Comments Template on CEIOPS- Consultation Paper on the Draft L2 Advice on SCR Standard Formula – Article 109 j Simplifications/Specifications for captives		
Name of Company:		
Disclosure of comments:	CEIOPS will make all comments available on its website, except where respondents specifically request that their comments remain confidential. Please indicate if your comments should be treated as confidential:	No
Reference	**Comment**	
General Comment	ECIROA appreciate being given the opportunity to comment on this draft paper. When considering these comments, it is important to recognise the special nature of captive companies which differ from commercial insurance and reinsurance undertakings in that:- (1) They write a restricted number of lines of insurance business (property, liability, for example) and normally issue a small number of policies (e.g. global programmes with one policy per insurance class) (2) They insure or reinsure a restricted number of risk units (sites, vehicles, for example) (3) They have a restricted number of insureds, or clients. ***Please note that where a comment has not been made on a particular paragraph, this does not indicate that we agree with the paragraph.***	

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1.		
1.1.		
1.2.		
1.3.		
2.		
3.		
3.1.		
3.2.	As business accepted and ceded can change quickly, as CEIOPS writes, we suggest that captives should be handled with a more case-by-case based supervision. To acknowledge the business model of a captive as described it is important that Solvency II for captives remains principle based. As captives cover a limited number of risks the law of large numbers does not play for them. That's why the captive premium level is traditionally safer and the associated loss ratio far lower than the traditional market one. The purpose being to have a mutualisation over time regarding the captive structure.	
3.3.	This comment is making a connection between capital and costs but does not mention risk. Captives are normally small undertakings which either employ a limited number of their own staff or outsource their administration to professional captive management companies. They do not need additional internal resources (which would have a significant impact upon their operating costs) and there is therefore no incentive for them. A mixed view on costs, increased capital charge and incentives to put resources in place is not based on a logical rationale. The result will be the opposite of what we are trying to achieve (i.e.	

	simplifications). We agree that it is important to quantify the risk but this should not lead to higher internal costs.	
3.4.		
3.5.	ECIROA is pleased to note that the work produced during the National Guidance is recognised, but would like to emphasize that whereas the QIS 4 has proved the calibration of these propositions, factors like the standard deviation have been increased to values higher than the ones proposed in other consultation papers.	
3.6.		
3.7.		
3.8.	ECIROA believes the captive definition in place in the level 1 text is sufficient to handle captives under a principle based system. Limitations to the application of simplifications is not necessary as captives are not exempted from Solvency II and as captives will follow the 99,5% confidence level requested by the new framework. The simplifications suggested will give the same result as the standard formula (tested with the national guidance under QIS4) but the result will be easier to calculate and to understand. ECIROA instead recommend a principle based system in which the local supervisor could deny the use of captive simplifications should the supervisor deem the captive risk to be too complex (as compared to a local supervisor having the power of asking for an internal model). As a general remark, we do not understand the use of the phrase 'unexpired risks' and ask for an explanation of what is meant by this phrase. Option 1A (a)(i) & (ii) ECIROA considers this wording to be too restrictive because: – (1) this will exclude any employee benefit business underwritten by captives (where the insured person could be the employee and therefore not a legal entity); (2) there are circumstances where captives may be insuring entities outside of the group (e.g. providing run-off cover for past liabilities for companies	

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	which were once part of the group and have now been sold; insuring joint venture companies etc.); and (3) companies may acquire new entities during the course of the year and need to insure them with the programme already in place. The suggested wording refers only to legal entities of the group at the time the contract was entered into. (Another example is Construction All Risks policies where projects could be added to the scope of the risks underwritten during the course of the policy year). Option 1B (a)(i) & (ii) ECIROA considers this wording to be too restrictive because Beneficiary has not been defined and in some countries can be interpreted as a natural person. This excludes captives which are underwriting employee benefit business where the Beneficiary is the employee (this is the normally the case for these policies where the policyholder is the group company and the beneficiary is the insured person or employee). We suggest that Option 1B(a) is not necessary and should not be used. Option 1 B (b) The classes of insurance which are deemed compulsory vary in different countries. Programmes underwritten by captives are generally global and the cover provided will be compulsory in some countries but not in others. It is therefore difficult to see how this wide-ranging exception could be applied. Additionally, the majority of third party insurance policies do not confer any rights to the policyholder to claim directly on the policy. The insured person is the company or entity and the liability owed to the third party is owed by the company (which can be held legally liable to respond regardless of any insurance policies underwritten by their captive or by the conventional insurance market). The insurance policy is only providing the means for the compensation to the third party to be paid. Provided the captive meets its SCR, ECIROA sees no reason why captives can not provide third party liability insurance, including compulsory classes. From the information we have, only approximately 40% of captives **do not** write third party risks. In line with the target of Solvency II i.e. the desire for transparency and the protection of the insured persons, ECIROA would accept that simplifications should not be allowable for captives which underwrite **direct** third party business (i.e. where the insured person has the right to make a direct claim on the policy). However, simplifications should be allowable for captives which reinsure third party risks. There are never any circumstances where an insured person can make a direct claim on a	

	reinsurance policy. ECIROA agrees with Option 2B (that Option 2A should not be included). (1) Insurance and reinsurance companies rely upon their own due diligence and internal guidelines when deciding whether to insure or reinsure to a captive. This is a business risk which does not form part of Solvency II and the companies should be allowed to decide whether they will accept this risk. (2) Such a structure of an insurance programme may challenge the existence of a real risk transfer and ECIROA sees this as impossible. Additionally, if the contract does not include any risk gap, under IFRS it may not any longer be classified as an insurance programme.	
3.9.	The paragraph should be deleted.	
3.10.		
3.11.	Please see the comments under 3.8 above.	
3.12.	We refer to CEIOPS text in point 3.3 where simplifications were deemed to produce a higher capital charge and would like to point out that this is contradicting the fear expressed in 3.12 that the protection of the "beneficiaries" would be undermined. A point to note is that captives usually have only a limited exposure (e.g. first layers). They are often used for compulsory risks because there is no other market. In this case, using a captive provides much more security for third parties than the application of a deductible on the insurance policy (written by the commercial insurers) which is borne by the Insured.	
3.13.	Please see the comments under 3.8 above. Third party liability risks have not been defined in the IAIS paper and assumptions should not be made as to what they are referring to. As the regulatory risk inherent in a captive (re)insurer can vary substantially it is important that the	

	principle based system is maintained in order to allow the local supervisor to make a judgement.	
3.14.	Please see the comments under 3.8 above. Captives normally write global programmes and simultaneous payment clauses are not allowed in all jurisdictions. The framework should not steer captives towards adopting new clauses in their insurance contracts. Captives being regulated with the same confidence interval as other undertakings, ECIROA does not see the objective of this point as captives will have the same level of prudence and security as other undertakings. We cannot see the link to the rationale of Recital 14a.	
3.15.		
3.16.	ECIROA fear that most captives will not qualify to use the captive simplifications under the suggested limitations. The scope of application would be less than 40% of the market. Besides, the application of QIS4 has been made also with the extensive use of proxies proposed in QIS 4 to simplify the calculation. In particular, the use of discounting factors for the estimation of best estimate of the technical provisions as well as the risk margin proxies (cf TS IV I and TS IV N) has been used by most QIS 4 participants. At this stage, we do not see any reference to this in the recent Consultation papers and would like to ensure such proxies will still be proposed in the future QIS5 for all undertakings. One option would be to mention them in this consultation paper.	
3.17.	ECIROA support the national QIS4 guidance. The risk is limited to the aggregate limits; Not taking into account this element could lead to a premium and additional non life premium risk higher than the aggregate limits meaning a 0% default probability (and not 0.05%) and a double-counting with the counterparty risk of insurer/reinsurer supplying the aggregate limits.	

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3.18.	Groups do not retain their profits in their captives – they retain risks in their captives which may have a good loss ratio. They accept the possibility of a variation in the profits (and losses) within their captive over time. ECIROA believes that the formula should be calibrated to recognise that captives have a lower combined ratio than 100% (as assumed in the standard formula). It is important to recognise that the expenses structure and the business model of a captive typically give a lower combined ratio than for a commercial insurer. The effect of not considering this lower combined ratio is a confidence level higher than the 99,5% requested. By using a uniform assumption of a 100% combined ratio, companies with a lower ratio will produce a higher confidence level than requested and companies with a higher ratio will produce a lower confidence level. This should be recognised. ECIROA understands there are discussion on the definition of the combined ratio and would like to propose the following one : ■ COMBINED RATIO is the sum of the expense ratio and loss ratio. This figure provides a single useful figure for measuring the captive's overall underwriting results, although it ignores investment income. ■ LOSS RATIO is the ratio of losses and loss adjustment expenses to captive earned premiums. This ratio gives the percentage of each euro that goes to pay losses and related expenses. The loss ratio usually range between 45% and 100% over a five-year period. ■ EXPENSE RATIO : This is the ratio of non-loss expenses to captive written premiums. It is a measure of how much of each captive premium euro goes to running the captive. For a captive program, this ratio usually does not exceed 25%. ECIROA also proposes that the consultation paper asks the industry for propositions on how to calibrate	

	the estimation of the combined ratio. One option would be to consider averages on a number of years depending on the class of business (CF TS XIII B 15), more detailed propositions could be made .	
3.19.	ECIROA support the use of a uniform standard deviation and correlation factors for all lines of business. In QIS 4, the proposed factors have proved to be consistent. Considering the maximum amount from the propositions made in CP 48 is a prudent approach.	
3.20.		
3.21.	ECIROA trust this point to be very important for all undertakings and is pleased to note that CEIOPS is considering the propositions made by the industry	
3.22.		
3.23.	Captives typically limit their risk by underwriting insurance policies subject to an annual aggregate limit. This limits their exposure for a particular class of business. Additionally, they may purchase stop loss reinsurance to limit their exposure for one class or multiple classes. These aggregate limits should be taken into consideration in the calculation of premium and reserve risk.	
3.24.		
3.25.	Captives normally do not have regional but global portfolios. The diversification of risk is geographically spread and not by the number of insured persons. Therefore, regional scenarios will not apply. ECIROA suggests that Method 1 should use model that would replace the tail of the LogNormal distribution by the tail of the Pareto distribution. We remain available to present CEIOPS such an approach either in this WG or in the CAT risk WG. This approach would also be taking into account the lower combined ratio being recognised as for premium risk. The use of aggregates (as described in 3.23 above) should be recognised. The CAT risk sub module should take into account the aggregate limits that stop the Captive	

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	commitment. Furthermore, there should be a link to premium risk. The maximum claim charge is limited by the aggregate limit. Part of this exposure limit is covered by the premium and the premium risk sub module capital charge. The CAT risk sub module is therefore linked to the premium risk sub module to avoid double-counting.	
3.26.	The captive structure is a very simple structure: one Mother Company, one insured, one policy holder and few (2-3) risks covered. Regarding this simple structure in order to have a balance one can not imagine 100 of assets to avoid the concentration risk. A commercial insurance company has a asset diversification policy because of the size of their insurance portfolio (different durations, maturities, type of the behavior) and number of LoB but also because of the huge amount of premium to management and the yield they promise to their client (life portfolio). Because of that Insurance companies need an ALM policy this is clearly not the case for captives where the liability structure need to be balance with a simple asset structure. Additionally Insurance companies often balance the underwriting results with their financials profits because of the secure underwriting captive policy (limited exposure, high premium, structural lower combined ratio) the asset structure is less aggressive.	
3.27.	The suggestion that the credit institution or cash-pooling entity of the group has a rating of AAA is unrealistic due to the limited number of AAA Banks and may lead to a concentration of captive assets with one financial institution. Currently, often the mother companies are higher rated than banks. ECIROA suggest BBB rating to be sufficient. Captives commonly engage in cash-pooling with their Parent company in order to maximise their returns. The funds are then invested by the treasury function of the parent. ECIROA suggests the inclusion of a ‘look-through’ approach, similar to SICAVs.	

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	Therefore, instead of considering one line in the computation, each underlying line would be considered as one line in the computation of the undertaking's concentration risk module. In practice, ECIROA also proposes that the CEIOSP requires each group to specify to the regulator of the undertaking its investments guidelines. If it is clear that the guidelines are such that the concentration risk will be nil, then an exemption can apply, otherwise the computation mentioned above needs to be produced. The concentration risk sub-module represents on average 78% of the total market risk module for captives whereas it represents 9.5% on average for the insurance market (cf. 3.6 consultation paper N°47). This shows clearly the captive specificity and the necessity according to the proportionality principle regarding the nature, scale end complexity of the risk, to define an appropriate simplified method. ECIROA believes that Concentration Risk should be moved to Pillar II (which follows the structure under Basle II) but understands that this change would have to be accepted by the Commission.	
3.28.	ECIROA suggests that captives should be able to make their own investment decisions, following the investment guidelines of their Parent Company. Cash pooling arrangements of less than 3M EUR should be assimilated to term deposits and therefore could be exempted when the group is rated A.	
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3.34.	ECIROA agrees with this approach but thinks that the suggestion to use the OF/SCR ratio of the captive as an equivalent to a rating will be a good solution, as proposed in CP51.	
3.35.	The framework should not steer captives towards adopting new clauses in their insurance contracts.	