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## Do they serve a purpose ?

- Life Insurance by definition is a) long term & b) based on perception of trust
- Perception of trust should be of comparable duration
- No long term trust = No long term business ?
- Life Insurance is only attractive if people trust that companies will meet in full their commitments in the long term
- There is always the possibility of things going wrong
  - Task 1 : Minimize this possibility (joint responsibility of Market + Supervision)
  - Task 2 : Apply the right treatment
- Life Insurance Guarantee Schemes (LIGSs) are purposed to be the "safety net" tool to ensure that institutional credibility is not lost
- LIGSs should operate as "last resort"

## Basic principles

- Should LIGSs be imposed across all companies OR should participation be at company's discretion ?
  - all companies are trustworthy at outset of an insurance contract. Otherwise they should not be allowed to write new business by the supervisor
  - Can future long term credibility be the subject of competition between companies ? **NO**
  - Clear advantage when LIGSs are compulsory. However, different solvency profiles of companies should result to different levels of contributions to LGF (range)
- LIGSs must be independent entities, not run by the industry. BoD members appointed by state / supervisor must be majority

## Criteria to be met trigger scheme design

- Consumer protection
  - Risk mitigation in the event of failure
- Market confidence and stability
  - Increased confidence promotes demand and enhances stability
  - but, funding requirements may impact financial position of companies
- Moral hazard
  - Structure must minimize excessive risk taking behaviors or other distortions
- Fair / Proportional redistribution
  - Not easy to define objectively, some schemes can be fairer than others
- Provide compensation to insured or/and secure continuation of contracts
  - Direct payments should only happen when other options are exhausted

## Regulation and LIGSs

- Failures have been rare and have not challenged systemic stability
- SOLVENCY II will certainly reduce the incidence of failures going forward
  - However, even the new regime does not create a zero failure environment
- LIGSs should strictly be mechanisms triggered only when other protection mechanisms fail
- Costs to provide the guarantees generally below 0,1% of gross premiums even in markets with relatively frequent failures. Expected rate of failure will become even smaller
- Large failures if dealt with through LIGSs will result to increased funding requirements. Facing large failures should trigger other mechanisms too

## Limitations

- Similar schemes in other financial services pave the way (banking, investments)
- Redistribution of funds from solvent to insolvent players and between their customers respectively, should limit moral hazard
  - guarantees should not cover 100% of the claim
  - an absolute maximum
  - a low common threshold + x% of the balance
- Moral hazard behaviors must be contained through a risk based approach to regulation (SOLVENCY II)
- LIGSs may follow similar approach by levying risk weighted contributions to insurance companies

## Funding

- Too many parameters
  - common rate vs rate by product type
  - initial phase of LIGS vs mature phase
  - fully loaded on premium vs sharing between customer and company
  - flat across all players vs risk weighted contributions
  - extent of guarantee
  - pay as you go vs accumulated provisions
- Funding rates must meet affordability & adequacy criteria (if LIGSs are meant to instill market confidence and promote demand)
- Rule of thumb : 0,3% on premiums is considered adequate up to 0,6% when funds are being at initial phase. SOLVENCY II will eventually decrease rates

## Harmonization across EU

- To date, a high degree of differentiation between member states
- Not even two countries with same rules
- Again, other financial markets pave the way. Harmonization of guarantees on deposits across EU sealed as of this year
- However, wide product variations in Long Term Life Insurance from country to country, is a barrier to adopting common rules for LIGSs across EU
- Operate LIGSs on host country base OR on home country base ?
    - Host : Level playing field in the same jurisdiction
    - Home : Rules for LIGSs should follow same rules for supervision

## Take away notes

✓ LIGS are **NICE TO HAVE**, they add value to consumers' trust i.e. they have a positive impact on a market driven by perceived confidence

✓ Similar Schemes in other markets competing with Life Insurance in the "share of wallet" battle, make LIGS a **MUST HAVE** too

✓ LIGS must remain **independent last resort mechanisms** igniting only when all others actions for securing customers' expectations have been exhausted

✓ Design and (hence) funding depict criteria adopted and priorities set. **Confidence, market stability and acceptable level of moral hazard are keys to decide upon structure of LIGS.** Funding must be affordable and adequate. New regulatory environment reduce funding rates eventually but they do not promise a zero risk environment

✓ Harmonization across EU hard to accomplish but some initial steps for implementing common basic rules must be made. **By 2020 with SOLVENCY II well in place, harmonization will be easier**