

Review of EU insurance Rules

A revised Solvency II regime

4 April 2022

On 22 September 2021, the European Commission presented its legislative proposals for amendments to the regulatory framework for the insurance industry, Solvency II. BDI and GVNW welcome the Commission's efforts to further evolve Solvency II and, in particular, to design prudential rules that are more proportionate. The objective of making the regulatory framework of Solvency II more appropriate for insurers with low-risk profiles is particularly important for the captive industry. Allowing exemptions from regulatory reporting, governance requirements, own-risk management and disclosure requirements is an important step in the right direction. However, we believe more needs to be done here.

Captives are insurers or reinsurers that are owned by an industrial, commercial or financial company which is not itself an insurer or reinsurer and that mainly insure or reinsure the risks of their owners. Captives have become more important in recent years because of their ability to address non-traditional risk factors (i.e. climate and sustainability issues) and to optimise the financing of their insurable risks. Large German corporations thus organize significant parts of their risk transfer and risk financing via their own captive insurance companies in order to manage capacity shortages of the insurance market, reduce volatility of insurance premiums and support a more dedicated risk management strategy.

From a prudential point of view, captives are different to classical insurers or reinsurers. Provided the original policyholder is the parent company, captives are not of systemic relevance. Since they are only doing business with other corporates, consumer protection rules do not apply. They follow a conservative investment strategy, do not have complex and therefore risky business models and the insured or reinsured risks pertain only to the parent company or its subsidiaries. For most captives their worst-case claim scenario can be defined in a deterministic manner. Hence, the application of the standard formula is not appropriate, and captives should be provided with a more suitable regulatory environment.

More proportionality is needed for the captive industry

Current rules state that to qualify for exemption from the scope of Solvency II, the undertaking and the total of its technical provisions shall not exceed 25 million euros and its annual gross written premium shall not exceed five million euros. In its proposal, the Commission aims to increase these two thresholds. However, we believe a more adequate criterion should be applied for the captive industry, allowing for a higher number of exemptions.

We believe, instead of the premium volume the number of insurance and reinsurance contracts would be a more adequate indicator of the complexity and risk propensity of respective undertakings. A small or medium sized insurer or reinsurer with an annual premium income of 30 million euro will realistically write more than 500 insurance contracts with a large number of customers and thus will need to apply stochastic methods to determine worst case loss scenarios. A captive insurer or reinsurer with an annual premium volume of 30 million euro will most probably write less than ten insurance or reinsurance contracts as it usually participates in the limited number of insurance programs of its parent company only. In our understanding, Solvency II should explicitly address insurers and reinsurer with larger numbers of insurance lines, insurance contracts and insureds due to their higher risk levels. Captives are undertakings with only a few insurance contracts and ultimately only one insured or reinsured, the parent company. Hence their business models show much lower levels of complexity than those of average insurance or reinsurance undertakings where the worst case scenario can be determined by adding up the insured limits of the insurance contracts written. Thus, the number of contracts is a key indicator.

Consequently, we suggest replacing the amount of technical provisions and the amount of annual gross written premium with the number of contracts written by an insurance and reinsurance undertaking. More precisely, insurance and reinsurance undertakings that write up to 20 insurance or reinsurance contracts by way of direct insurance or active reinsurance should be exempted from Solvency II.

We kindly ask co-legislators to consider our proposal.

Imprint

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