FERMA FOCUS
RISK TRANSFER

FERMA's position paper on the European Commission's Insurance rules' review – focusing on the proposed amendments on proportionality

12 January 2022

Key messages:

- FERMA **welcomes the significant strides made in the Commission's proposed amendments to Solvency II in regards to proportionality**
- In particular, FERMA welcomes the new classification of 'low-risk profile undertakings'
- However, **we believe that Solvency II could be even more proportionate for captives**, which both operate in a very specific risk-profile and provide European enterprises with a different option for risk transfer, which is crucial in current market conditions
- **FERMA therefore calls for captives to be treated automatically as low-risk profile undertakings**, based on their specific low-risk profile
    - That is unless the captive poses a systemic risk or has been in breach of its solvency requirement in previous three years, for instance

Introduction

The Federation of European Risk Management Associations (FERMA) represents, through its 22 Member Associations in 21 countries, almost 5,000 professional risk and insurance managers.

FERMA members are both directly and indirectly impacted by any possible changes to Solvency II:

1) FERMA represents captive (re)insurance undertakings through our members that have chosen to make use of them. Between one-quarter and one-third of FERMA members use or manage captive (re)insurance entities to cover certain insurable risks of their operations. The *direct* impact of any change in Solvency II here ranges from the amount of capital needed to the range of reporting requirements.
2) FERMA members are also *indirectly* affected by changes in Solvency II in that any change to capital, risk management or disclosure requirements for insurers will have an impact on their *customers – i.e. individual and corporates*. The bulk of FERMA members are risk and insurance professionals who work for organisations that do not make use of a captive (re)insurance entity.

FERMA has been asking for more proportionality in Solvency II for a long time. We are therefore pleased to see that the European Commission and EIOPA – through its Opinion on 17 December 2020 – acknowledge that the proportionality of Solvency II could be improved.

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It is encouraging to see in the proposed amendments that there is: (i) a new 'low-risk profile undertaking' classification; and, (ii) an unambiguous acknowledgement of the specific nature of the (low) risk profile of some (re)insurance captives.

However, FERMA takes the view that Solvency II could be amended in a way that would further reduce complexity for small and less risky insurers, specifically captives, one of the five main problems that the Commission has set out to address in its review of the rules.

Our suggested approach

FERMA recommends amending Solvency II so that captives are treated automatically as low-risk profile undertakings.

As previously stated, FERMA is a strong supporter of the new 'low-risk profile undertaking' classification as a way of bringing about more proportionality in the way the Directive is applied. We also fully support the Commission's aim behind the proposed amendments that more proportionate rules should be available *automatically* to low-risk profile undertakings. Furthermore, FERMA welcomes the formal recognition that captives operate a particular risk-profile in recital 14 of the proposed text, "*[c]aptive insurance undertakings and captive reinsurance undertakings which only cover risks associated with the industrial or commercial group to which they belong, present a particular risk profile that should be taken into account when defining some requirements…*"

This particular – and, importantly low- – risk profile of captives should be taken into account when defining their prudential requirements and subsequent reporting obligations across the three pillars. FERMA therefore proposes simplifying (and clarifying) the Solvency II text by automatically classifying captives as low-risk profile undertakings. This proposal would also mean that national competent authorities would not have to assess whether captives meet the criteria in Article 29.

Captives are an essential part of a vibrant and competitive EU insurance market. The role that captives play in supporting European enterprises expanding the scope of available insurance coverages, in reducing Total Cost of Risk, in consolidating and mutualizing group' risks, and in leveraging and increasing the negotiation power of a multinational corporation towards the traditional insurance market, could be viewed as particularly important at this juncture where insurance coverage for several large risks (eg cyber) is diminishing.

Furthermore, and importantly in terms of European sovereignty, FERMA is absolutely convinced that the EU has an integral role to play in terms of supporting the insurance 'buyer' – enterprises – by ensuring the Single Market facilitates competitively priced options for risk transfer *in* the EU. Captives are a crucial part of this mix and FERMA believes that this is another important argument for considering making the framework simpler for captives.

To provide a fuller picture, FERMA also acknowledges that NCAs may have reasons to withhold the low-risk status from captives for various reasons. It would also be in the interest of the industry to include certain limitations on the granting of the low-risk status to all captives. If any of the following apply, we propose that NCAs or EIOPA can withhold the low-risk profile undertaking status from captives:

- the captive may pose a systemic risk to the national and/or European insurance market. We are open to further discussions on this point; or
- the captive has breached its Solvency requirements in the last three years

We have provided some suggested wording changes to the relevant areas of the Commission's proposed text below *in Annex*.

Conclusions

FERMA recognises the important progress in certain areas of the proposed amendments to Solvency II as regards proportionality. However, we are of the firm belief that more can be done to make Solvency II truly risk-based and proportionate. We say this as insurance buyers, but also users of captives during hard market conditions, and also amid increasing focus on the 'insurability' of certain risks. Options for risk transfer are therefore more important than ever. FERMA looks forward to contributing our unique expertise to the political discussions on Solvency II.

About FERMA

The Federation of European Risk Management Associations brings together 22 national risk management associations in 21 European countries. FERMA represents the interests of nearly 5000 risk and insurance managers in Europe active in a wide range of business sectors from major industrial and commercial companies to financial institutions and local government bodies. More information can be found at www.ferma.eu

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Annex – FERMA's suggested wording proposals

For information, proposed additions to the text are indicated in blue. Proposed removals of text are indicated by ~~scorethrough~~ and the article references are based on the European Commission's proposed text in COM(2021) 581 final, 2021/0295 (COD), dated 22 September 2021.[1]

- Recitals -

(14) Captive insurance undertakings and captive reinsurance undertakings which only cover risks associated with the industrial or commercial group to which they belong, ~~present~~ operate in a ~~particular~~ specific risk profile that is directly and inextricably linked to the specificities of the industrial or commercial group and should be taken into account when defining ~~some~~ requirements, in particular on own-risk and solvency assessment, disclosures and the related empowerments for the Commission to further specify the rules on such empowerments. Moreover, captive insurance undertakings and captive reinsurance undertakings should, based on the specific risk-profiles of their business models also be able to benefit from the proportionality measures ~~when they are~~ classified as low-risk profile undertakings, unless they are deemed by their NCA to pose a systemic risk to their national or European insurance market, or has breached its Solvency requirements in the last three years.

- Amendments to Directive 2009/138/EC –

(5) Article 13 is amended as follows:

(a) in point (7), point (b) is deleted;

(b) the following points (10a), (10b), (10c), and (10d) are inserted:

'(10a) 'low-risk profile undertaking' ~~means~~ is assigned to ~~an insurance and reinsurance~~ i) an insurance and reinsurance undertaking that meets the conditions set out in Article 29a and has been classified as such in accordance with Article 29b; ii) captive insurance and captive reinsurance undertakings unless they are deemed by their NCA to pose a systemic risk to their national or European insurance market, or has breached its Solvency requirements in the last three years;

(13) the following Articles 29a to 29e are inserted:

'Article 29a

Criteria for identifying low-risk profile undertakings

'1. Member States shall ensure that insurance undertakings are classified as low-risk profile undertakings, according to the process set out in Article 29b, where, for two consecutive financial years prior to such classification, the undertakings meet the following criteria:

(a) For undertakings pursuing life insurance activities and for undertakings pursuing both life and non-life insurance activities in accordance with Article 73 whose

[1] Accessed here: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0581&from=EN

technical provisions related to the life insurance activities represent 20% or more of the total technical provisions gross of the amounts recoverable from reinsurance contracts and special purpose vehicles, as referred to in Article 76, and whose annual gross written premium income related to the non-life insurance activities represents less than 40% of the total annual gross written premium, all of the following criteria shall be met:

(i) the interest rate risk submodule referred to in Article 105(5), point (a), is not higher than 5 % of the technical provisions, gross of the amounts recoverable from reinsurance contracts and special purpose vehicles, as referred to in Article 76

…

[New insertion, i.e. Article 29a 1. (d)] (d) captive insurance and reinsurance undertakings, based on the specificities of their business models are classified as low-risk profile undertakings, unless they are deemed by their NCA to pose a systemic risk to their national or European insurance market, or have breached their Solvency requirements in the last three years.