levels of funding at this stage.

Portfolio transfer and/or compensation claims

As indicated earlier, we consider that the purpose of an IGS covering life insurance should be to facilitate portfolio transfer(s). Logically, any ex-ante contributions to an IGS should be reduced to reflect that fact. Additional ex-post funding would be required if portfolio transfer is not attainable or if the IGS has to make a contribution to a transfer and suffers a shortfall. We also concur that IGS should compensate policyholders within a pre-defined period which must be of sufficient length to enable all legal formalities for a transfer to have taken place and to ensure that supervisors have taken all steps necessary to assist the process.

We shall be pleased to assist the Commission with any additional questions and to participate further in the consultation process in the coming months.

Yours sincerely,

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Association of International Life Offices