EIOPA Divergence from Solvency II on Scope for Captives

- Captive (re)insurance undertakings are a very important risk management tool for Europe's largest multinational corporations. Solvency II demands proportional treatment for captives. Disproportionate rules would have a significantly negative impact on the 'real economy'.
- Captives insure risks that the commercial insurance market prices too highly or either cannot or will not insure. Without captives, many corporations would be forced to transfer significant risk back on their balance sheets.
- The Solvency II Directive [Recital 21] states that "[the Directive] should also take account of the specific nature of captive insurance and captive reinsurance undertakings. As those undertakings only cover risks associated with the industrial or commercial group to which they belong, appropriate approaches should thus be provided in line with the principle of proportionality to reflect the nature, scale and complexity of their business".
- However, EIOPA has diverged from the Solvency II Level 1 text agreed by the European Parliament by seeking to narrow the scope of captives that will receive proportional treatment. In the Level II text (Article 78 SCRSC1), EIOPA has placed restrictions on the types of captives that will be allowed to use simplifications to calculate their Solvency Capital Requirement (SCR).
- The revised scope offered by EIOPA's advice significantly limits the number of captives who can use the SCR simplified calculations – only 20% of captives could apply under the EIOPA Level II rules. This is a clear breach of the principle of proportionality.
- The narrowing of scope is a clear divergence from the intention and spirit of the Solvency II Directive's Level 1 text. The Solvency II Directive calls for the proportional treatment of captives and does not specify that proportional treatment should only apply to specific captives. The Directive calls for proportional treatment to be applied to all captives.
- EIOPA does not have the scope to alter the Level 1 text as part of the drafting of Level 2 Implementing Measures. Narrowing the definition is contrary to the general approach of the process whereby Level 2 cannot change the definition and principles agreed in the Directive.
- Our solution to this problem is to make a very minor technical adjustment to Article 29 (4) through Omnibus II, which will act to enhance Recital 21 by making it legally binding. Our suggested amendment will not change the intention or spirit of Solvency II. It will give Parliament greater power to prevent EIOPA abusing its position and incorrectly interpreting the Directive in a way that will be harmful to 'real economy' interests.

Proposed Amendment to the Solvency II Directive through the Omnibus II Proposal

Article 29 (4) of the Solvency II Directive

The Commission shall ensure that implementing measures take into account the principle of proportionality, thus ensuring the proportionate application of this Directive, in particular to **captive insurance and reinsurance undertakings and** small insurance undertakings.

Draft Level 2 Measures for the Solvency II Directive

SUBSECTION 3
PROPORTIONALITY AND SIMPLIFICATIONS

Article 77 SCRS1

(Art. 109 of Directive 2009/138/EC)
Proportionality

1. Insurance and reinsurance undertakings may, for the purposes of Article 109 of Directive 2009/138/EC, use the simplified calculations included in this chapter for a risk module or sub-module of the Solvency Capital Requirement standard formula where such simplified calculations are proportionate to the nature, scale and complexity of the risks faced by the undertaking and where the standard calculation for that risk module or sub-module would be an undue burden for the undertaking.

2. For the purpose of paragraph 1, insurance and reinsurance undertakings shall determine whether the simplified calculation is proportionate by carrying out an assessment which shall include:

   (a) an evaluation of the nature, scale and complexity of the risks of the undertaking falling within the relevant module or sub-module;

   (b) an evaluation in qualitative or quantitative terms, as appropriate, of the error introduced in the results of the simplified calculation due to any deviation between the following:

      – the assumptions underlying the simplified calculation in relation to the risk;

      – the results of the assessment referred to in point (a).

3. A simplified calculation shall not be considered to be proportionate to the nature, scale and complexity of the risks if the error referred to in point (b) of paragraph 2 is material, unless the simplified calculation leads to a Solvency Capital Requirement which exceeds the Solvency Capital Requirement that results from the standard calculation.

The error shall be considered to be material if it leads to a misstatement of the Solvency Capital Requirement that could influence the decisions-making or judgement of the intended user of the information relating to the Solvency Capital Requirement.

Article 78 SCRSC1

(Art. 109 of Directive 2009/138/EC)
General provisions for simplifications for captives

Subject to the captive insurance or reinsurance undertaking complying with Article SCRS1, simplifications which are specifically made available to captive insurance and reinsurance undertakings shall apply only to captive insurance and reinsurance undertakings as defined in Article 13 of Directive 2009/138/EC that meet the following requirements:

(a) in relation to the insurance obligations of the captive insurance undertaking, all insured persons and beneficiaries are legal entities of the group of the captive insurance or reinsurance undertaking and were also legal entities of that group at the time the relevant contract was entered into;

(b) in relation to the reinsurance obligations of the captive insurance or reinsurance undertaking, all insured persons and beneficiaries of the insurance contract underlying the reinsurance obligations are legal entities of the group of the undertaking and were also legal entities of that group at the time the underlying contract was entered into;

(c) the insurance obligations of the captive insurance undertaking and the insurance contract underlying the reinsurance obligations of the insurance or reinsurance captive undertaking do not relate to any compulsory third party liability insurance.