

<b>Comments Template on CEIOPS-CP 71 Consultation Paper on the Draft L2 Advice on Calibration of the non-life underwriting risk</b>		<b>Deadline 11.12.2009 12.00 CET</b>
Name of Company:	AGERE (Association des Gestionnaires de Réassurances) AON ECIROA (European Captive Insurance & Reinsurance Owners' Association) FERMA (Federation of European Risk Management Associations) MARSH	
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:	Confidential/Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> <li>⇒ <b>Do not change the numbering</b> in the column "reference".</li> <li>⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph, keep the row <u>empty</u>.</li> <li>⇒ Our IT tool does not allow processing of comments which do not refer to the specific paragraph numbers below.               <ul style="list-style-type: none"> <li>○ If your comment refers to multiple paragraphs, please insert your comment at the first relevant paragraph and mention in your comment to which other paragraphs this also applies.</li> <li>○ If your comment refers to sub bullets/subparagraphs, please indicate this in the comment itself.</li> </ul> </li> </ul> <p><b>Please send the completed template, in Word Format, to <a href="mailto:secretariat@ceiops.eu">secretariat@ceiops.eu</a>. Our IT tool does not allow processing of any other formats.</b></p> <p>The numbering of the paragraphs refers to Consultation Paper No. 71 (CEIOPS-CP-71/09).</p>		

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Reference	Comment	
General Comment	<p>When considering the following comments, it is important to recognise the particular nature of captive companies which differ from commercial insurance and reinsurance undertakings in that: -</p> <ol style="list-style-type: none"> <li>1. They write a restricted number of lines of insurance business (e.g. property damage &amp; liability) and normally issue a small number of policies (e.g. global programmes with only one policy per insurance class)</li> <li>2. They insure or reinsure a restricted number of risk units (e.g. sites, premises, vehicles)</li> <li>3. They have a restricted number of insureds / clients</li> <li>4. the purpose of the captive is to add flexibility to the tools available to the group risk manager in managing and mitigating the risk of the parent group in a cost efficient manner.</li> </ol>	
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3.395.	<p>The Cat model proposed for captive is not acceptable in its present form, since the parameters currently used are not properly estimated. Therefore, the model produces results not in line with the requirements of the 99,5% calibration of the Directive.</p> <p>Indeed, we note that the model is built such that a Pareto tail replaces the Log Normal distribution</p>	<b>Public</b>

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at the 80<sup>th</sup> percentile of that LogNormal. The model assumes a combined loss ratio of 75% and a standard deviation of 15%. However:

- If we assume a standard mean combined ratio of 75% for all captives, the Pareto tail will not attach anymore to the 80<sup>th</sup> percentile of the company, and the model is not calibrated anymore to the 99.5<sup>th</sup> percentile.
- On the CP79, §3.18 it is mentioned that "CEIOPS has received guidance from the European Commission saying that the expected profit/loss for new business is not expected to be modelled in the SCR standard formula". Then we understand that a combined ratio of 100% should have been used. If it is the case, this method is not reliable anymore.
- Besides, the results are based on a standard deviation of 15%, which is inconsistent with other consultation papers.

It's really important to mention that the model is very sensitive to the combined loss ratio used. Therefore, a calibration of the model using a standard 75% combined ratio instead of the expected combined ratio of the companies leads to inadequate results. For example, for the line of business "Fire and Other Damage" a combined ratio of 75% leads to a capital charge of 920% of premiums while a ratio of 100% would lead to a capital charge of 1210% of premiums.

In addition, the Pareto distribution is very sensitive to the shape parameter alpha. This parameter would need to be calibrated carefully for aggregate losses on the captive market. However the parameter used for the proposed capital charges seems to be the ones used in the Swiss Solvency Test, where parameters of the Pareto model have been calibrated based on individual losses above an attachment point of CHF 5 million in the Swiss market. This calibration is clearly not applicable to aggregate losses of the European captive market and therefore the proposed capital charges lead to results non-representative of the actual risks of captive market.

In case the expected combined ratio of the company can be taken into account, we recommend to calibrate the shape parameter alpha of the Pareto per line of business based on the European captive market aggregate losses and then formulate the attachment point as a function of the expected combined loss ratio. Otherwise, this model cannot be applied because it gives volatile and

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	<p>non-accurate results.</p> <p>For instance, if we were to apply the same model on insurance companies, assuming a combined loss ratio of 100%, that would result in a capital charge of 1334% of premiums for the property LoB calibrated using a standard deviation of 30% (specification for NPL Property: CP71 §3.6). This should be compared to a proposed capital charge of 250% of premiums for the same risk (§3.394).</p>	
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