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Europe: Q&A with Guenter Droese, chairman of European Captive Insurance and Reinsurance Owners' Association

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Post speaks to Guenter Droese about the captive market and the potential impact of Solvency II

For the EU's industrial insurance buyers who operate captives, Solvency II is the hot topic for 2015. In fact, the new regulation and its implications were the main topics on the bi-annual European Captive Forum in Luxembourg on November 11 and 12 of last year.

Post spoke to Guenter Droese, Chairman of the European Captive Insurance and Reinsurance Owners' Association, about what this year may have in store for the market.

ECIROA is the lobbying organisation of captive owners. It aims to provide regulators with insight into captives' activities and protect the interests of its 81 members. The issues it covers include the implementation of Solvency II as well as organising International Programmes with the International Association of Insurance Supervisors.

Guenter Droese is a former managing director of Deutsche Bank AG and Deukona, its in-house broker. He was globally responsible for risk transfer into the insurance markets as well as for Deutsche Bank's captives. Droese is a former member of the European Insurance and Occupational Pensions Authority's Insurance and Reinsurance Stakeholder Group. After graduating as an economist, he initially worked as senior account manager and underwriter for Allianz. Today, he also lectures at Goethe University, Frankfurt.

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Do you think the scandal surrounding Luxembourg firm PWC's tax practices [it was accused of setting up company structures to minimise tax and obtain favorable tax treatment from for their clients] will have an impact on the attractiveness of the country's role as a captive domicile?

Droese: As chairman of ECIROA I am happy to say the regulatory laws, rules and guidelines in Luxembourg will be applied to all insurers and reinsurers in this country. There is no special treatment for captives and no tax advantage has been identified by home tax authorities of any captive parent. After the start of Solvency II in 2016 all European insurers and reinsurers will have to apply the same regulatory regime anyway.

If Solvency II applies without meaningful simplifications for their captives in the EEA, how will European captive owners react?

Droese: All captives should consider two questions: Firstly, what is the difference in quantitative results of Pillar 1 with and without the simplification in Article 89 [captives are eligible for simplifications if: they refrain from writing compulsory third party liability; and for other lines of business they extend insurance cover only to entities which belong to their parent's group]? And secondly, what is the predicted impact of the Principle of Proportionality?

Unfortunately the European Commission has not really understood the specific features of captives - [particularly] how they settle third party liability claims of subsidiaries which are no longer part of the parent's group. In the implementing measures the EC has defined captives with limitations, which we are still discussing with EIOPA. The objective is to allow local supervisors to decide whether the criteria for captives are met.

The advantage of using the simplifications should be quantified by each captive. It might be rather small. Nevertheless we are still trying to receive an interpretation of Art. 89 which will enable all supervisors to apply the simplifications to captives as defined under Solvency II.

The PoP will have a significant influence on how to prepare the application. Captives and their managers need to prove that the nature, scale and complexity of their activities allow for a reduced number of staff. The level of documentation according to the requirements of Pillar 2 determines how much workload and cost captives will have to carry. It will be crucial to get experienced support for proving the documentation of the PoP approach will be sufficient.

One of the key limitations for captives in Solvency II is the requirement that policyholders remain part of their owner's group throughout the cover period. Which solutions do you see for this dilemma?

Droese: As mentioned above, we are waiting for final advice from EIOPA on how to interpret the simplifications. The principle to "comply or explain" should be applied to convince local supervisors that the legally binding commitment to settle a claim from a captive's existing policies cannot be broken. [At the same time] this limitation is recognised as a violation of the rule that the directive's "definitions" cannot be delimited. Ultimately, the local supervisors will have to decide about captive status.

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Which repercussions in your members' multinational insurance programmes do you foresee due to capital penalties for fronting for unrated offshore captives in Solvency II?

Droese: The reply needs to be given in two parts. Firstly, the rules seem to be very strict and cause an increase of capital need either for the captive, for the fronting insurer or for both. This can be remediated with provisions for collateral in an economically reasonable way.

Secondly, in future the solvency capital requirements and minimum capital requirements can be used by insurers and reinsurers as a rating substitute. This will allow customers to compare insurers' performance in the market by means of a predetermined quantification process - Pillar 1 - under the control of local supervisors.

Although Solvency II is designed as a common set of rules for all EEA member states, some observers expect competition between the regulators. What is your opinion on that?

Droese: In the coming years we will definitely not see competition between regulators. As local laws and particularities vary there might be some differing interpretations once the Principle of Proportionality is applied. This has to be accepted. The various countries' performance on the targets of Solvency II will be the main measure to judge whether supervisors and insurers will finally comply with the principles rolled out by the European Commission.

What does ECIROA plan for 2015 to achieve further progress in the buy-in of EIOPA and the European Commission in terms of adequate rules for captives?

Droese: ECIROA will watch how local supervisors implement requirements and will report on conduct. We will be observing the potential deviations country by country. We will organise member workshops to assess the options we have with a forward-looking and constructive attitude. I recommend all member captives to review their strategy and adjust it where necessary. ECIROA will contact EIOPA and local regulators whenever it feels captives are not treated in line with the Principle of Proportionality. This might happen in some situations, I believe.

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