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European Captive Forum 2010

The Luxembourg captive conference indicates that captives may be higher up the EC's agenda, but will still face challenges from Solvency II

by ***Gavin Bradshaw***

The inaugural European Captive Forum – successor to the long-running Luxembourg Rendez-vous – exceeded all expectations when more than 680 delegates descended upon the Luxembourg Congrès on 19-20 October.

Given the preponderance of EU-based risk and insurance managers it is unsurprising the issue of Solvency II dominated the conference programme, but it is notable that attendees included captive owners and risk managers from as far afield as Mexico, South Africa and the United States, as well as regulators from Bermuda and the Caribbean.

With the deadline for QIS5 results now expected in mid-November, captive-owning delegates were no doubt eager to get the lowdown on what the likely conclusions from the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) would be. Certainly, they flocked into the afternoon 'Regulatory Panel' session on day one, featuring representatives of the European Commission, CEIOPS and the Luxembourg insurance regulator.

Karel Van Hulle (left), head of the pensions and insurance unit at the Competition Directorate of the European Commission (EC), confirmed that CEIOPS had been given a two-week grace period to work on the QIS5 statistics, but reiterated that the implementation deadline of 1 January 2013 was still on target, with the EC and Council of Ministers expecting to receive the rulebook for their consideration by June 2010.

Carlos Montalvo Rebuelta (left), Secretary General of the CEIOPS Secretariat, bolstered this expectation with the announcement that CEIOPS is planning to issue its final recommendations to the EC ahead of the March 2011 schedule.

Tomas Wittbjer (right), a former chairman of Luxembourg reinsurance managers association AGERE and global head of insurance at IKEA/IKANO as well as a board member of the Captive Insurance Companies Association (CICA), related that up to 50% of European captives had participated in the fifth CEIOPS quantitative impact study (QIS5), a fact which no doubt prompted Montalvo to offer reassurance to captive owners that captive insurance companies would be considered distinct from commercial carriers.

Van Hulle said that the results of QIS5 would demonstrate the consequences of the calibration of Solvency II technical specifications on the non-life sector. "It is not yet right – we still need to work on it," he said. However, he added the release next month of the Omnibus II new supervisory structure, to be implemented as of 1 January 2011, contained some transitional measures, including Level II implementing measures that would help in fine-tuning the technical specifications.

"Some say it doesn't go far enough, others have said to me 'you have gone too far'," he said. "What we have tried to do is strike the right balance."

Victor Rod (right), director of the Luxembourg Commissariat Aux Assurances, stressed the importance of the manageability of local implementation of Solvency II measures. "The problem when it comes to Solvency II is that there will be very little space for local tastes," he said. Rod argued that the EC has a role to play in rebalancing industry requirements with its political masters in member countries. "It is essential that captives are not swamped by an administrative burden," he said.

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Day one: challenges and changes

In the opening session of the forum, Wittbjer declared that: "National regulation belongs to the past. We are faced with global regulation." Rudolf Flunger (left), head of insurance specialty at Swiss Re, took up that theme in his keynote speech, warning that the insurance industry as a whole is facing the risk of "excessive regulation" in the wake of recent economic difficulties. "The worst has been avoided but economic growth will be slow. The consensus is that such a crisis must be avoided in future and therefore regulation has come to the fore," he said.

Flunger said tighter regulatory scrutiny

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is also affecting captives and that reinsurers may struggle to deliver to clients as a result of increased regulation. Although the insurance markets have shown resilience in the face of economic difficulties they would struggle if the regulatory burden was too heavy, he said.On top of this, investment income for insurers, particularly in the non-life market, has been reaching record lows. "A 5-6% return on equity is not what shareholders want to see," said Flunger. This dip in investment income has been eroding underwriting profitability in the US property and casualty (P&C) market. Flunger also drew attention to a trend that has been growing since 2005, with hard market reserve releases outpacing soft market rate increases for insurers. The situation for some carriers, he said, was that "claims that are paid and business costs are higher than premiums collected".

Flunger said the prospects for the non-life market as a whole are moderate, but a modest rather than exuberant economic environment plus budget constraints for insurance buyers meant that underwriting profitability has been deteriorating, with rate increases appearing in unprofitable lines of coverage.

Captive business models are also likely to be in the spotlight due to parental budget considerations and Flunger said there will be pressure on well-capitalised captives as a revenue source for parents. And with regulatory requirements becoming tougher, he suggested that the Pillar II and III requirements for Solvency II may be thought too onerous, outweighing captive benefits and meaning that captive running costs will increase.

With insurers across the board experiencing higher capital needs and access to capital becoming more difficult, said Flunger, risk managers seeking to demonstrate the value of the captive would need to do make some or all of the following changes to the programme:

- higher retentions;
- broader coverages and greater diversification of programmes;
- more retrocession/reinsurance use;
- exit of certain lines, or of single captives where the parent has multiple captives.

Day two: opportunities and aims

In a major session on the second day of the forum, 'Solvency II: Threat to offshore', moderator Gordon Rowell, head of insurance supervision at the Cayman Islands Monetary Authority (CIMA), was joined by representatives of the Bermuda Monetary Authority (BMA), the Guernsey International Insurance Association (GIIA) and international law firm Steptoe and Johnson.

Shanna Lespere (left), director of insurance supervision, complex institutions and restoration, run-off and monitoring at the BMA, took a positive line, saying that Bermuda views regulatory equivalence with Solvency II as an opportunity as well as a challenge. However, she added, it was important to recognise that the ultimate aim of the directive was global market stability. "We have a number of insurers conducting significant business into the European market and from a company perspective there is an opportunity to avoid regulatory duplication," she said. "We all need to feed into the debate. I think some of the positions on QIS5 are a bit speculative at the moment for third countries as well as the European market."

However, Dominic Wheatley (right), chief marketing officer for Willis International Practice, based in Guernsey, made the case for captives being recognised as distinct from other insurance entities under the Directive. "Solvency II objectives are about managing systemic and insurance group risk. Clearly captives are not a part of the insurance system and they are not part of insurance groups either," he said. "For captives to be subject to regulation designed to control systemic risk isn't logical, so Solvency II certainly isn't fit for purpose as a regulatory framework for dealing with captives."

Whereas the BMA is currently applying the principle of proportionality to captives and small insurers "on a day-to-day basis", according to Lespere, Wheatley argues that for independent jurisdictions such as Guernsey, it is not proportionality that is the main issue but equivalence where, he said, the objective is to provide credibility and admissibility of reinsurance assets. "That is very important for commercial insurance companies but the issue of admissibility is less persuasive when the reinsurance assets you are dealing with are in a captive," he said. "I don't see that equivalence for a pure captive domicile is a very attractive option."

Gordon Rowell (left) chipped in towards the end of the session to highlight a key issue for regulators in addressing the potential impact of Solvency II. "From a captive perspective, it is still valuable to meet your regulator and discuss what you're doing," he said. "It would be disappointing to lose the qualitative assessment process in exchange for a quantitative one."

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