Director General

To: IMF
International Monetary Fund (IMF)
700 19th Street
N.W., Washington D.C. 20431

Your reference: -
Our reference: ECO-10-014

Subject: **Insurance industry comments on IMF financial services taxation study**

Brussels, 01 February 2010

Dear Sir/Madam,

The strength and impact of the measures taken by world leaders in response to the global economic crisis and the coordination of activities at G20 level has been unprecedented. The CEA, the European insurance and reinsurance federation, is closely following the G20 process, as cooperation will be essential to ensure that consistent measures are taken across the globe, to avoid regulatory fragmentation and to reduce market distortions and opportunities for regulatory arbitrage.

We have noted the G20 leaders' request that the IMF prepare a report "*with regard to the range of options countries have adopted or are considering as to how the financial sector could make a fair and substantial contribution toward paying for any burdens associated with government interventions to repair the banking system*". In response to this request, we understand that the IMF is seeking stakeholders' views by 1 February 2010 on the potential usefulness and impact of various approaches to financial sector taxation to consider in their study.

In considering the case for a "Financial Service Tax" and in analysing the different options countries have adopted or are considering, we would like to encourage the IMF to take the following points into account:

- **Differences in the type and level of risk posed to the economy by different financial institutions need to be recognised**

  It is regrettable that some of the proposals that have been put forward so far do not acknowledge the distinct characteristics of different financial institutions and may require the wider financial sector to cover the costs of bailing out some of its sectors, i.e. banking.

  The insurance industry was not the source the crisis, but has been affected by it. The unique characteristics of the insurance business model — a more prudent, long-term investment strategy and the active management of assets and liabilities — have protected the insurance industry from the worst impacts of the financial turmoil. Due to the significant differences in the business model of (re)insurers and banks, insurance does not generate the kind of systemic risk that arises in banking.

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Furthermore, financial problems materialise more slowly in insurance than in banks, allowing for earlier intervention by the insurers' management and ultimately the supervisory authorities. Even if corrective measures are not effective and do not prevent an (re)insurer from dropping below its minimum capital requirements, the likelihood that an insurance claim is not paid out is minimised by the fact that the insurer has to maintain sufficient assets to cover its statistically anticipated claims (technical provisions). This makes it possible to transfer insurance liabilities to another institution or to put them in run-off (meaning that existing contracts will be honoured until they expire).

The European Union is currently developing the most advanced prudential regulatory framework for the supervision of the insurance industry – Solvency II – which requires the consideration of all assets and liabilities of the (re)insurer under a total balance sheet approach and which sets capital requirements based on the insurer's true risk exposure. European insurers believe Solvency II is also the timely and appropriate answer to the crisis for the insurance sector and trust it will be a benchmark at global level.

- Cross-subsidisation is inappropriate as it rewards riskier sectors on the expense of less risky sectors

As different financial institutions pose very different types and levels of risks to the financial system and the economy as a whole, we believe that it would be inappropriate to penalise the financial sector as a whole for the risks and shortcomings in one sector. Such an approach may be even counterproductive: by spreading contributions equally throughout the wider financial sector, moral hazard would be exacerbated as riskier business sectors would be covered by the contributions of more conservative ones. Differentiating levies to reflect the risk posed by a financial institution in order to minimise the moral hazard would be unworkable as levies need to be kept relatively low if they are not to distort the economic contribution of an efficiently functioning financial sector. The varying risk of financial institutions means it would be very difficult to calibrate an appropriate levy that fairly reflects the diversity of individual firms.

- The cumulative effect of measures needs to be considered

Policy-makers are rightly considering new or strengthened measures to reduce the likelihood and impact of future financial crises. However, we are deeply concerned about an inappropriate spill-over of measures taken to address problems in the banking sector to the insurance sector in general, and the cumulative effects of the different measures for the insurance industry. There is a risk that inappropriate measures may prevent financial services from performing efficiently their role of providing capital to the real economy. Insurers have a major stake in the efficient running of the global financial system, not least as providers of capital to the banks.

An upfront charge poses a serious challenge because it would be almost impossible to calculate a reasonable level of fee. The advantage of existing arrangements is that the penalty costs of drawing on liquidity support fall on those who actually need it.

The CEA therefore urges the IMF to study the options very carefully before making proposals, as there are significant operational difficulties with many of them. We would be pleased to provide you with any additional information you may require or to answer any questions you may have. We look forward to responding again when the IMF publishes its initial study.

Yours sincerely,

Michaela Koller
Director General