

To: Solvency II SG
From: Economics & Finance department
Date: 15 February 2012
Reference: ECO-SLV-12-090

Subject: EIOPA Cat TF L3 - Guidelines on reinsurance - new topic

| Summary

In link with EIOPA Cat Task Force on Level 3 issues, there has been some new proposals done by one member on the guidelines for the application of reinsurance part.

One of them deals with the use of pools of reinsurance, the other one with the way to compute the sum insured needed to assess the Cat SCR within the standard formula.

Members are asked to send first reactions or major concerns by Friday 17 February 14h00 and more detailed feedback by Wednesday 22 February COB to ecofin@cea.eu

- **Application of reinsurance when dealing with pools.**

Within COVEA we have analysed all the external pools we are member of and have given some thoughts as to how their effect on the insurer's net situation could be fairly reflected.

We think this could in fact be done in quite a simple way as long as we pay attention to some wording. **While the current wording for computation of charges states that the basis for gross charge is premiums (or sums insured according to the risk considered) gross of any reinsurance, this needs to be worked out differently in the case of pools, otherwise there would be potential double-counting or mistreatment.** Indeed to reflect the effect of the pool on the risks the insurer is facing, we need to acknowledge that there is first a cession generally followed by a reverting acceptance (defined according to all sorts of rules : a share of the pool reflecting the market share of the ceding insurer, a capacity to the choice of the insurer..). This means that the basis of the gross charge should be premiums (or sums insured according to the risk considered) gross of all reinsurance with the exception of premiums (or sums insured) ceded to pools which should be deducted from the basis as they should lead to an addition corresponding to the share that is accepted back from the pool.

For instance, applied to the man made liability risk this would translate as follows:

$P_{(liability, i)}$ denotes the premiums earned by the insurance or reinsurance undertaking during the last 12 months in relation to insurance and reinsurance obligations in liability risk group i ; for this purpose premiums shall be gross, without deduction of premiums for reinsurance contracts, apart from premiums ceded to pools, and include premiums accepted from pools

$Lim_{(i,1)}$ denotes the largest liability limit of indemnity provided by the insurance or reinsurance undertaking in liability risk group i ; excluding liability limits ceded to pools and adding the liability limits accepted from pools.

- **Definition of the sum insured** for the computation of gross cat charges (when derived from sums insured and not premiums) and the application of reinsurance.

Indeed the problem of the definition of sum insured which is of great importance starts with the gross computation, therefore it could be advantageously handled through the reinsurance guidelines as it is nowhere else handled and has something to do with the application of reinsurance. The definition should also include the reference period the sums insured should relate to.

What does a sum insured mean ? Does it mean the same for nat cat or man made modules ?

Sums insured are not defined in draft Level 2 measures and they can potentially be assessed in several different ways:

- 1) Amounts contractually defined as values at risk. What if these amounts do not exist in contracts? In France, no such amounts exist in the contracts for property damage, motor damage or bodily injury.
- 2) Limits defined in the contracts i.e. limitations of the values at risk or so called contractual guarantee limits
- 3) PML
- 4) EML
- 5) Worked out amounts by insurers based on their own risk analysis assumptions

There is a threat of a huge inconsistency of application across markets and undertakings, potentially not in line with the calibration of the different charges of the non-life cat module. To this end the expected Level 3 compilation of the parameters underlying the calibration of the standard formula should also shed some light on this.

A guideline for the definition of sum insured may be required and should at least contain the following:

"Sums insured should be defined as contractual guarantee limits where they exist, otherwise (ceding) undertakings should demonstrate that they have worked on a best effort basis to compute the amount"

Which time period should the sum insured relate to?

This needs to be clarified for homogeneous application across markets and undertakings.

A recommendation could be to refer to 31/12/N i.e. the date at which SCR is computed.

Last, there is a special case with dwellings:

In France, there is no building sum insured on segments such as residential insurance (the building SI is the rebuilding cost, w/o contractual limit). Each company estimates its aggregates according to its own methodology (or to a broker's one). This means that the same dwelling could be estimated at 100 by company A and at 200 by company B, giving quite a different assessment of the gross charge where the risk is actually the same. Then should average values be given to ensure that companies will estimate the risk consistently? If not, this could encourage some companies to use lowest average values...

For contents sum insured there is the same kind of issue. Some companies set average values by room in their contracts, other ones set global values by policy, others determine an amount unknown to the client in the contract. Again, for the same content risk, different values are computed or available in IT systems according to different companies.

On top of all of this, Nat Cat scenarios are based on "aggregates" not distinguishing the dwelling and its content.

Thus it is recommended to exclude the contents SI of the gross charge calculation, as the content loss is really low compared to the building loss, which is not correctly reflected by the assessment of the sum insured (or the different vulnerabilities are not taken into account in the calibration) and which could create potential huge differences in the results.