Prepared by:

Sinéad Clarke, FSAI
Eamonn Phelan, FSAI

AUGUST 2015

Stepping stones to ORSA: Looking beyond the preparatory phase of Solvency II

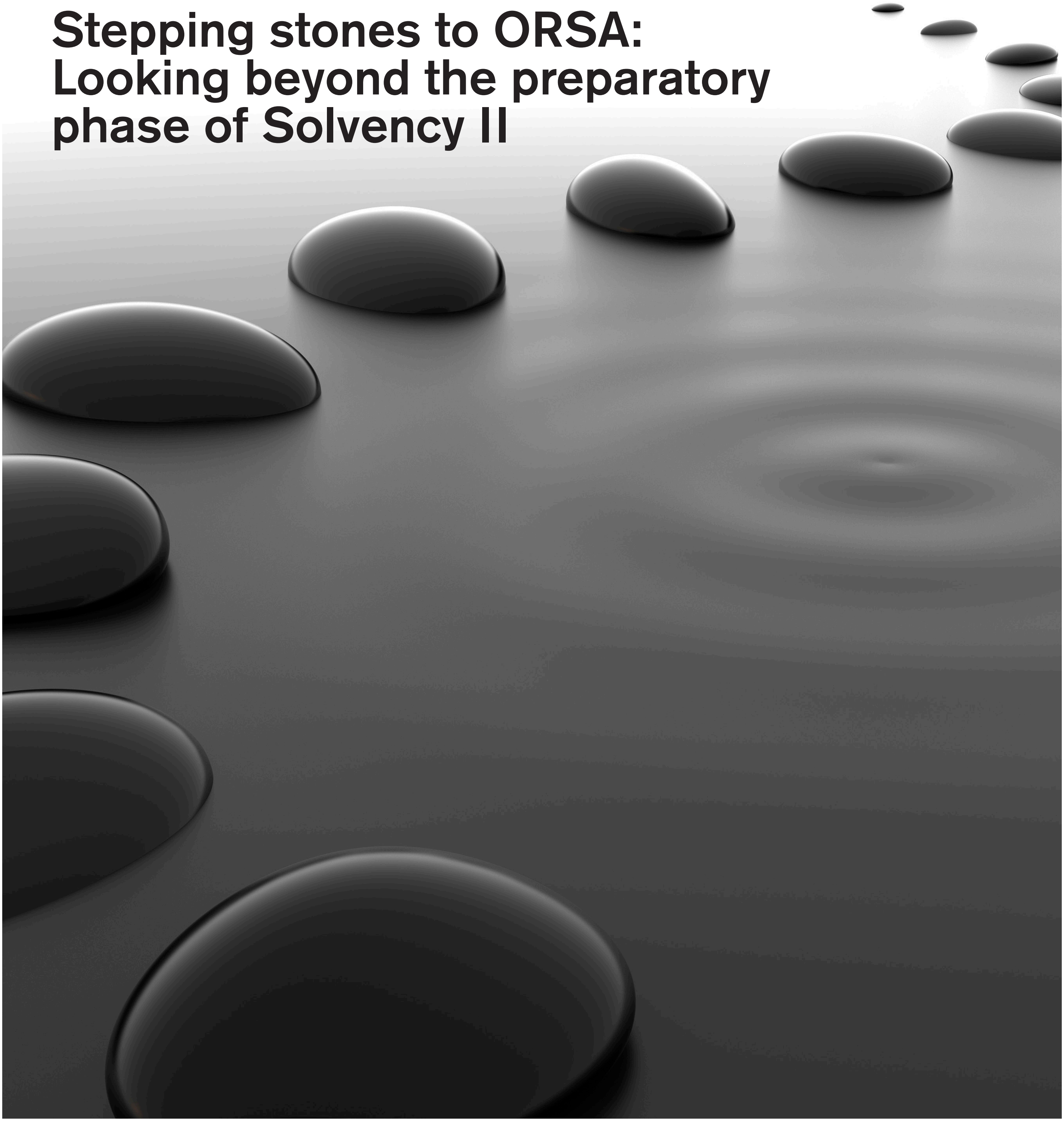


TABLE OF CONTENTS

AUTHORS AND ACKNOWLEDGEMENTS

LEAD AUTHORS

Sinéad Clarke, FSAI, is a consulting actuary with the Dublin office of Milliman.
Contact her at sinead.clarke@milliman.com.

Eamonn Phelan, FSAI, is principal and consulting actuary with the Dublin office of Milliman.
Contact him at eamonn.phelan@milliman.com.

CONTRIBUTING AUTHORS

United Kingdom: Fred Vosvenieks, Consulting Actuary, and Neil Cantle, Principal (London)

Germany: Matthias Meng, Senior Manager, and Thomas Wiedenmann, Senior Manager (Dusseldorf)

France: Henri Laugier, Principal (Paris)

Italy: Luca Pratelli, Senior Consulting Actuary (Milan)

The Netherlands: Dennis de Vries, Consulting Actuary (Amsterdam)

Spain: Glennfor Hellement, Senior Consultant, and Luca Inserra, Principal (Madrid)

The Nordics: Steve Hardwick, Head of Consulting (Stockholm)

Central and Eastern Europe: Grzegorz Darkiewicz, Senior Consultant (Warsaw)

ACKNOWLEDGEMENTS

The authors would like to thank Henny Verheugen, Principal (Amsterdam), for his contribution to the production of this research report.

1. INTRODUCTION

1.1. BACKGROUND

In recent years a greater emphasis has been placed on risk management by insurers and regulators alike, most obviously through the introduction of specific requirements relating to own risk and solvency assessments in many different territories around the globe. Regulators in the United States, Canada, Australia, Switzerland, Singapore, Japan, Brazil, South Africa, and Bermuda, amongst others, have all introduced, or are soon to introduce, own risk and solvency assessment requirements.

In Europe, Solvency II will be implemented in full on 1 January 2016, introducing the Own Risk and Solvency Assessment (ORSA) requirements to insurers and reinsurers[1] operating within the European Union. However, during 2014 and 2015, many of these insurers were subject to the Forward Looking Assessment of Own Risks (FLAOR) requirements following the publication of the preparatory guidelines for Solvency II by the European Insurance and Occupational Pensions Authority (EIOPA) in October 2013. The FLAOR is based on the ORSA principles and is expected to be carried out on a best efforts basis during the preparatory phase.

Own risk and solvency assessments generally require undertakings to assess their own capital requirements, based on their own risk profiles and risk tolerances, both at a point in time and in the future. Therefore, such assessments should be closely linked to the insurer's risk appetite and should consider all material risk exposures, not just those risks that are assessed in the capital requirement calculations. This risk assessment can be quantitative or qualitative, depending on the type of risk in question. The emphasis is on the word 'own' and, as such, there does not tend to be much regulatory guidance on how insurers conduct their own risk assessments, given the individual nature of these exercises. The ORSA and FLAOR are no different in this respect. While many documents have been published outlining what is required under each of these assessments, many insurers across Europe struggled initially to understand how to meet these requirements, which were perceived by many to be quite daunting.

In general, the components of the ORSA under Solvency II consist of three main assessments:

1. Assessment of own risks and overall solvency needs (including a forward looking assessment).
2. Demonstration of continuous compliance with the Solvency Capital Requirement (SCR) and technical provisions.
3. Assessment of deviations of the risk profile from the assumptions underlying the SCR.

The FLAOR requirements for these assessments are generally more limited than what will be required in the ORSA once Solvency II has been fully implemented. Therefore, the 2014 and 2015 FLAORs can be seen as stepping stones toward the full ORSA. The diagram in Figure 1 summarises, at a high level, how the requirements in 2014 and 2015 vary compared with full Solvency II implementation.

FIGURE 1: STEPPING STONES TO ORSA

2014 FLAOR	2015 FLAOR	ORSA
Best Efforts Basis	**Best Efforts Basis – Following Some Regulatory Feedback**	**Full Compliance**
▪ Assessment of own risk and overall solvency needs (inc. forward looking assessment)	▪ Assessment of own risk and overall solvency needs (inc. forward looking assessment) ▪ Assess continuous compliance with SCR and technical provisions ▪ Assess significant deviations in risk profile	▪ Assessment of own risk and overall solvency needs (inc. forward looking assessment) ▪ Assess continuous compliance with SCR and technical provisions ▪ Assess significant deviations in risk profile
Preparatory Phase		Full Implementation

1 Throughout the remainder of this document the terms 'insurer' and 'insurance undertakings' are used to refer to both insurance and reinsurance undertakings.

While many of the requirements are common between the preparatory phase and full implementation, the preparatory guidelines issued by EIOPA only require the assessment of continuous compliance and deviations in the risk profile from the assumptions underlying the standard formula in 2015. These requirements were delayed following stakeholder comments to EIOPA during a consultation process on the preparatory guidelines. However, some national supervisory authorities (NSAs) requested that undertakings carry out these assessments in 2014, e.g. France and the Netherlands.

The preparatory requirements are being assessed on a 'best efforts' basis by many NSAs, whereby insurers are to comply with the guidelines to the best of their ability while showing progress in respect of any guidelines with which they have not been fully compliant. Many regulators have provided feedback during 2015 on the first set of FLAORs that were submitted (during 2014). This feedback will enable insurers to improve their processes in advance of full implementation. However, irrespective of the regulatory feedback, many insurers may still struggle to fully satisfy all of the ORSA requirements once they are introduced at the start of next year.

Despite its limitations, the FLAOR is undoubtedly a useful first step towards full implementation of the ORSA and many insurers have made significant progress in developing risk management frameworks and processes to meet the requirements in the preparatory guidelines. This paper outlines how insurers in different European countries have approached the preparatory guidelines and what steps can be taken to build on the progress achieved during the preparatory phase to meet the full ORSA requirements from 2016 onwards.

1.2. OUTLINE OF THIS PAPER

In Section 2 of this paper, we discuss general readiness for the ORSA across Europe. We outline how European insurers can build on the FLAOR processes to ensure full compliance with the ORSA requirements once Solvency II is implemented in full, and we discuss common areas for improvement as well as emerging best practice across Europe.

In Sections 3 to 11, we focus on development in some of the main European territories and provide more detailed commentary on experience in those jurisdictions, as follows:

- Section 3: United Kingdom
- Section 4: France
- Section 5: Germany
- Section 6: Italy
- Section 7: Spain
- Section 8: The Netherlands
- Section 9: Ireland
- Section 10: The Nordics
- Section 11: Central and Eastern Europe

Throughout the remainder of this paper, the term ORSA has generally been used when discussing requirements and improvements that are relevant for the preparatory phase as well as for full Solvency II implementation. However, specific reference to the 2014 FLAOR and 2015 FLAOR is made where necessary.

2. GENERAL STATE OF READINESS FOR ORSA ACROSS EUROPE

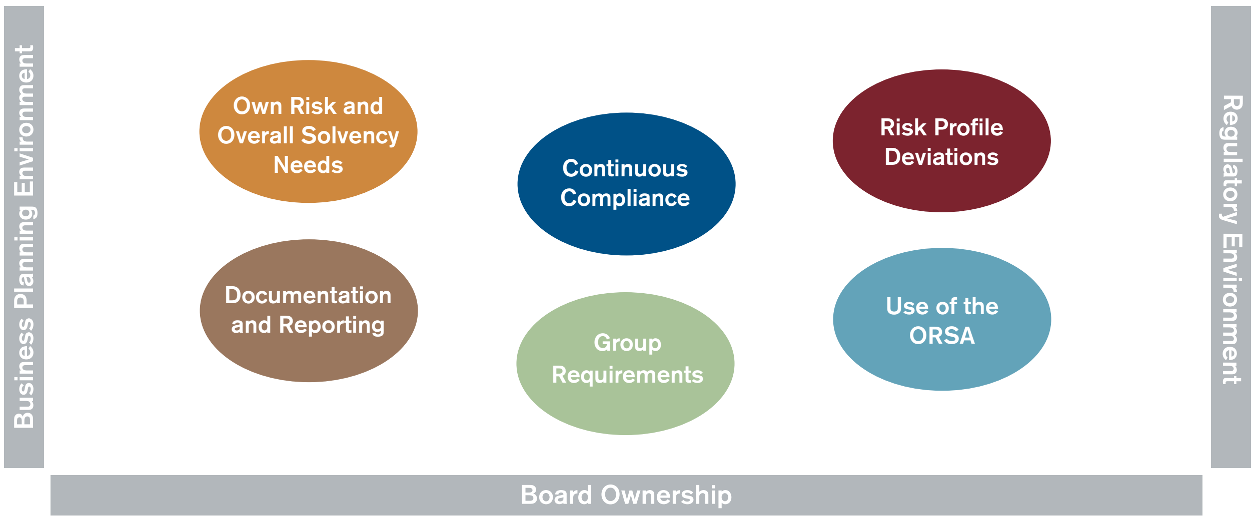
2.1. INTRODUCTION

While EIOPA issued a standard set of preparatory guidelines in 2013, there were various differences in how these guidelines were interpreted and implemented by NSAs across Europe. As a result, we have observed varying degrees of readiness of insurance undertakings for the different ORSA components across European member states.

While this points to some obvious issues with regard to maximum harmonisation (which is discussed in more detail in Section 2.8 below), it is also important to note that we are still in the preparatory phase, albeit the latter stages. This means that undertakings can use this time to develop their ORSA processes further in advance of full Solvency II implementation and may be able to learn some lessons from their European neighbours.

Figure 2 outlines the main components of the ORSA, some of which are discussed in more detail in this section from the point of view of general readiness across Europe.

FIGURE 2: MAIN ORSA COMPONENTS



2.2. ASSESSMENT OF OVERALL RISK AND SOLVENCY NEEDS

The ORSA should include an assessment of the overall solvency needs of the undertaking, taking into account its risk profile, risk appetite, and business plan. This assessment should include a description of all the risks that the undertaking is exposed to and it should be carried out on both a quantitative and qualitative basis. It should cover all material risk exposures, including risk exposures that are not quantified by the standard formula or internal model. In addition, the assessment should include risk exposures that may be difficult to quantify, such as operational risk, strategic risk, and reputational risk, although such risks can be assessed qualitatively.

The quantitative aspects of the overall solvency needs assessment should be carried out by analysing a wide variety of stress (single factor) and scenario (multifactor) tests, including reverse stress tests where appropriate. The calibration of the stresses should reflect the actual past experience of the undertaking under stressed conditions, as well as likely future experience. Management actions may also be considered in the stressed scenarios.

The assessment of overall solvency needs should include a forward-looking perspective, i.e. the undertaking needs to project its capital requirements over the business planning period, allowing for new business, in addition to considering risks that the undertaking could be exposed to in the future. The forward looking assessment may pose challenges for many undertakings, in particular in relation to modelling constraints. Undertakings may find it difficult to project solvency capital requirements into the future allowing for the impact of new business and rebalancing of assets. However, proxy modelling techniques may be helpful in addressing these challenges.

Assessment of own risk

The first step of this process is to assess the undertaking's own risk exposures. Under Solvency II, undertakings must define a risk appetite and approve risk tolerance limits as part of the risk management system and then set up processes and procedures to monitor and manage risk exposures, e.g. risk registers and Key Risk Indicators (KRIs). Undertakings should be able to use this information in the assessment of own risk. As part of the ORSA process, undertakings will need to show how the key risk exposures link to their risk appetites and risk tolerances. Undertakings will also need to rank risk exposures, to identify the most material risks.

A key part of this assessment is that undertakings consider all material risk exposures; regardless whether or not they are quantifiable. While undertakings are normally capable at identifying the main risks that they are exposed to, such as market risks and underwriting risks, they are generally poor at identifying risks that are harder to quantify, e.g. reputational risk or strategic risk. Reverse stress testing and profit and loss attribution analysis are useful ways to identify risk exposures, including those that are not captured in the SCR calculation.

In addition to identifying all material risk exposures, undertakings will need to outline whether risk exposures are backed by capital or risk management techniques are used to reduce the exposures. Material risk exposures that are backed by capital will need to be considered in the assessment of overall solvency needs. Where risk exposures are mitigated, undertakings will need to explain and justify the risk mitigation techniques used.

Many undertakings may already be doing this under the current solvency regime, where NSAs introduced specific requirements in respect of systems of governance and assessment of risk exposures in advance of Solvency II. Undertakings that are already assessing risk exposures on a regular basis should be better placed when carrying out this assessment for the ORSA.

However, many NSAs have criticised undertakings for not considering all key risks in their 2014 FLAORs, even in countries such as the UK and Ireland that already require insurers to assess their risk appetites on a regular basis under the current regime. The main feedback was that undertakings generally ignored risks that are not considered in the SCR calculation or did not consider possible future risk exposures or emerging risks. Undertakings will need to improve on this in their 2015 FLAORs, as noted by many NSAs. In order to achieve this, undertakings should distinguish the ORSA as an independent process, not connected to the SCR calculation, and consider all material risk exposures in this assessment.

The French NSA, the Autorité de Contrôle Prudentiel et de Résolution (ACPR), has also encouraged undertakings to make better use of existing risk metrics in deciding on what stress tests and scenarios to consider in this assessment. This could include KRIs, risk registers and risk mapping, and asset liability matching studies. Undertakings in other countries should also consider this, as the use of existing metrics and processes may improve the ORSA without the need for significant development.

Assessment of overall solvency needs

Following assessment of their risk profiles, undertakings then need to calculate their own solvency needs. There is an obvious overlap between these two assessments, where the assessment of risk profile should be used to drive the calculation of overall solvency needs.

The explanatory text in the Final Report on the Level III Guidelines[2] states that this assessment is expected to at least:

- Reflect the material risks arising from all assets and liabilities, including intragroup and off-balance sheet arrangements
- Reflect the undertaking's management practices, systems, and controls, including the use of risk mitigation techniques
- Assess the quality of processes and inputs, in particular the adequacy of the undertaking's system of governance, taking into consideration risks that may arise from inadequacies or deficiencies
- Include explicit identification of possible future scenarios and address potential external stresses
- Use a valuation basis that is consistent throughout the overall solvency needs assessment
- Connect business planning to solvency needs

Ideally, undertakings would use an economic capital model to calculate their own solvency needs based on their specific risk exposures and internal capital requirements. For example, undertakings may prefer to ensure that they have sufficient capital to cover a 1-in-100 year event over a five year time horizon, instead of the standard formula requirement to hold enough capital to withstand a 1-in-200 year event over a one year time horizon. The 1-in-100 year risk events considered in the calculation of overall solvency needs would be explicitly calibrated to the undertaking's specific risk exposures. This assessment would consider all

2 Guideline 7 in EIOPA's Final Report on Public Consultation No. 14/017 on Guidelines on own risk and solvency assessment.

risks that the undertaking is exposed to, including risks that are not easily quantifiable such as strategic risk and regulatory risk (with sophisticated modelling techniques being employed to quantify such risks). Such an economic capital model would provide an accurate, yet complex, assessment of the undertaking's 'own' overall solvency needs.

In practice, however, the implementation and maintenance of such a model may be disproportionate to the actual risk exposure of many insurance undertakings, in particular those that are using the standard formula to calculate the SCR. In fact, EIOPA has specifically stated that the assessment of overall solvency does not require complex modelling techniques and that where economic capital models are used they do not need to meet the internal model requirements. An alternative to an economic capital model is to use stress and scenario tests as a proxy to calculate the undertaking's own solvency needs. This is the approach that the majority of European insurers have taken in the preparatory phase at least.

One of the main criticisms aired by NSAs across Europe in respect of the 2014 FLAORs was that undertakings did not consider their 'own' risk exposures in the assessment of overall solvency needs. Instead, too much focus was placed on the Pillar I risk modules and capital calculations without adjusting them to reflect the undertaking's actual risk exposure or to consider risks outside the scope of the standard formula. In addition, some group ORSAs did not consider both group-specific risks (e.g. contagion risk, operational risks associated with group structure, etc.) and group-wide risks (i.e. the risks associated with the entities within the group including non-insurance activities). Group ORSAs are discussed in more detail in Section 2.7 below.

This may be due to an insufficient assessment of the undertaking's (or group's) risk profile in the first instance. Without properly determining the risk profile it would be difficult to calculate the overall solvency needs as, by its nature, this calculation should reflect the specific risk exposures of the undertaking. During the preparatory phase, undertakings will have the chance to improve on the work carried out for the 2014 FLAORs by firstly carrying out a full assessment of their risk profiles and secondly using this to determine their overall solvency needs. This includes assessing for all material risk exposures, regardless of whether or not those risks are covered in the SCR calculation, e.g. volatility risk, spread risk associated with EU government bonds, etc. The assessment should also consider risks that are not easy to quantify such as reputational risk or strategic risk, although they can be assessed on a qualitative basis.

In addition, undertakings should consider if they need to make any adjustments to the Solvency II basis in the calculation of overall solvency needs. This could involve looking at things like the extrapolation of the yield curve to the ultimate forward rate, the allowance for contract boundaries or transitional arrangements, etc. In fact, some NSAs – e.g. the Central Bank of Ireland (CBI) and the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) in Germany – have specifically noted that undertakings should consider the extrapolation of the yield curve in their 2015 FLAORs. Undertakings should also consider the confidence interval and time horizon of the Pillar I calculation (i.e. a 1-in-200 year event over a one year time horizon) and whether this is appropriate for their own assessments of overall solvency needs.

Where the confidence interval and time horizon of the Pillar I calculation are deemed to be appropriate, undertakings should consider the calibration of the shocks to ensure that they reflect the specific risk exposures of the undertaking. For example, the current low interest rate environment in Europe has undermined the calibration of the interest rate shocks to some extent. The interest rate shocks are calibrated as a percentage shock to the risk-free yield curve, i.e. the lower the yield curve, the lower the shock. Between March and June of 2015, the European risk-free yield curve moved by more than the standard formula shock in percentage terms. However, in absolute terms this was far from a 1-in-200 year event. Therefore, undertakings should consider whether the standard formula shock is an appropriate reflection of their actual interest rate risk exposures in the overall solvency needs assessment, particularly in the current economic environment.

The appropriateness of the standard formula calibrations for other material risk exposures should also be considered in the ORSA and undertakings should examine risk exposures not included in the SCR calculation, as mentioned above. For example, the Istituto Per La Vigilanza Sulle Assicurazioni (IVASS) in Italy has specifically requested that undertakings consider the risks associated with their asset portfolios and EU government bonds in particular.

The stress and scenario tests included in the ORSA should reflect the undertaking's risk exposures and be used to assess the overall solvency needs. The Level III Guidelines state that undertakings 'should subject the identified material risks to a sufficiently wide range of stress tests or scenario analyses in order to provide an adequate basis for the assessment of the overall solvency needs.' The French NSA, the ACPR, has gone so far as to specifically propose stress and scenario tests that should be included in the 2015 FLAOR. These include two different interest rate scenarios, one based on an extended period of low interest rates and another based on a short period of low interest rates followed by a sudden increase, which are particularly important in the current economic environment. The ACPR has also suggested that undertakings run a scenario based on the worst event experienced by the undertaking to date, e.g. a solvency breach or a significant loss in earnings.

While the stress and scenario tests should cover plausible and reasonable scenarios, undertakings should also consider stress and scenario tests that are sufficiently onerous to materially impact the Solvency II balance sheet, particularly in light of some of the market movements that were observed during the financial crisis. The Dutch NSA, De Nederlandsche Bank (DNB), has stated that the stress tests considered in the 2014 FLAORs were not severe enough and has requested that undertakings consider 'impossible' shock scenarios in future assessments. Undertakings should also consider reverse stress testing, i.e. scenarios that would cause insolvency or bankruptcy.

There are also some risk factors that are best addressed through approaches other than holding additional capital. Liquidity risk is generally cited as one such risk, especially as liquidity risk can be more pronounced on the Solvency II balance sheet through the recognition of a relatively illiquid negative best estimate liability (BEL) as an asset. Undertakings can reduce liquidity risk exposures through a number of management actions not related to capital, for example opening a line of credit with a third party or looking at alternative reinsurance options such as monetising a portion of the negative BEL (although such actions may introduce new risks to the balance sheet, e.g. operational risk). The use of management actions is another area that undertakings should consider for the 2015 FLAOR and future ORSAs, as noted by many NSAs, and is discussed in more detail below.

In the 2014 FLAORs many European undertakings expressed their own solvency needs as a percentage of the SCR (e.g. 120% to 150%). However, little consideration was given as to whether this was appropriate. The SCR is expected to be more volatile than the solvency margin under the current regime. Therefore it may be more appropriate to express own solvency needs in a different way, e.g. as a fixed buffer in excess of the SCR. The most appropriate method will vary by undertaking as it will depend on individual circumstances, but this is something that undertakings should consider in advance of full Solvency II implementation.

Financial modelling

Undertakings may find it challenging to project the Solvency II balance sheet for the forward looking assessment of own risks, in particular considering the allowance for future new business, rebalancing of assets, and projection of capital requirements. Additional complications may arise from the need to combine real-world projections with risk-neutral calculations (e.g. for the technical provisions) at each future time period.

Undertakings need to consider the methodology to use for these projections. For example, some larger insurance undertakings may be recalculating the Solvency II balance sheet in full at each future point in time, while smaller undertakings may be using proxy models to project technical provisions and capital requirements based on certain underlying risk drivers. Layering in the effect of new business is another added complication for undertakings that may be struggling with projections for existing business.

Many European undertakings made adjustments to existing business plan projections for their 2014 FLAORs, which generally resulted in a manual, time-consuming process that can lead to increased operational risk. This was particularly the case in France, where the deadlines imposed by the ACPR resulted in some undertakings simply making high-level adjustments to existing business plans. In the UK, the Prudential Regulation Authority (PRA) noted the projection of forward solvency figures as a significant weakness of the 2014 FLAORs. Going forward, undertakings should invest in developing, automating, and industrialising the process for future ORSAs. In addition, some undertakings used the Solvency I balance sheet as the basis for the overall assessment of solvency needs. While this was allowed under the preparatory guidelines, these undertakings will now need to move to an alternative basis for future ORSAs, which could signal the need for significant model development.

A common issue across Europe is that business plans are generally prepared on an International Financial Reporting Standards (IFRS) or local accounting standard basis and the focus tends to be on the income statement rather than the balance sheet. The transition to Solvency II, including the development of models to project future balance sheets and capital requirements, may be a burdensome process for many undertakings, even before the consolidation at group level is considered.

Independent validation is also an area that undertakings should consider in the future, once the models are sufficiently developed. While this is something that internal model users are focused on, standard formula undertakings across Europe have not really considered independent validations of their ORSA models as of yet. In some countries, for example in Spain, undertakings are prioritising independent review of their Pillar I calculations, but we may see a move toward independent review of the ORSA in the future, in particular if NSAs consider this to be a valuable exercise.

Various approaches were taken by European undertakings in relation to the time horizon used for the forward-looking projections in the 2014 FLAOR. In general most undertakings used the business planning time horizon of three to five years for their FLAOR projections, but a number of undertakings considered much shorter time lines, e.g. one to two years. The Level III Guidelines state that the forward looking assessment should consider a 'medium term or long term perspective as appropriate', therefore a short-term time horizon would not be sufficient. This was reiterated in the feedback from NSAs. For example, in Ireland the CBI stated that many of the 2014 FLAORs focused on a short-term time horizon and has indicated that a term of three years may not be appropriate, depending on the undertakings risk profile.

Management actions

It is also important that undertakings consider management actions in the assessment of own risk and solvency needs. This includes risk mitigating actions that are already in place, which should be outlined in the own risk assessment. Where undertakings have chosen to accept risks, they should outline the rationale and also explain why it is appropriate in the context of the undertaking's risk appetite.

Many NSAs (including the CBI and the ACPR) criticised the lack of information on management actions in the 2014 FLAORs. The DNB has specifically requested that undertakings show results of the stress and scenario tests before and after future management actions are considered. EIOPA also expects that the record of the ORSA shows the impact of management actions on the assessment of overall solvency needs. In order to do this, the management actions would need to be quantifiable. This is a further area of improvement that undertakings can focus on in the 2015 FLAOR and future ORSAs.

In the assessment of overall solvency needs, undertakings should consider whether future management actions could be taken to reduce the impact of adverse events in the stress and scenario tests. In calculating the technical provisions, any assumptions regarding future management actions need to be detailed in the future management action plan and approved by the board of directors (the Board).[3] There is no such requirement with regard to management actions considered in the ORSA. However, as the ORSA must be reviewed and approved by the Board, the Board would need to be comfortable with any management actions considered in the process. As a result, any management actions identified in the ORSA should be objective and realistic and undertakings should also consider if the management actions are plausible following the occurrence of a shock event and achievable within appropriate timescales.

There are many different types of management actions that undertakings can consider (once they are consistent with the undertaking's risk appetite). They may include decisions to mitigate against the risk (e.g. using hedging strategies to mitigate investment risk) or to transfer the risk (e.g. through reinsurance). One of the most severe actions would be to close the business, although this should only be considered in the most extreme circumstances. A possible alternative would be to close a specific line of business and transfer the remaining liabilities to a third party, if a willing buyer existed. Another management action would be to simply retain the risk and not take any actions to reduce the exposure. However, this may not be possible in some cases, i.e. where the undertaking's SCR or risk appetite is breached.

Management actions may also include raising additional capital, in which case undertakings would need to consider whether capital of a sufficient quality could be raised following a shock event and in sufficient timelines. This is linked to the assessment of continuous compliance that is discussed in more detail in Section 2.3.

Internal models

Undertakings that are seeking approval to use an internal model to calculate their capital requirements under Solvency II are in a slightly different position to standard formula undertakings with regard to this assessment. This is because the internal model should already calculate the SCR (or overall solvency needs) based on the undertaking's specific risk exposures, rather than 'standard' risk exposures as per the standard formula.

For internal model undertakings, the validation processes of the internal model may form part of the ORSA. However, undertakings will need to consider whether they need to develop further stress and scenario tests specifically for the ORSA. The process and procedures for setting the stress and scenario tests should be consistent with the internal model requirements.

Undertakings can demonstrate that the internal model plays an important role in the system of governance of the undertaking, as required under the 'use test,'[4] by using the internal model in the ORSA. However, if a different recognition or valuation basis is used in the ORSA compared with the internal model, it will also need to be explained and justified. In reality, we expect that most undertakings will use their internal models in the ORSA and this was allowed for the FLAOR under the preparatory guidelines, even though most internal model users were still working through the approval process. However, internal model users may also need to consider the risk that the internal model application would be rejected by the NSA in the assessment of overall solvency needs.

In future ORSAs, this assessment should be used to demonstrate that all material risk exposures identified by the undertaking are included in the internal model SCR calculation and should confirm and evidence the continued adequacy of the internal model, as noted by the PRA. Where risk exposures are identified that are not included in the internal model, the ORSA should justify the reasons behind their exclusion.

3 As per Article 23 of the Delegated Acts.
4 Outlined in Article 120 of the Solvency II Directive.

2.3. ASSESSMENT OF CONTINUOUS COMPLIANCE WITH THE SCR AND TECHNICAL PROVISIONS

As part of the ORSA process, undertakings are required to assess whether or not they comply with the solvency capital requirements on a continuous basis. This assessment should at least consider:

- Potential future material changes in risk profile
- The quantity and quality of own funds over the business planning period
- The composition of own funds across tiers and how this composition may change as a result of redemption, repayment, and maturity dates during its business planning period

The Actuarial Function should provide input into the assessment of continuous compliance with the calculation of the technical provisions, including details of any potential risks arising from uncertainties connected with this calculation.

The assessment of continuous compliance was not required by EIOPA in the 2014 FLAOR. However, some European regulators, e.g. the DNB, the ACPR, and the Polish supervisor, the Komisja Nadzoru Finansowego (KNF), did require undertakings to carry out this assessment in 2014 and it is required under the preparatory phase guidelines during 2015 as well as in the ORSA itself once Solvency II is fully implemented.

This assessment is required to ensure that the capital management process considers how changes in the undertaking's risk profile can affect the SCR and Minimum Capital Requirement (MCR) and how the own funds may change in stressed scenarios. In addition, undertakings need to consider the evolution of own funds allowing for redemptions, repayments, or maturities over the business planning time horizon.

The explanatory notes to the Final Report on Level III ORSA Guidelines[5] provide details on what undertakings should consider under this assessment, including the following:

- Capital management including at least issuance, redemption, or repayment of capital instruments, dividends, and other distributions of income or capital, and calls on ancillary own funds, including both projected changes and contingency plans in the event of a stressed situation
- The interaction between capital management and risk profile and its expected and stressed evolution
- The undertaking's ability to raise own funds of an appropriate quality and in an appropriate timescale, if required, having regard to access to capital markets, the state of the markets, dependence on a particular investor base, investors, or other members of the group and the impact of other undertakings seeking to raise own funds at the same time
- How the average duration of own funds (contractual, maturity, or call dates) relates to the average duration of insurance liabilities and future own funds needs

In addition, undertakings should assess and identify any relevant compensating measures and offsetting actions that could realistically be taken to restore or improve capital adequacy or cash flow position after a stress event occurs. These requirements effectively enforce the link that should exist between the ORSA and capital management in the undertaking's strategic business planning.

As 2015 is the first year that undertakings are due to carry out this analysis, this year will be a learning process for many. We expect that some undertakings will not be able to achieve all the requirements of the Level III Guidelines during 2015. However, any progress made in this space during 2015 can be developed on further during 2016 and future years.

From what we have seen with regard to this assessment so far, it appears that many European undertakings are focussing on how to estimate or recalculate the SCR on a regular basis in order to assess continuous compliance for their 2015 FLAORs. While regular solvency monitoring is an important risk management tool for insurance undertakings, the assessment of continuous compliance with the SCR should go beyond this and look to ensure that the undertaking is sufficiently capitalised to withstand any expected changes in the economic environment, risk profile, or otherwise during the business planning time horizon.

Such an assessment would obviously also need to consider the expected development of own funds, including in stressed conditions, as outlined in the Level III Guidelines. Much of the information in respect of own funds may already be covered in the undertaking's capital management policy or medium-term capital management plan. These documents may be used as resources by undertakings in developing this assessment in the 2015 FLAOR and future ORSAs. While it is unlikely that these

5 Guideline 10 in EIOPA's Final Report on Public Consultation No. 14/017 on Guidelines on own risk and solvency assessment.

documents will consider the evolution of own funds in stressed conditions, the forward-looking stress and scenario tests used in the assessment of overall solvency needs can also be used for this assessment. This is something that undertakings will need to embed in the ORSA process going forward.

French and Dutch insurers have already completed the assessment of continuous compliance in the 2014 FLAOR and/or earlier versions of the ORSA. Based on what we have seen in these territories, undertakings are generally focusing on demonstrating regular solvency monitoring, rather than specifically addressing the points outlined in the Level III Guidelines. The Dutch NSA has commented on this in its feedback on the 2014 FLAOR and has specifically asked undertakings to consider the development of own funds in future assessments.

With regard to the continuous compliance with technical provisions, undertakings should rely on input from the Actuarial Function to meet this requirement. Specifically, the Level III Guidelines[6] state that the Actuarial Function should:

- Provide input as to whether the undertaking would comply continuously with the requirements regarding the calculation of technical provisions
- Identify potential risks arising from the uncertainties connected to this calculation

This may be interpreted as requiring undertakings to have adequate processes and procedures in place to ensure that the technical provisions are calculated correctly based on the advice of the Actuarial Function. For example, undertakings should ensure that the technical provisions are calculated in line with the methodology and assumptions set out in the most recent Actuarial Function report and that the methodology and assumptions continue to remain appropriate over time.

2.4. ASSESSMENT OF RISK PROFILE DEVIATIONS FROM SCR ASSUMPTIONS

Undertakings need to assess how their risk profiles deviate from the assumptions underlying the SCR. A qualitative analysis is required in the first instance and a quantitative analysis is only required where significant deviations exist.

While the assessment of risk profile deviations was not actually required by EIOPA in the 2014 FLAOR, some European NSAs still required undertakings to carry out this assessment in 2014 (e.g. the ACPR, the KNF, and the DNB). This assessment is required by all NSAs in 2015 under EIOPA's preparatory phase guidelines and will form part of the annual ORSA process under full implementation of Solvency II.

For undertakings using the standard formula, this analysis is required because, by its nature and design, the standard formula is a standardised calculation based on the general quantifiable risk exposures of an average insurance undertaking. It is not designed to capture the specific risk exposures of all undertakings and as a result it may not reflect the actual level of capital that a specific undertaking needs. The aim of this assessment is to ensure that the Board and senior management understand the assumptions underlying the SCR and consider whether these assumptions are appropriate given the undertaking's actual risk profile.

Internal model users that are already working through the pre-approval phase are not required to carry out this assessment in their 2015 FLAORs as it should already be included as part of the internal model framework. However, under full Solvency II implementation, internal model users will need to assess any deviations in their risk profiles compared with the assumptions underlying the internal model SCR. This assessment is necessary to demonstrate the continued appropriateness of the internal model.

EIOPA published a document in July 2014 called 'The underlying assumptions in the standard formula for the Solvency Capital Requirement calculation' to aid undertakings in this assessment. This document does not describe a specific approach for undertakings to take to complete this assessment, but rather outlines the key assumptions underlying the calibration of each of the standard formula risk sub-modules. It is up to individual undertakings to decide how to approach this assessment. In addition to assessing the extent to which the risk exposures are overstated or understated in the standard formula sub-modules, undertakings should also consider risk exposures that are not included in the standard formula risk sub-modules. Given the importance of this document, some NSAs (e.g. BaFin and the ACPR) have translated the full document (or the key points) into the local language to aid undertakings in this assessment.

The preparatory guidelines require undertakings to carry out an initial qualitative assessment and only assess significant deviations on a quantitative basis. The same approach will apply when Solvency II is implemented in full:[7] 'The undertaking should assess whether its risk profile deviates from the assumptions underlying the SCR calculation and whether these deviations are significant. The undertaking may as a first step perform a qualitative analysis and if that indicates that the deviation is not significant, a quantitative assessment is not required.'

6 Guideline 11 in EIOPA's Final Report on Public Consultation No. 14/017 on Guidelines on own risk and solvency assessment.
7 Guideline 12 in EIOPA's Final Report on Public Consultation No. 14/017 on Guidelines on own risk and solvency assessment.

It is not clear how undertakings will determine whether the qualitative assessment indicates that the deviation is 'significant.' The results of a recent Milliman survey in Ireland indicate that a high proportion of undertakings (70%) have not yet defined what constitutes a significant or material deviation. However, some NSAs (e.g. BaFin and the DNB) have linked this to the requirements in respect of capital add-ons outlined in Article 279 of the Delegated Acts. This Article states that a deviation of 10% or more is significant unless there is 'strong evidence that this is not the case'[8] and a deviation of 15% or more is undeniably significant. In calculating the percentage deviation, undertakings should assess the difference between the capital requirement as calculated based on their own risk exposures and the standard formula SCR. This means that undertakings would need to carry out a quantitative assessment if the qualitative assessment suggested that the deviation could be of the order of 10% or more.

The assessment of deviations in the risk profile should include analysis of the various risk modules and sub-modules in the SCR calculation and the correlations between the modules and sub-modules.

The explanatory text originally published as part of the Final Report on the Level III Guidelines[9] states that EIOPA expects the assessment process to include analysis of:

- The risk profile and an assessment of the reasons why the standard formula is appropriate, including a ranking of risks
- The sensitivity of the standard formula to changes in the risk profile, including the influence of reinsurance arrangements, diversification effects, and the effects of other risk mitigation techniques
- The sensitivities of the SCR to the main parameters, including undertaking-specific parameters
- The appropriateness of the parameters of the standard formula or of undertaking-specific parameters
- The nature, scale, and complexity of any simplifications used and justification of their use
- How the results of the standard formula are used in the decision-making process

These requirements link this assessment back to the own risk assessment, the overall solvency needs, and the strategic decision-making process of the undertaking. However, in some circumstances the undertaking may not be able to use the assessment of overall solvency needs to analyse deviations in the risk profile, in particular where the assessment of overall solvency needs has been prepared on a different basis to Solvency II, where different confidence intervals or time horizons have been used, or where agreed management actions have been considered that could impact on the undertaking's risk profile.

Based on the results of a Milliman survey carried out in Ireland in 2015, we expect that many Irish undertakings will try to meet these requirements in their 2015 FLAORs. The survey results show that most undertakings will carry out an analysis of the company's risk profile and an assessment of why the standard formula is appropriate, including a ranking of risks and an analysis of how the results of the standard formula will be used in the decision-making process. In addition to this, many undertakings have also stated that they will provide explanations of the nature, scale, and complexity of the risks to justify any simplifications used, at least on a qualitative basis.

In the UK, many undertakings will be able to use the Individual Capital Assessments (ICA) under the current solvency regime as a reference point for this assessment, as the majority of ICAs are calibrated to the same confidence interval as the standard formula, generally cover the same risk exposures as the standard formula, and are parameterised to reflect undertakings' specific risk exposures. This is in contrast to other European countries where the existing regime cannot be used as a reference point for this assessment.

In the Netherlands, undertakings struggled to meet all the requirements of this assessment in their 2014 FLAORs, with many arguing that an internal model would be needed to properly complete the assessment. Most undertakings focused on the qualitative analysis, with few carrying out a full quantitative analysis. The situation in France was similar, with only 20% of undertakings carrying out quantitative assessments, even though the ACPR had stated that undertakings need only focus on the main risk factors for the 2014 FLAOR.

We expect to see similar situations across other European countries in 2015 as this is the first year that most undertakings will be required to complete this assessment. However, undertakings will be able to build on any progress made in 2015, and any feedback from the NSAs, in order to improve this assessment under full Solvency II implementation.

8 Based on the factors set out in Article 276 of the Delegated Acts.
9 Guideline 12 in EIOPA's Final Report on Public Consultation No. 14/017 on Guidelines on own risk and solvency assessment.

Qualitative assessment

Undertakings should be able to use the analysis of own risk and overall solvency needs in the qualitative assessment as there should be significant levels of overlap between the two. A starting point could be to firstly consider the SCR risk modules and assess deviations from these on a qualitative basis. For each risk module, the undertaking would need to compare its specific risk exposure to the standard formula, using the paper published by EIOPA that describes the assumptions underlying the standard formula. The qualitative assessment may include an analysis of why the standard formula is appropriate, along with the other requirements stated in the EIOPA guidelines (as outlined above).

Some risks that could fall into this category include market risk (where the undertaking's actual asset mix differs significantly from the asset mix assumed in calibrating the standard formula), longevity risk (in respect of impaired life annuities), or interest rate risk (where the standard formula shock may not be severe enough in the current low interest rate environment).

Following this assessment, undertakings will also need to consider if their risk profiles include risks that are not included in the SCR calculation. Again the assessment of own risk and overall solvency needs can be used here as undertakings should have already considered these risks in that analysis. Undertakings should initially focus on the most material risks, as non-material risks are unlikely to result in a significant deviation. Some risks that could fall into this category include spread risk in respect of government bonds, volatility risk (as this is no longer assessed under the standard formula), and the risks associated with employee defined benefit pension schemes.

Where the analysis of own risk and overall solvency needs has been prepared on a Solvency II basis and is appropriate to use in this assessment, undertakings should be in a good position to carry out the qualitative assessments for 2015 at least. Any improvements that are being made to the own risk and overall solvency needs assessment for the 2015 FLAOR (for example following feedback from the NSA) should flow through to this assessment.

Quantitative assessment

Any potentially significant deviations in risk exposure will need to be assessed quantitatively. As a starting point for the quantitative assessment, undertakings may consider the risk exposures that have the highest capital charges in the Pillar I calculation or known risk exposures that are not included in the Pillar I calculation such as volatility risk and spread risk on EU government bonds.

The quantitative assessment will require undertakings to recalculate the capital charges based on their own specific risk profiles. This may be easier said than done as it would effectively require undertakings to calibrate their own 1-in-200 year event scenarios, much in the same way as internal models are developed. However, it is likely that undertakings will use approximations and proxy modelling techniques to carry out this assessment instead, for example by adjusting the standard formula shocks instead of calibrating shocks from scratch.

It is important to remember that undertakings should consider risk exposures that are overstated by the standard formula as well as those that are understated. BaFin has stated that it wants undertakings to focus on risk exposures that are understated by the standard formula as overstatements are not a cause for concern from a regulatory perspective. However, in assessing whether the standard formula is appropriate as a whole, undertakings should consider both overstatements and understatements of their risk exposures, otherwise the recalculated capital requirements will always be higher than the standard formula if they are only considering risks that are understated.

Figure 3 charts the hypothetical quantitative analysis for a fictional life insurer that sells a wide variety of business, including some investment guarantees. This has included the following steps:

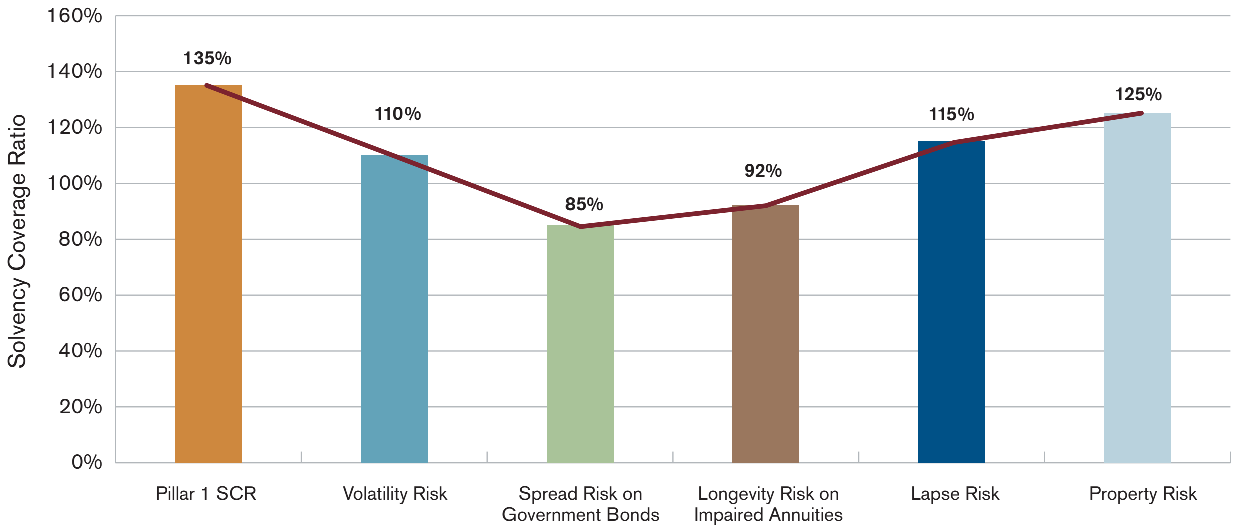
- **Allow for volatility risk:** Based on the volatility risk sub-module that was included in earlier drafts of the Solvency II text.
- **Allow for spread risk on EU government bonds:** Based on the capital charges for similarly rated corporate bonds.
- **Recalibrate the longevity risk sub-module for impaired annuities:** The recalibration is high-level, based on a slightly reduced shock to allow for the fact that longevity improvements are less likely on impaired lives.
- **Recalibrate the lapse risk sub-module:** To be based on a 1-in-200 year lapse event for the undertaking's specific risk exposures (which are less sensitive to lapse risk than the standard formula).
- **Recalibrate the property risk sub-module:** To be based on a 1-in-200 year property crash in the undertaking's national market (where its property investments are held), rather than the general European market.

Undertakings should also consider whether changes to the long term guarantee measures are appropriate, for example removing the volatility adjustment or changing the extrapolation of the yield curve to consider a different last liquid point or ultimate forward rate.

Once the capital charges have been calculated for each risk module, they need to be aggregated to calculate an overall capital requirement. A relatively simple way to do this could be to continue to use the correlation matrix defined within the standard formula for risks that are considered in the Pillar I SCR calculation and to assume that additional risks not considered in the standard formula are fully correlated with the other risk modules. This would be considered a prudent approach, as it would understate the diversification benefits in respect of risks not considered in the standard formula. There is likely to be some level of diversification across the various risks. However, it is important to note that any differences in the correlation factors should also be analysed as part of this assessment and that undertakings will need to justify the approach taken.

Figure 3 shows the incremental change in the solvency coverage ratio based on this assessment for the fictional insurance undertaking. The final capital charge calculated after the adjustment for property risk is approximately 8% lower than the standard formula SCR. Based on the parameters outlined in Article 279 of the Delegated Acts, this would not constitute a significant deviation in risk profile compared with the assumptions underlying the standard formula.

FIGURE 3: ASSESSMENT OF DEVIATION IN RISK PROFILE COMPARED WITH ASSUMPTIONS UNDERLYING THE SCR



Such an assessment will require a significant amount of work, in particular where the undertaking has to calibrate (or recalibrate) 1-in-200 year shock events to reflect its actual risk exposure. However, once an undertaking has assessed the deviations in risk profile to a sufficient level of detail, the analysis should remain fairly constant from year to year. It may need to be updated in certain circumstances, for example following significant changes in the undertaking's risk profile or business plan or changes to the standard formula calibration, but otherwise we would expect that the qualitative analysis would not need to be updated considerably on an annual basis. Therefore it may be advantageous for undertakings to take the time to develop the processes and systems to carry out this analysis in detail during the preparatory phase. While the quantitative analysis will need to be updated each year to reflect the most up-to-date solvency position, the methodology and processes used to do this should not be subject to a significant amount of change year-on-year once they have been developed.

Alternatively, undertakings can carry out this assessment on a 'best efforts' basis during the preparatory phase and build on this to improve the analysis next year. For example, undertakings may carry out a relatively high-level analysis of the assumptions underlying the standard formula SCR during 2015. Such an analysis may provide enough information to assess the most significant deviations in their risk profiles on a qualitative basis and simple risk driver approaches could be used to quantify the impact of the most material deviations. The qualitative assessment could then be extended next year to capture all risk exposures and more accurate techniques could be used to assess the most material deviations.

There will be a variety of approaches taken in the 2015 FLAORs but it is expected that a high proportion of undertakings will fall short of meeting the full Solvency II requirements for this assessment. We have already observed this in the 2014 FLAORs in France and the Netherlands and in some of the 2015 FLAORs for other European countries that have been submitted to date, in particular where undertakings have generally focused on the qualitative analysis with little or no quantitative analysis. However, as mentioned above, undertakings will be able to build on the progress made during 2015 to improve this assessment in 2016 and future years. We also expect that NSAs will provide feedback to undertakings next year in respect of their 2015 FLAOR reports, including feedback on what they expect to see with regard to this assessment. Such feedback should provide useful information for undertakings to enable a move toward full Solvency II compliance in the 2016 ORSA and in future assessments.

Capital add-ons

One area of concern for undertakings during 2015 is in relation to what NSAs will do if this assessment points to a significant deviation in the undertaking's risk profile compared with the assumptions underlying the standard formula. The ORSA, including this assessment, should not result in an obligatory capital add-on but some NSAs (e.g. BaFin and the DNB) have referred to Article 279 in the Delegated Acts when stating what constitutes a significant deviation and this Article is specifically in relation to capital add-ons.

The explanatory notes to the Level III Guidelines say that if the outcome of the quantitative assessment suggests that there are significant deviations between the risk profile of the undertaking and the SCR calculation, the undertaking would be expected to consider how this could be addressed. The guidelines cite a number of ways to do this, including taking measures to better align the risk profile with the standard formula, applying to use undertaking-specific parameters (USPs) in the SCR calculation where this is allowed, or to develop an internal model or partial internal model. Alternatively, the undertaking could decide to de-risk.

This implies that EIOPA (and consequently NSAs) would not be satisfied with a situation whereby a significant deviation continued to exist for some time, without the undertaking setting out steps to be taken to address it. This raises the question of what will happen if undertakings do not take steps to change the calculation of the SCR or to better align their risk profiles to the standard formula? In some cases, undertakings may be satisfied that such deviations are dealt with in the ORSA and included in the undertaking's own assessment of overall solvency needs. If this is not the case, however, we may see NSAs intervene and impose capital add-ons where significant deviations are not addressed.

2.5. USE OF THE ORSA AND THE ROLE OF THE BOARD

Under Solvency II, the Board is responsible for the review and approval of the ORSA. The Level III Guidelines on ORSA state that ORSA process should take the form of a 'top-down approach' and that: 'The AMSB[10] should take an active part in the ORSA, including steering how the assessment is to be performed and challenging the results.'

This needs to be carried out within the context of the business planning process and the Board's strategic decision making, as the Solvency II Directive states: 'The own-risk and solvency assessment shall be an integral part of the business strategy and shall be taken into account on an ongoing basis in the strategic decisions of the undertaking.' The Level III Guidelines expand on this by saying that the results of the ORSA process should be considered in strategic decisions regarding capital management, business planning, and product development and design.

Board engagement and integrating the ORSA into the business planning process are expected to be key challenges for many undertakings. In addition to achieving these requirements, undertakings also need to demonstrate this to NSAs.

The Boards of many European insurance undertakings struggled to be actively involved in the 2014 FLAOR process. This may have been partially due to the late introduction of the final preparatory guidelines at the end of 2013 and the fact that it was the first time the assessment was carried out. It may also be a result of a general lack of understanding by some Boards of the ORSA and what exactly their role should be in the process. Following the first year's teething problems, it is expected that Board engagement will be a priority for 2015 and we have seen many European regulators comment on this in their feedback this year.

The CBI, for example, has stated that Boards generally acted as 'reviewers' of the 2014 FLAORs rather than being actively involved in the process and that this will need to be improved going forward, while the ACPR has criticised the outsourcing of the FLAOR process to external providers where it has limited the Board's involvement and also impacted on the use of the FLAOR in strategic decision making. In the UK, the PRA observed a lack of sufficient evidence of Board engagement in the ORSA process.

Undertakings should be able to use this feedback in order to build on the experience of the 2014 FLAOR and engage the Board more actively in the 2015 FLAOR (where they have not already been submitted to NSAs) and future ORSAs. The 2014 FLAOR can be seen as a learning process as the Board will now be more familiar with the concept of the ORSA, having gone through the first iteration.

In many European countries, some undertakings have facilitated training sessions to educate Boards and senior management on the ORSA process. This has generally improved Boards' understandings of the ORSA process and, more importantly perhaps, what their roles should be in the process. This in turn has led to increased Board engagement in the 2015 FLAOR relative to the 2014 FLAOR. However, the appetite for Board training has varied widely from country to country. For example, we have seen an increased demand for Solvency II Pillar II Board training in Ireland over 2014 and 2015, while Board training in someother countries has generally been limited to the larger insurers.

10 Administrative, management, or supervisory body.

FIGURE 4: BOARD ENGAGEMENT

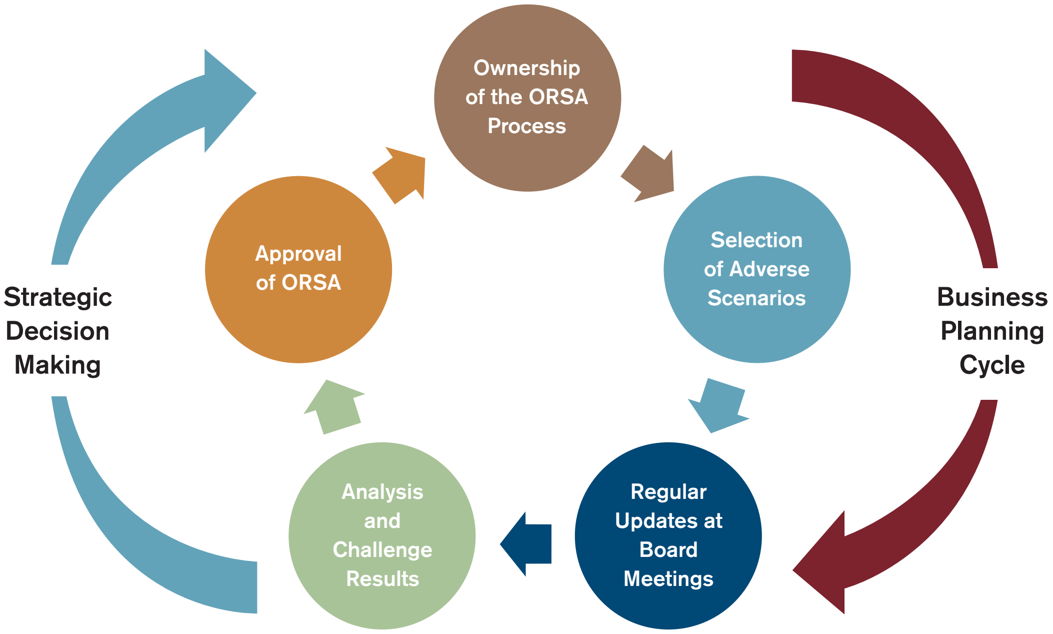


Figure 4 outlines, at a high level, how Boards could be engaged in the ORSA process. The Board should view the ORSA as an annual process or cycle, rather than just a document or report. As the ownership of the process rests with the Board, it should initially be involved in steering the process and deciding how the assessment is to be performed.

This should involve discussing the undertaking's risk exposures, setting how the own solvency needs are calculated, and selecting of adverse scenarios that should be tested. The Board may also be involved in setting how continuous compliance is assessed and how deviations in the risk profile of the undertaking compared with the assumptions underlying the SCR should be analysed. The processes and procedures for these assessments should be approved by the Board in the ORSA policy and reviewed on an annual basis.

Strategic decision making

Through the ORSA process, it is expected that senior management, including the Risk Management Function, would update the Board regularly at board and committee meetings on the progress of the ORSA and any material findings to date. The ORSA process should be embedded into the business planning process and influence the strategic decision-making process. We have already mentioned some links between the assessments outlined above and the strategic decision-making process. It is important that the Board would be informed about any material findings that may influence the undertaking's strategy in advance of making any key decisions. As a result, regular updates may be crucial to ensuring that the ORSA is embedded into the business planning process of the undertaking. It would not be appropriate to simply wait until the report is presented to the Board in full at the end of the process because by that point it may be too late for the ORSA to influence the undertaking's business strategy.

The undertaking's business plan should form the central scenario (or base case) for the ORSA. However, the ORSA also must be used in the decision-making process that influences the undertaking's business strategy. This leads to some circularity in reality which may confuse or complicate the process. However, as undertakings will generally have established business planning procedures in place, it is likely that they will drive the ORSA process in the early years at least. Any findings or outcomes from the ORSA process can then be used to influence the following years' business plans, which is consistent with the view that the ORSA process is a cycle rather than a discrete exercise.

Throughout the year, the minutes from Board meetings, including any discussions relating to the ORSA, should be clearly documented. Such documentation can then be used to demonstrate the Board's involvement in the process. At the end of the ORSA process, the Board should be given the opportunity to analyse and challenge the results and conclusions where appropriate. Analysing the results of the ORSA should enable the Board to advance its understanding of the risks that the undertaking is exposed to and any changes to risk exposures year on year.

The ORSA should inform discussion between the Board and senior management with regard to the undertaking's risk appetite and how best to deal with risk exposures that may breach the undertaking's capital requirements under its own solvency assessment. These discussions should influence the strategic decision making of the undertaking and may lead to changes in the undertaking's business plan. For example, risk management techniques such as reinsurance or hedging programmes may be introduced where the ORSA indicates risk exposures that are in excess of the Board's risk appetite. Alternatively, the assessment of overall solvency needs may show that the undertaking has a significant amount of own funds in excess of its overall solvency needs and the Board may decide to issue a dividend as a result, provided that is has the distributable earnings to do so without impacting on the undertaking's liquidity position. Such discussions and decisions should also be recorded and documented.

In Ireland, the CBI has stated that the ORSA process represents a 'tremendous opportunity' for undertakings to integrate and join existing infrastructure and processes in relation to risk management, capital management, and business planning. Such integration should improve information flow throughout the undertaking and lead to more decision making that is more risk-focused and informed by comprehensive and accurate information.

Challenging the results of the ORSA should enable the Board to steer future processes. If the Board is not satisfied with any aspects of the ORSA it may advise senior management to take an alternative approach in the ORSA process for the following year. For example, the ORSA may need to be updated to consider new and emerging risk exposures that the Board believes are becoming relevant to the undertaking. Again, the discussions surrounding the Board's analysis and challenge of the ORSA should be documented in full to demonstrate Board involvement. The explanatory notes in the Final Report on the Level III Guidelines specifically state that the challenge process performed by the Board should be documented in the record of the ORSA.

In the UK, the PRA stated that the more advanced undertakings had developing detailed management information as part of the ORSA framework, including an 'ORSA dashboard' used to stimulate Board engagement and discussion. The ORSA dashboard follows a similar structure to the ORSA report but with up-to-date information presented in a more visual way (tables, charts, and key messages). This is something that undertakings in other countries may consider in order to improve Board engagement and the use of the ORSA in strategic decision making in the future.

Formal approval

The Board is also required to formally approve the ORSA process and results, including the FLAOR during the preparatory phase (although some NSAs have not formally requested Board approval of the FLAOR). The ORSA must be approved by the Board before the internal report is shared with relevant staff and the supervisory report sent to the NSA. The requirement for a formal approval really necessitates active involvement by the Board in the process as it would be difficult for the Board to stand over formal approval of a process that it has not fully engaged with along the way.

The Board should also be aware of the feedback from NSAs which focused on Board engagement as a key priority for 2015, in particular from the CBI, the ACPR, and the PRA. While the level of feedback from NSAs has varied greatly throughout Europe, in general we would expect that, in most countries, the Boards of insurance undertakings would be more comfortable with the FLAOR process in 2015 and have a better understanding of what they need to do to be more actively involved in the process going forward.

We have already seen this in many countries, where Boards were involved in the process at earlier stages this year compared with last year. Most notably, we have seen the Boards of some undertakings steering the process from its beginnings through discussion and approval of the stress and scenario tests to consider in the overall solvency assessment for 2015. We expect this will continue throughout the remainder of 2015, with Boards actively discussing and challenging the results of the FLAOR before the process and report is approved.

While it is not expected that Board engagement will be up to the full Solvency II standard by the end of 2015 for all insurance undertakings, this is an incremental process. We expect that engagement should improve year-on-year as Boards become more familiar with the ORSA process (and the dynamics of the Solvency II balance sheet in general) and that the ORSA will gradually become more embedded within the undertaking's business planning process as senior management begins to see the benefits of the process.

It is worth bearing in mind that this is a whole new concept for many Boards (and senior management) so it is only natural that it will take time before they are completely comfortable with the process. This is one of the benefits of the preparatory phase, as it allows Boards and senior management to work through some 'dry runs' of the process, and learn from this experience, before Solvency II is implemented in full.

2.6. DOCUMENTATION AND REPORTING REQUIREMENTS

Documentation is another key part of the ORSA process. The Solvency II texts require undertakings to have at least the following documentation on the ORSA:

- Policy for the ORSA
- Record of each ORSA
- Internal report
- Supervisory report

The Level III Guidance sets out specific requirements with regard to the ORSA policy and the ORSA record, which are discussed further below. Each undertaking is free to draft the internal report and the supervisory report in whatever format is most appropriate. The supervisory report should be submitted to the NSA as part of the Solvency II Supervisory Review Process. Its aim is to provide a basis for dialogue between the undertaking and the supervisor in relation to the key risk exposures of the undertaking.

We have seen different NSAs take different approaches with regard to what they have required undertakings to do in respect of documentation and reporting requirements during the preparatory phase. In Italy, for example, IVASS specifically stated what it expects solo undertakings and groups to document in the FLAOR reports. The Finnish Financial Supervisory Authority provided undertakings with an example of a table of contents for the FLAOR report, while other NSAs left this up to undertakings themselves. The PRA stated that it would not prescribe the format or content of the report as it should reflect the specific circumstances of the undertaking. A number of NSAs also imposed reporting deadlines on undertakings with regard to the submission dates of their supervisory FLAOR reports (e.g. IVASS, BaFin, the ACPR, and the Icelandic supervisor, Fjármálaeftirlitid), while other NSAs did not prescribe any FLAOR reporting timescales.

We have also seen mixed feedback from NSAs with regard to the standardisation of the content of the 2014 FLAOR documents. In particular the Spanish NSA, the Dirección General de Seguros y Pensiones, has criticised the use of standardised external templates, which has led to certain contents of the FLAOR being the same for many undertakings, in particular in the description and assessment of own risks and in the description of the system of governance. However in Denmark, the NSA has praised the use of standard templates, stating that it has improved the quality of the FLAOR process and report for at least the smaller undertakings.

A common theme across most European countries is that undertakings generally prepared only one FLAOR report in 2014, which was used as both the internal report and the supervisory report. This is perfectly acceptable under the requirements. It is likely that undertakings will continue to produce a single report for the foreseeable future, due to the workload involved in preparing this report.

Insurance industry commentators have stated that the best reports clearly identify the three different assessments: the assessment of own risk and overall solvency needs, the assessment of continuous compliance, and the assessment of significant deviations in risk profile. Given the significant overlap between these three assessments, however, it is understandable that undertakings may find it difficult to separate them in the report. This is an area that undertakings should consider in more detail in future reports.

Evolution of ORSA documents

Over time, we expect to see the contents of the ORSA documents, including the policy, record, and reports, evolve and change as undertakings become more comfortable with the Solvency II requirements and what the various stakeholders expect to gain from the ORSA process.

The requirements of the ORSA policy are prescribed in the Level III Guidelines so it is unlikely that the content will change significantly from year to year. However, all risk management policies are required to be reviewed on an annual basis and reapproved by the Board.[11] Therefore the policy will need to be updated to reflect any changes in the undertaking's risk profile or business plans and to the ORSA processes and procedures in the future.

One area where there is scope for change is in relation to the ORSA reports. We may see some divergence between the internal report and the supervisory report as undertakings start to consider that the Board and NSAs may be interested in different aspects of the ORSA process. The Board may be predominantly concerned with the conclusions that can be drawn from the ORSA to drive strategic decision making, while the NSAs may be more interested in the assessments of future solvency cover and the appropriateness of the standard formula. As the ORSA process becomes more embedded into the undertaking's risk management framework and supervisory review process, undertakings will become more comfortable with what the stakeholders want to see documented in each of these reports.

11 As required under Article 41 (3) of the Solvency II Directive.

Article 306 of the Delegated Acts outlines what should be included in the supervisory report. This includes the qualitative and quantitative results of the own risk assessment and the conclusions drawn by the insurance undertaking from those results. If should also include details on the methods and main assumptions used in the assessment of the undertaking's overall solvency needs and a comparison between those solvency needs, the regulatory capital requirements, and the undertaking's own funds. In addition, the supervisory report should include qualitative information on the deviation in risk profile from the underlying assumptions of the standard formula, and where significant deviations have been identified a quantification of the deviation.

Over time we expect that undertakings will begin to redraft the supervisory reports to only include the information outlined in this article and any other specific information requested by the NSA. We have already seen NSAs complain about the length of the FLAOR reports. The PRA has noted that the best reports were 'not too long' and BaFin has requested a reduction in the size of the supervisory report, but an increase in the content of the report, i.e. more quality and less quantity. The Norwegian supervisor, Finanstilsynet, has also requested that undertakings aim to keep the ORSA report as concise as possible. In Italy, IVASS actually requested that the supervisory report be approximately 30 pages in length, although in reality the reports prepared by Italian undertakings tended to be much longer than this.

The record of the ORSA

The record of the ORSA is also likely to become an important document from an NSA's point of view and over time some of the detail from the supervisory and internal reports may be moved to the record of the ORSA instead. To date, there has not been much discussion with regard to the record of the ORSA. This may be due to the fact that many undertakings have not yet prepared these documents, focusing on the FLAOR report and ORSA policy instead.

The Level III Guidelines state that record of the ORSA should evidence and document the ORSA process. EIOPA has also stated that the record of the ORSA should contain a lot more information than what should be included in the internal and supervisory reports. It should provide information on how the ORSA is performed to a level of detail that would enable a qualified third party to evaluate the assessment. In addition the explanatory text to the Final Report on the Level III Guidelines[12] states what the record of the ORSA should include. This is outlined in Figure 5.

FIGURE 5: RECORD OF THE ORSA

Own Risk and Overall Solvency Needs
- Details of the own risk analysis
- Details of the links between the risk assessment and the capital allocation process
- An explanation of how the approved risk tolerance limits were taken into account
- An explanation of how risks not covered with own funds are managed
- Details of the overall solvency needs over a one year period as well as the forward looking assessment
- A description of what internal and external factors taken into consideration in the the forward looking assessment

Management Actions
- Action plans arising from the assessment of overall solvency needs and the rationales for them
- Details of any planned relevant management actions, including explanation and justification
- Impact of planned management actions on the assessment of overall solvency needs

Continuous Compliance
- Details on the conclusions of this assessment and the rationale behind them

Deviations in Risk Profile
- The identification and explanation of the differences between the undertaking's risk profile and the assumptions underlying the calculation of the SCR, including how the undertaking will address (or has addressed) significant deviations

Board Ownership
- A record of the challenge process performed by the Board

Internal Models
- A description of the changes made to the internal model during the application process

Process
- A technical specification of the approach used for the ORSA assessment

12 Guideline 5 in EIOPA's Final Report on Public Consultation No. 14/017 on Guidelines on own risk and solvency assessment.

This shows that the record of the ORSA should contain a significant amount of information and it is easy to see how this could include more detail than the internal and supervisory reports. However, many undertakings may currently be including this level of detail in the FLAOR reports themselves, and in some cases this overlaps with what NSAs have requested that undertakings include in their FLAOR reports. A more reasonable approach may be to include the detailed information in the record of the ORSA and to draft the internal and supervisory reports as an 'executive summary' of the ORSA, provided that this includes a sufficient level of detail to enable its use in strategic decision making and to meet the regulatory requirements. The record of the ORSA would then be available to the Board, senior management, and the NSA if further information was required.

2.7. GROUP REQUIREMENTS

There are some specific ORSA requirements for groups. The ORSA must be conducted for the group as a whole, reflecting all entities that fall within the scope of group supervision. However, a single ORSA report document can be prepared for the group so long as it details the results of the ORSAs from each legal entity. Where a group wishes to produce a single ORSA it needs to get prior approval from the NSA.

The group ORSA should address possible sources of capital within the group and identify potential needs for additional capital. It should also assess the availability, transferability, and fungibility of capital, and any envisaged transfer of capital within the group, which would have a material impact on any individual entity, and its consequences. The group ORSA should also cover any risk transfer across the group via hedging strategies or group reinsurance programs. The ORSA should demonstrate the alignment of individual strategies with the ones established at the group level.

We have observed a variety of approaches with regard to the group ORSA. There is not a specific approach that is favoured by groups throughout Europe — some groups prepared single FLAOR documents in 2014, while others did not. In general the workload is expected to be the same, regardless of which option is chosen, as a single ORSA is required to show the results of the ORSA for each legal entity.

Group ORSAs should consider both group-specific risks such as contagion risk, risk associated with intragroup transactions, risk concentrations, and operational risks associated with group structure, amongst others, as well as group-wide risks (i.e. the risks associated with the entities within the group). They should also assess the risks associated with entities that are non-regulated, non-financial, and entities that are not in the European Economic Area (EEA).

In general, the comments in this paper in respect of individual entity ORSAs apply equally to groups. In addition, the feedback published by NSAs applies as equally to group ORSAs as to individual entity ORSAs. The PRA provided specific comments for groups in its feedback on the 2014 FLAOR (noting that the best reports considered group-specific risks as well as group-wide risks and that several reports contained insufficient detail on the overall direction of the group from a strategic and risk perspective), but other regulators tended to provide more general feedback.

One common topic mentioned by a number of NSAs across Europe was that subsidiaries of large groups tended to focus on the risk exposures of the group rather than the local entity risk exposures in the 2014 FLAOR reports. This will need to be improved on in 2015 and future years. While subsidiaries will need to assess the group risk exposures for the group ORSA, it is also important that they have the freedom to assess local risk exposures too. This is required even where a single group report is prepared, i.e. for inclusion in the local entities section of the group ORSA.

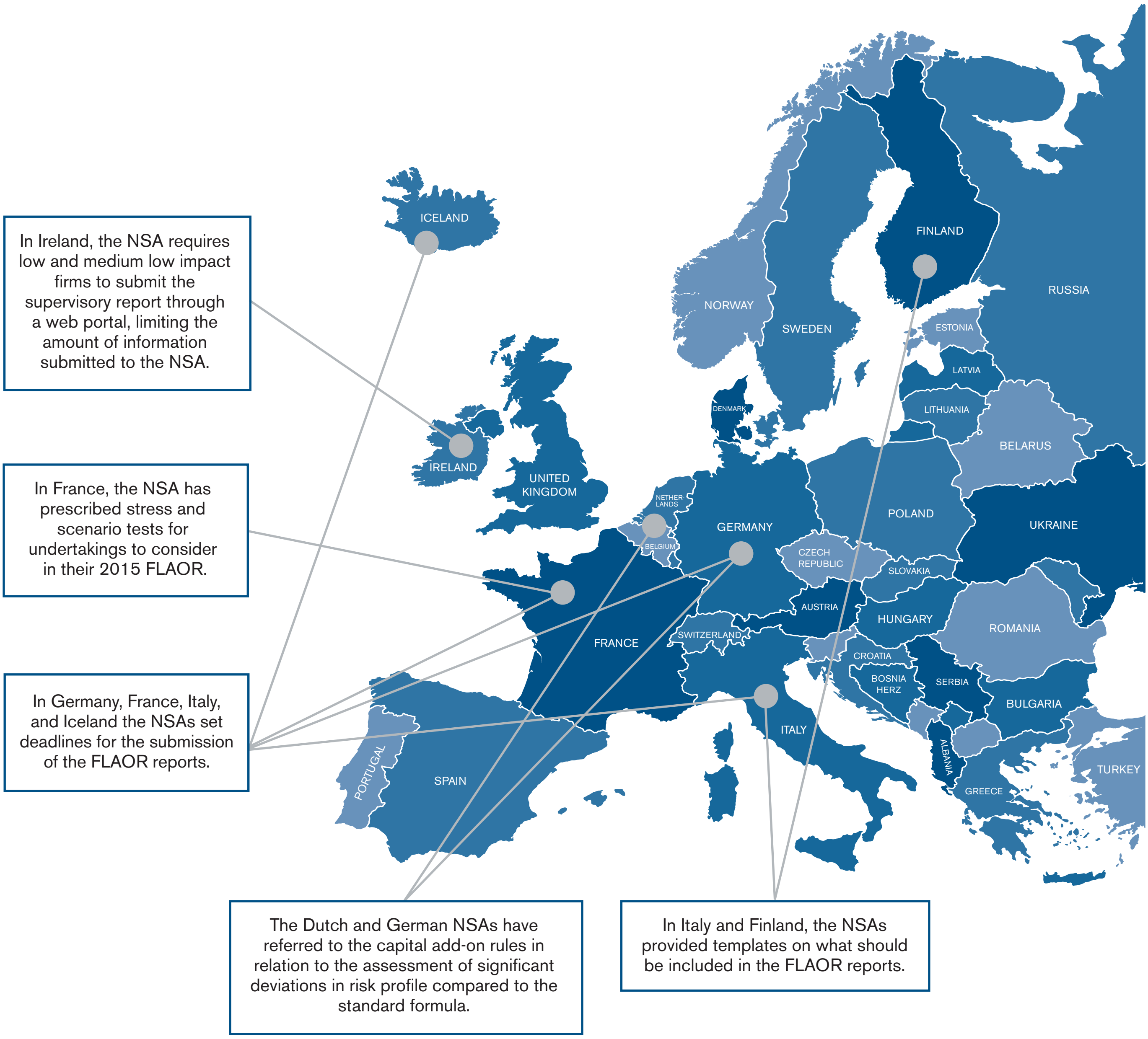
The reporting deadlines imposed by some NSAs (e.g. in Italy, Iceland, Germany, and France) may also create practical issues for large groups, where subsidiaries are working toward different deadlines in different member states for the completion of their local FLAORs or ORSAs. Groups will have had to deal with this during the preparatory phase in 2014 and 2015. It remains to be seen whether these NSAs will continue to impose these deadlines under full Solvency II implementation.

2.8. MAXIMUM HARMONISATION

One of the key aims of Solvency II is to achieve 'maximum harmonisation' in insurance supervision across Europe. This means that member states have little discretion when transposing the Solvency II Directive into national law, with most largely replicating the text of the Directive and only adapting it where absolutely necessary.

However, it may be difficult to achieve maximum harmonisation with regard to NSAs' interpretations of the Solvency II Directive and associated Level II and Level III texts. We have already seen this with regard to the different interpretations of and focuses on the FLAOR requirements by NSAs across Europe. Figure 6 outlines just some of the differences in approach taken by NSAs in the FLAOR assessments in 2014 and 2015.

FIGURE 6: DIFFERENCES IN 2014 AND 2015 FLAOR ASSESSMENTS



As time goes by we may see more of a divergence in interpretation as NSAs across Europe begin to focus on particular output from the ORSA or specific themes. This may not necessarily be a bad thing as insurance undertakings operating in different markets and selling different products are likely to have different risk exposures.

EIOPA has established Colleges of Supervisors for the effective and consistent supervision of groups across Europe. EIOPA is also a member of each of these colleges, which should aid in the aim of consistent supervision. The quality and consistency of the ORSA process across a group is part of the action plan of the College of Supervisors for 2016. As part of this dialogue, NSAs will have a chance to discuss their interpretations of the ORSA requirements, which may lead to more consistency across Europe. While the colleges have been set up specifically with group supervision in mind, it is likely that the discussion between NSAs and EIOPA will also have an impact on their interpretations of the rules for solo undertakings.

3. UNITED KINGDOM

3.1. INTRODUCTION

In the UK, the Individual Capital Assessment (ICA) has been in a place for a number of years, and firms are typically using the ICA as a starting point for their FLAOR processes. However, the FLAOR and ORSA differ from the ICA in a number of key areas, which are explored in more detail below.

The ORSA is broader than the ICA. The risks considered in the ORSA are about more than just failing to meet capital requirements. Rather, they relate to the uncertainties associated with delivering on the undertaking's goals and ensuring the associated risks are well understood and managed with appropriate resources, so that the risk profile of the undertaking remains within the risk appetite set by the Board.

The national supervisory authority in the UK, the Prudential Regulation Authority (PRA), issued preparatory guidelines to UK firms in December 2013 which largely mirrored the preparatory guidelines issued by EIOPA. Undertakings were allowed to use the capital requirements under the current regime for the 2014 FLAORs but the PRA expects that all undertakings will move toward a Solvency II basis for the 2015 FLAORs. No timelines were prescribed in respect of when reports should be submitted to the PRA, although it was noted that this should be detailed in the undertaking's ORSA policy.

In June 2015, the PRA issued a letter to UK insurers outlining its general feedback following a high-level review of the 2014 FLAOR reports. The overall assessment was that the FLAORs were 'of a reasonable quality.' There were, however, two specific areas where the PRA observed notable weaknesses, namely in respect of stress testing and the forward looking assessment. This is commented on in more detail in Sections 3.2 to 3.5 below.

3.2. OWN RISK ASSESSMENT AND OVERALL SOLVENCY NEEDS

The assessment of own risk and solvency requires firms to consider all of their material risks (not just the ones covered by the Pillar I SCR calculation), whether or not they are deemed to be quantifiable.

The PRA views the ORSA within the strategic management of the business rather than focusing on the solvency aspect of it. The approach outlined by the PRA requires firms to also consider wider risks, where capital is not an appropriate mitigant, e.g. liquidity risk, reputation risk.

For quantifiable risks most firms are building on work previously completed under the ICA regime,[13] but many seem to be struggling to convincingly describe risks not covered by their ICAs. The requirement to explain the risk profile is a challenge for most undertakings, and one where there may not be existing expertise within the firm. The challenge spans areas such as operational, strategic, and reputational risk.

The ICA focussed on risks that produce financial uncertainty, and specifically those which might be absorbed with capital. Most UK undertakings equate risk with the capital needed to absorb it and often avoid the issue of understanding the actual risk itself, which can have consequences beyond immediate financial losses. This has led to widespread use of statistical approaches based on loss data and expert estimates which, by design, do not provide any rigorous linkage to other (non-capital) outcomes or directly back to risk management efforts. Scenario-based approaches are slightly more helpful but arguably leave firms open to the criticism that they have missed important scenarios, so the process for choosing them needs to be pretty robust. The most sophisticated approaches utilise developments in complex modelling techniques, such as casual models which show how the underlying dynamics of risks can simultaneously lead to a range of outcomes.

The PRA has expressed concern over the types of scenarios and stresses being considered. In its feedback letter to the insurance industry, it stated that 'none of the reports reviewed contained sufficient evidence of appropriate stress and scenario testing.' Specific issues relate to the fact that the assessment is:

- Too focused on regulatory capital (rather than the amount of capital firms think they need)
- Too simple (the PRA cited that reverse stress testing should be included)
- Insufficient in its consideration of management actions in adverse scenarios

Scenario and stress testing methodologies have advanced considerably over the past few years, and a key theme is the need to consider multi-factor scenario tests in the ORSA. This is an area that UK undertakings will need to develop further for the 2015 FLAOR and future ORSAs.

13 ICAs typically focused on market risk, credit risk, insurance risk, operational risk, and liquidity risk. Some undertakings also explicitly covered the risks associated with employee pension schemes in the ICA.

In most cases, the shortcomings are in developing the scenarios in the first place – the models are typically capable of producing the results once the scenario itself has been agreed and implemented. There are some technical challenges in producing the calculation, such as calibration of economic scenarios in stochastic models, although these are surmountable.

The guidance is clear that the assessment of risk should include decisions with regard to the extent to which non-capital mitigation techniques are used and consideration of the effectiveness of the system of governance in different circumstances. The more advanced firms in the UK typically decide the scenarios to test initially, rather than using capital requirements to select the scenarios. The scenarios' dynamics are then explored, including, but not limited to, their capital consequences.

The PRA also noted a weakness in respect of the forward-looking aspect of the 2014 FLAORs. While the majority of UK FLAORs produced in 2014 provided reasonable reviews of the current and past risks and solvency positions, they did not include sufficient forward looking assessments. The PRA appreciates that this may be due to difficulties in projecting solvency figures. However, undertakings are expected to find ways to estimate future solvency positions as part of the ORSA under Solvency II. In addition, the PRA stated that the ORSA should explore risks to which the undertaking might become exposed in the future, including emerging risks.

The PRA anticipates that UK undertakings will develop their FLAOR processes further in 2015 to improve on these weaknesses in advance of full Solvency II implementation.

3.3. CONTINUOUS COMPLIANCE AND ASSESSING RISK PROFILE DEVIATIONS

Continuous compliance with the SCR and technical provisions

UK undertakings will be required to carry out this assessment for the first time in 2015. To assess continuous compliance, some undertakings have implemented sophisticated solvency monitoring approaches (in some cases to monitor solvency on a daily basis), while others are relying more on indicators and roll-forward approaches. Roll-forward approaches are commonly used by UK undertakings to report to the PRA on a monthly basis under the current ICA regime.

Proxy modelling techniques such as curve fitting and least squares Monte Carlo have been employed as regular solvency monitoring solutions by some UK insurers. These solutions typically automate the risk profile associated with market risk and the undertaking's assets, although rolling forward the insurance risk profile has presented some challenges.

However, the Level III Guidelines require firms to consider the evolution in own funds in the assessment of continuous compliance, and, while many UK undertakings are focusing on demonstrating regular solvency monitoring in 2015, the evolution of own funds seems to be an area in which undertakings are still struggling. Undertakings will need to develop ORSA processes to look at this for future assessments.

Assessing risk profile deviations compared with the SCR

The assessment of deviations in risk profile is also high on the UK regulator's list. Undertakings must explain how their risk profiles differ from those in the SCR using the standard formula approach. There are a number of areas where undertakings may diverge from the standard formula. Some of these are discussed in Section 2.4 above. Specifically to a UK context, however, guarantees under with-profits and variable annuity contracts give rise to equity, interest rate, and property volatility risks, which may not be consistent with the standard formula assumptions.

The majority of ICAs are calibrated to the same confidence level as the standard formula and generally cover the same risk exposures as the standard formula. In addition, the ICAs have been parameterised to reflect undertakings' specific risk exposures. Therefore, in most cases, the ICA can provide a unique reference point for comparing the undertaking's actual risk profile with the standard formula. Undertakings can start by comparing the impact of each stress and, if there are any material differences, they can look in more detail at the data, methodology, assumptions, etc. underlying the deviation. This is in contrast to other European countries where the existing regime cannot be used as a reference point for this assessment.

In its feedback letter to the insurance industry, the PRA reiterated the importance of this assessment in stating that the ORSA 'should demonstrate that the standard formula is appropriate for the risks in the business and is representative of its risk profile and that the ORSA framework should be used to monitor, on an ongoing basis, the appropriateness of the standard formula.'

While the PRA has stated that it expects most UK undertakings to be well aligned to the standard formula, undertakings will still need to justify the appropriateness of the standard formula. This is expected to be a key challenge for UK undertakings, both in terms of justifying the overall appropriateness and addressing weaknesses or gaps with respect to specific risk exposures, in particular where the ICA calibrations are stronger than the standard formula equivalent. This may be the case for many undertakings where the ICA calibrations have gradually been strengthened over time (for example, because of the PRA's view, industry benchmarking, and so on).

3.4. USE OF THE ORSA AND THE ROLE OF THE BOARD

A key difference between the ICA and the ORSA is the role of the Board. The guidelines make it very clear that the Board is to take a hands-on role in steering the ORSA assessment and in challenging the results of the process. This may be a significant cultural change for some UK insurers as it is different from the level of engagement needed for ICA exercises. UK Boards are concerned about how this should work in practice — particularly how they will go about providing suitable evidence for the PRA that this engagement or challenge has taken place and that its insights have been used in decision making. Many UK undertakings are still wrestling with this, but those closest to meeting the PRA's expectations thought carefully about recording specific discussions relating to the 2014 FLAOR and any key decisions coming from them.

The PRA feedback points to more advanced undertakings developing detailed management information as part of the ORSA framework, including an 'ORSA dashboard,' which follows a similar structure to the report but with up-to-date information presented in a more visual way (tables, charts, and key messages). These dashboards have been used to stimulate Board engagement and discussion.

Irrespective of this, however, the PRA has noted that some 2014 FLAOR reports did not sufficiently evidence the extent of the Board's involvement, in particular with regard to challenging the results of the FLAOR. In addition, there is a lack of evidence to show how the ORSA has been embedded into the business planning process, including how the results have been used to inform strategic decision making. This lack of evidence may be due to the fact that these guidelines were not fully complied with in respect of the 2014 process. Regardless, going forward, undertakings will need to ensure that these guidelines are complied with and that this is evidenced in the 2015 FLAOR and future ORSA documentation.

3.5. DOCUMENTATION AND REPORTING REQUIREMENTS

The PRA did not prescribe the format or content of the 2014 FLAOR report, recognising that the report needed to reflect the specific risk profile and governance mechanism of each undertaking and group. The PRA also concluded that it was not going to provide a 'summary sheet' for undertakings to use when submitting their FLAORs.

In its feedback to the insurance industry, the PRA cited that the best FLAOR reports:

- Include a clear summary
- Highlight the main messages and issues
- Are not too long
- Clearly signpost supporting documentation

They did not provide any other specific feedback in respect of the reports themselves. However, they did provide some specific feedback in relation to the ORSA policy, noting that the policy should be a stand-alone document and not from part of the ORSA report, and they provided some detail on what was considered to be best practice in respect of the ORSA policy.

4. FRANCE

4.1. INTRODUCTION

In France, the national supervisory authority, the Autorité de Contrôle Prudentiel et de Résolution (ACPR), extended the scope of the FLAOR in some circumstances beyond that envisaged in the interim guidelines issued by EIOPA, following a pilot ORSA in 2013. As part of this extension, the ACPR requested that undertakings complete all three key requirements of the FLAOR for the 2014 report. This included:

1. **Assessment of own risk and overall solvency needs:** The ACPR acknowledged that the SCR could be a part of the assessment of overall solvency needs, but that this assessment could not be limited to the risk exposures covered in the SCR. The assessment of other risk exposures could include asset liability matching, liquidity risk, hedging strategies, etc. Undertakings should consider management actions that could be pursued in order to mitigate the risks in adverse scenarios (i.e. by capital or other means).

2. **Continuous compliance:** The ACPR requested that the assessment of continuous compliance with the capital requirements (SCR and MCR) and technical provisions be performed across the business planning horizon, and, at a minimum, up to the Solvency II implementation date (1 January 2016).

3. **Deviations in risk profile:** The ACPR advised undertakings to limit this analysis to the main drivers of the risk profile, focusing on parameters where undertakings could justify an adjustment of the SCR, e.g. through the use of USPs or a partial internal model. While this is less onerous than the full ORSA requirements, it went beyond the FLAOR requirements that were set out by EIOPA for 2014.

In addition, all French insurance undertakings and groups within the scope of Solvency II were required to prepare a FLAOR report during the preparatory period (in contrast to 50% market coverage required by EIOPA). The FLAOR supervisory report was requested to be submitted to the ACPR by 24 September 2014, but undertakings were free to choose the valuation date used in the projections.

Without requiring formal approval by the Board, the ACPR requested that the Board be involved in the FLAOR process, through the definition of the business plan, risk appetite and risk tolerances of the undertaking, and the adverse stresses and scenarios to be tested in the FLAOR.

A large share of the French market participated in the 2014 FLAOR. The ACPR stated that of the 404 FLAOR reports received in respect of 2014, 205 were received from non-life insurers (86% of the market share), 170 were received from life insurers and composites (70% of the market share), and the remaining 29 reports were submitted by other undertakings, including groups and reinsurers. Of the reports received, 92% covered all three requirements of the FLAOR.

The ACPR has stated that the same framework will apply in respect of the 2015 FLAOR reports, with some refinements, based on its analysis of the 2014 exercise. The submission date for the 2015 FLAOR is 18 September 2015. The feedback from the ACPR is discussed in more detail in the sections below.

4.2. OWN RISK ASSESSMENT AND OVERALL SOLVENCY NEEDS

There is no uniform market practice amongst French insurers in terms of defining overall solvency needs. A significant part of the market defines this as the amount of capital necessary to cover a percentage of the SCR in stressed conditions, taking into account the development of the business over the projection term. The percentage is generally defined within the undertaking's risk appetite framework as the target minimum solvency ratio to be maintained in a stress scenario. However, the calibration of the stress tests and the target post-stress solvency ratios vary significantly across undertakings.

Stress tests are generally defined in respect of risk factors where the company has a significant exposure (in terms of amount or in terms of sensitivity) and are calibrated based on either statistical observation (e.g. for financial risks and, for the most advanced undertakings, underwriting risks) or based on the undertaking's own experience (e.g. for operational risk where undertakings have poor or non-existent data).

As mentioned above, most undertakings in France assessed their own solvency needs based on the SCR calculation in 2014. Many undertakings, however, did make an allowance for spread risk in respect of EU government bonds in assessing their overall solvency needs, in particular where they had significant exposures to EU government bonds. In other cases, undertakings also considered interest rate and equity volatility risk in assessing their overall solvency needs. The stress tests for these risk exposures were generally calibrated based on historical data.

Internal model undertakings generally used the internal model framework to carry out this assessment, defining the overall solvency needs as the economic capital necessary to survive an extreme event with a probability above 99.5%.

In its feedback to the insurance industry, the ACPR noted that the assessment of own risk and overall solvency needs generally included a description of the undertaking's material risk exposures, along with a forward-looking analysis. It noted that undertakings rarely included an analysis of technical provisions, reinsurance, and investments, and that group FLAORs often neglected the risk factors specific to group structures, such as contagion risk. These items will need to be improved for the 2015 FLAOR and future ORSAs. The ACPR has encouraged undertakings to make better use of existing metrics in deciding on what stress tests and scenarios to consider in the 2015 FLAOR, provided that they enrich the ORSA. This could include such metrics as key risk indicators (KRIs), risk registers, risk mapping, and asset liability matching studies. This will be a key area for development for French insurers in 2015 and beyond.

In addition, the ACPR has proposed some specific scenarios for undertakings to consider in their 2015 FLAOR, including:

- **Interest rate risk:** (a) Prolonged period of low interest rates, and (b) short period of low interest rates followed by a sudden increase in interest rates (savings and protection business).
- **Increase of legal age of retirement** (protection business).
- **Regulatory risk:** (a) Mass lapse, and (b) increased competition on prices (both linked to recent changes in regulation for health, protection, and non-life business).
- **Increase in inflation rates** (non-life and annuity business).

The ACPR has also suggested that undertakings run an additional scenario based on the worst event experienced by the company. The ACPR has left it up to the undertaking to define this specific scenario, but it could be based on a scenario that caused, or almost caused, a solvency breach such as a market crash, or a scenario that resulted in a large loss of earnings such as a material operational risk event.

4.3. CONTINUOUS COMPLIANCE AND ASSESSING RISK PROFILE DEVIATIONS

Continuous compliance with the SCR and technical provisions

Most undertakings complied with the ACPR requirements to assess continuous compliance through the projection of the SCR and eligible own funds, taking account of the future development of the business plan in the base scenario and the stressed scenarios as defined by the undertaking in the 2014 FLAOR. Of the undertakings that submitted FLAORs in 2014, 82% covered the assessment of continuous compliance with the SCR, and 31% covered the assessment of continuous compliance with the MCR, but only 12% covered the assessment of continuous compliance with the technical provisions.

The framework defined by the ACPR requires undertakings to demonstrate that they will comply with the SCR and MCR under the base case and stressed scenarios. Large players in the market had understood the EIOPA Guidelines to require undertakings to set up tools and systems within the risk management framework to demonstrate regular solvency monitoring, e.g. to be able to identify an early breach and report it to senior management or the ACPR. Those undertakings had set up proxy models to assess the solvency ratio, or KRIs, based on breakeven limits or thresholds on a frequent basis. The parameters of these models are generally assessed with regression analysis based on stressed scenarios, focusing on the main risk exposures of the undertaking. Other undertakings are using approaches based on enterprise risk management KRIs. Such approaches generally assess the limits or thresholds of the main risk factors that the undertakings are exposed to, based on sensitivities of the solvency ratio to those risk factors.

While such approaches can be used to demonstrate regular solvency monitoring, they do not meet all of the requirements with regard to the assessment of continuous compliance in the ORSA. For example, the EIOPA Guidelines require undertakings to assess the quality and quantity of own funds, including the tiering of own funds, as part of the assessment of continuous compliance. As the ACPR has not specifically required French undertakings to look at own funds under the preparatory phase (other than in the calculation of the solvency ratio), undertakings may have some work to do in this space in advance of full implementation.

In addition, over 85% of French undertakings did not include an assessment of continuous compliance with the technical provisions in the 2014 FLAOR. Many undertakings may need to develop methods and procedures to carry out this assessment. The EIOPA Guidelines require the Actuarial Function to provide input into this assessment and to identify any potential uncertainties connected with the calculation of the technical provisions. French insurers will need to provide more detail on this in their 2015 FLAORs.

Assessing risk profile deviations compared with the SCR

In 2014, the ACPR limited the scope of this requirement to qualitative analysis of the main risk factors only. Most undertakings complied with these guidelines – of the FLAOR reports received by the ACPR in 2014, 72% included this qualitative analysis, with 20% carrying out this assessment on a quantitative basis using approaches such as enterprise risk management (ERM) analysis, KRIs, sensitivity analysis of risk factors, or based on empirical data and statistical analysis using past data. Some undertakings also used approaches similar to those that can be used to calibrate USPs.

The main objective of this analysis is to demonstrate that, at an individual risk module level, and at an overall level, the assumptions underlying the calibration of the standard formula are either adequate or conservative, compared with the company's risk profile.

Most undertakings intend to gradually extend the scope of this assessment to include quantitative analysis of significant risk factors, which is in line with the requirements of the ACPR and the ORSA under full Solvency II implementation. In addition, undertakings will need to extend this assessment to consider any significant risks not covered in the SCR calculation. Some of the larger French undertakings started to develop methods to assess significant deviations in their risk profiles on a quantitative basis during 2015. It is not yet clear whether these undertakings will include this assessment in their 2015 FLAORs, as it was not specifically requested by the ACPR.

In general, it is expected that this is an area that French insurers will need to develop over the course of 2015, and in future years, in order to ensure compliance with the ORSA requirements. Section 2.4 above discusses some of the approaches that undertakings can use to carry out this assessment.

4.4. USE OF THE ORSA AND THE ROLE OF THE BOARD

In France, the integration of the FLAOR into the business planning process was jeopardised to some degree by the reporting deadlines imposed by the ACPR. The ACPR requested that the supervisory report be submitted by 24 September in 2014 (with the 2015 FLAOR due to be submitted on 18 September 2015). However, most of the larger French undertakings had already developed their ORSA processes with a December submission date in mind, based on the requirement to integrate the ORSA into the business planning process. For example, the ORSA process may have been developed with the following timelines in mind:

- Strategy setting during the summer months, including defining budgeted sales and expenses
- Business planning and ORSA calculations to be carried out in the autumn, with some of the more advanced undertakings leaving time for an iterative process allowing for the interaction between strategic decisions and risk management
- Board review and approval in December, followed by submission of the supervisory report

For undertakings that had already defined the valuation and validation process in previous exercises, it was impossible to report the results of the 2014 FLAOR to the ACPR, as it was still being performed at the required submission date. This resulted in many undertakings reporting numbers in their 2014 FLAORs based on earlier valuation dates, with high-level adjustments made in some cases to reflect the most up-to-date balance sheet.

As this exercise was the first real dry run, Board involvement was fairly limited. In many cases, the ORSA report was presented to the Board after being sent to the ACPR, without formal approval or, in some cases, without any Board involvement.

In its feedback, the ACPR reported that a significant number of the reports were prepared by, or with the help of, external providers, thus limiting the ownership of the process by the undertaking and, in particular, by senior management and the Board. The ACPR noted that outsourcing of the FLAOR process generally resulted in a limited (or even lack of) strategic dimension to the FLAOR and in a lack of concrete plans for management actions or strategic and operational decisions resulting from the process.

For 2015, the ACPR has requested that the Board demonstrates its involvement in the FLAOR process, engages in debate on the FLAOR framework and results, and validates the FLAOR reports. In addition, the ACPR has requested the integration of the ORSA process within the risk management framework and within the strategic analysis of the company, with the expectation that the results of the ORSA will be translated into actual management actions.

4.5. DOCUMENTATION AND REPORTING REQUIREMENTS

The ACPR has not provided a large amount of specific feedback on the documentation or reporting requirements. Its current focus is on risk management policies and it recommends that undertakings formalise and approve their policies during the preparatory phase, specifically requesting that undertakings prioritise their ORSA policies.

This feedback is likely to be based on the results of an ACPR survey in 2014 which indicated that most undertakings are not sufficiently prepared with regard to their risk management policies — less than 30% of undertakings stated that they were largely prepared (more than 75% of the work done) and over 40% of undertakings stated that they are not prepared (less than 50% of the work done) or had not yet begun drafting their risk management policies.

Therefore, it is expected that French insurers will need to focus on developing the ORSA policy and getting this approved by the Board in 2015.

5. GERMANY

5.1. INTRODUCTION

On the whole, the German national supervisory authority, the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), introduced similar requirements for the preparatory phase as those outlined by EIOPA. BaFin did not explicitly require projections of capital requirements and overall solvency needs to be calculated on a Solvency II basis in 2014, as the Solvency II preparatory phase technical specifications were not published until April 2014. As a result of this, undertakings were allowed to assess their overall solvency needs based on the current solvency regimes, but local accounting approaches on a book value basis were not allowed. Nevertheless, for the 2014 FLAOR, almost all undertakings used the Solvency II basis to calculate and project their risk capital and own solvency needs. In 2015, all German undertakings that are subject to the Solvency II regime are required to use the Solvency II basis for the assessment of overall solvency needs in the FLAOR.

Additionally in 2015, all undertakings need to demonstrate the appropriateness of the standard formula based on their individual risk profiles and consequently report any deviations between their own solvency needs and the standard formula calculations.

BaFin requested that undertakings submit their FLAOR reports within six months of the opening valuation date, so for example, where an insurer used 31 December as the opening balance sheet date for the FLAOR, the supervisory report had to be submitted to BaFin by end June.

5.2. OWN RISK ASSESSMENT AND OVERALL SOLVENCY NEEDS

In Germany, most undertakings used the Solvency II basis as the underlying balance sheet in the 2014 FLAOR, with many undertakings basing the calibration of the Solvency II balance sheet on a local quantitative impact study on Pillar I calculations conducted by BaFin in 2014.

In general, the assessment of overall solvency needs was either based on the undertaking's own risk model (for example an economic capital model) or its Pillar I calculations. Most German undertakings closely aligned their own solvency needs to the Pillar I capital requirements in the 2014 FLAORs, without considering their full current risk exposures or their future risk exposures. The stress and scenario tests considered in the 2014 FLAORs were generally insufficient to cover all risk exposures. Instead, undertakings tended to focus on the risks included in the SCR calculation. Where additional risks such as reputational or strategic risks were covered, this was generally qualitative.

Whilst most German undertakings included single factor stress tests in their 2014 FLAORs, scenario tests and reverse stress tests were only considered in some cases. Where scenario tests were included, undertakings generally based them on the resilience tests required under the current solvency regime (e.g. property and equity shocks). A small number of undertakings considered reverse stress tests based on individual risk drivers in the 2014 FLAOR. Reverse stress tests based on combined scenarios were not generally considered.

Going forward, insurers will need to consider scenario and reverse stress tests, in addition to single factor stress tests, based on the individual risk profile of the insurer. In addition, the stress tests and scenarios should consider both external and internal factors that could impact on the solvency of the undertaking.

Where recommendations in respect of future management actions were included in the 2014 FLAOR, they were generally derived from the outcomes of stress tests, sensitivities, and projections. In cases where the stresses resulted in a breach of the SCR, undertakings generally outlined management actions that could be taken to rectify the situation, although this tended to be on a qualitative basis rather than a quantitative basis. In general, potential management actions were assessed only at a very high level.

Projections of future technical provisions and capital requirements were generally based on the undertaking's established business planning time horizon (usually three to five years). The majority of life insurance undertakings projected the balance sheet on a stochastic basis as significant guaranteed benefits are offered by most German life insurers. Undertakings that do not offer significant guarantees generally used a more high-level approach, often based on risk drivers. This approach, however, tended to be favoured by non-life insurers rather than life insurers, given the nature of their obligations. Regardless of which approach was used, the projections were generally carried out with the minimum level of automation, resulting in a significant amount of manual calculations and general processing issues for German undertakings. We expect that many undertakings will need to develop their models further in 2015, and in future years, to automate and industrialise this process.

5.3. CONTINUOUS COMPLIANCE AND ASSESSING RISK PROFILE DEVIATIONS

Continuous compliance with the SCR and technical provisions

German insurers will need to assess continuous compliance with the SCR and technical provisions for the first time in 2015. It is expected that many German insurers will demonstrate regular solvency monitoring as part of this assessment. However, this assessment also requires undertakings to consider the evolution of own funds over the business planning period so further work will be required in this area. This is discussed in more detail in Section 2.3 above.

Assessing risk profile deviations compared with the SCR

The assessment of whether or not the undertaking's risk profile deviates from the assumptions underlying the standard formula is required in Germany for the first time in 2015. This process includes a number of steps. Firstly, the underlying assumptions of the standard formula need to be compared with the undertaking's risk profile as described in the document published by EIOPA in July 2014. BaFin has provided undertakings with a German translation of this paper because of its importance in this process. All risks have to be justified qualitatively, including risk exposures that are not included in the standard formula calculation.

Secondly, in cases where there are possible deviations in the risk profile, undertakings need to test whether these deviations are significant. This needs to be assessed on a quantitative basis and should identify what the capital charge for that specific risk would be if it was calculated based on the undertaking's actual risk profile rather than the structure underlying the SCR. BaFin has stated that it is mostly concerned with risks that are understated in the SCR rather than those that are overstated, but undertakings should assess both.

Following the quantitative assessment of deviations, undertakings then need to justify the SCR calculations. BaFin issued a technical specification in relation to this assessment in March 2015 in which it classified a 10% deviation as significant and a 15% deviation as 'undeniably significant.'[14] The deviation can be assessed by comparing the undertaking's own solvency needs with the total SCR.

The identification of significant deviations of the risk profile will not automatically result in an increase in the SCR through the use of a capital add-on. But it could provide BaFin with a reason to examine whether or not the undertaking should use USPs or an internal model or partial internal model. Potential supervisory actions could be avoided by adjusting the risk profile to remove or reduce deviations from the underlying assumptions of the standard formula, for example through the use of management actions such as reinsurance or hedging programmes. However, such management actions may take time to plan and implement.

5.4. USE OF THE ORSA AND THE ROLE OF THE BOARD

The Boards of German insurance undertakings were required to approve the 2014 FLAOR process and reports, resulting in some form of Board involvement in 2014 FLAORs. Reviewing, challenging, and approving the FLAOR process, however, generally occurred at a very high level. For many undertakings, the approval of the FLAOR report, and the connected discussion and challenge of results, was carried out at the same Board meeting.

As a result, the majority of German insurers did not use the FLAOR as part of the business planning process in 2014. Most undertakings considered the first report as a regulatory compliance exercise, but in the future it is clear that the ORSA needs to be connected to the strategic planning processes. Many of the larger undertakings have already started to embed the ORSA process into their business planning frameworks and we expect that smaller undertakings will do this incrementally over the next year or so.

In 2014, many German undertakings integrated the FLAOR process with existing risk management processes under the current solvency regime. Going forward, we understand that some undertakings plan to rethink their processes to be more in line with the ORSA requirements under Solvency II. This may involve undertakings revising their internal ORSA policies and may also require changes to existing systems of governance.

Board usage of the FLAOR is still at an early stage in Germany. Although an increased understanding by the Board of its role in the ORSA process was observed from 2014 to 2015, Board ownership is still not at an acceptable level. Some insurers have facilitated ORSA training sessions for the Board and senior management, which has resulted in an improved acceptance and greater understanding of the process, and should ultimately lead to increased Board engagement in the future.

14 This is based on Article 279 of the Delegated Acts which focuses on capital add-ons.

5.5. DOCUMENTATION AND REPORTING REQUIREMENTS

BaFin has stated that the FLAOR reports should reduce in size but increase in content, i.e. it wants more quality and less quantity. In some specific comments on the 2014 FLAOR reports, BaFin stated that the supervisory report should only contain the necessary information and that information which could be found in other reports and documentation should not be included in a FLAOR report.

In addition, BaFin has requested that undertakings include an outline of the whole risk profile in the FLAOR report for 2015, including detailed descriptions of the undertaking's risk exposures.

It is not yet clear whether BaFin will continue to require German insurers to submit ORSA reports within six months of the opening valuation date. However, if the six-month deadline continues to be in place under full Solvency II implementation, undertakings will need to rethink their ORSA processes to make sure that they view the ORSA as a continuous cycle rather than a discrete process. This may involve engaging Boards in the latter half of the year to begin steering the ORSA process for the coming year, instead of waiting until the balance sheets results are available at the year-end.

6. ITALY

6.1. INTRODUCTION

The Italian national supervisory authority, Istituto Per La Vigilanza Sulle Assicurazioni (IVASS), issued a letter to insurance undertakings in April 2014 outlining the requirements that would apply during the preparatory phase. These largely mirrored the preparatory guidelines issued by EIOPA. In particular, the two-phased approach was adopted, whereby the assessments of continuance compliance and risk deviations from the standard formula were not required in 2014. These assessments were required for the first time in 2015.

In common with some other European supervisors, IVASS set out strict deadlines with regard to when the regulatory reports needed to be submitted. The 2014 FLAOR was to be submitted by 31 October 2014 (based on a valuation date of 31 December 2013) and the 2015 FLAOR was to be submitted by 30 June 2015 (based on a valuation date of 31 December 2014). IVASS also provided specific detail on what should be included in the FLAOR report, which is discussed in more detail in Section 6.5 below.

Undertakings were allowed to use a valuation basis that differed from the Solvency II basis, for example an IFRS or economic capital basis, but if they chose to use a different basis they were required to demonstrate why it provided a better perspective on the undertaking's risk profile, strategy, and business management, as required under the EIOPA guidelines. However, most undertakings in Italy prepared their 2014 and 2015 FLAORs on a Solvency II basis.

In March 2015, IVASS issued a general letter to undertakings outlining feedback in respect of the 2014 FLAOR and setting out additional requirements for the 2015 FLAOR. The main feedback was that the 2014 FLAORs generally included too much focus on the description of the FLAOR process and governance structures and not enough commentary on the methodologies and assumptions used in assessing the own risk and solvency needs as well as insufficient analysis of the results. IVASS also indicated that the projection term should cover a minimum of three years.

In addition, IVASS noted that the 2014 FLAORs did not provide sufficient information on the data sources used to carry out the projections. As data plays an important role in the reliability of the results, IVASS requested that undertakings provide commentary on the source and quality of the data used in the forward looking assessments as well as details of the assumptions underlying the calculations in the 2015 FLAOR.

6.2. OWN RISK ASSESSMENT AND OVERALL SOLVENCY NEEDS

Many Italian insurers focused on the SCR stresses in assessing their overall risk and solvency needs in the 2014 FLAOR. In general, only single factor stress tests were considered, with few undertakings preparing reverse stress tests or scenario tests. In addition, some undertakings simply applied these stresses to the balance sheet at a point in time, rather than projecting the Solvency II balance sheet under the stressed conditions.

We expect that many undertakings will improve the assessment of overall solvency needs in the 2015 FLAOR by including scenario tests and reverse stress tests. In addition to the general feedback, we understand that IVASS has also provided some individual feedback to undertakings in respect of the stress tests considered in their 2014 FLAORs which should drive improvements in 2015 and beyond.

IVASS also included some commentary in respect of investment risk in its general feedback to the insurance industry. IVASS has requested that undertakings consider specific risks relating to their portfolios of assets, citing investments in government bonds as a particular example. In this regard, it has requested that undertakings include stresses to the macroeconomic environment in the 2015 FLAOR, including detail on the impact that these stresses may have on the undertaking's ability to meet liabilities to policyholders and any management actions that the undertaking could consider to mitigate this investment risk.

6.3. CONTINUOUS COMPLIANCE AND ASSESSING RISK PROFILE DEVIATIONS

Continuous compliance with the SCR and technical provisions

IVASS did not require Italian undertakings to carry out this assessment in 2014, so 2015 is the first year that Italian undertakings will be assessing continuous compliance as part of the FLAOR process.

Many undertakings have taken a high-level approach with regard to continuous compliance by describing the process of how the SCR is monitored on a regular basis (e.g. through the use of risk drivers, proxy modelling, etc.) and how the technical provisions are coordinated by the Actuarial Function. It is expected that undertakings will need to spend more time developing this section of the ORSA under full Solvency II implementation, in particular monitoring the development of own funds over the projection period as outlined in the Level III Guidelines.

Assessing risk profile deviations compared with the SCR

The assessment of how deviations in the risk profile compared with the assumptions underlying the standard formula was also required for the first time in 2015. Many Italian undertakings struggled to understand how best to meet this requirement, with most focusing on a qualitative assessment rather than a quantitative assessment. This suggested that there were no significant deviations in their risk profiles compared with the standard formula. However, the definition of the 'standard' formula means that it cannot meet the specific risk exposures of all insurers, so some undertakings are likely to have significant deviations in their risk profiles compared with the assumptions underlying the standard formula.

Where Italian undertakings left it until the start of 2015 to begin work on the 2015 FLAOR, the end June deadline limited the amount of time available to consider how to tackle these assessments (as it overlapped with the preparatory phase submission of information deadlines). This may have been a contributing factor in the high-level approach taken by most insurers. As a result, it is expected that a lot of work needs to be carried out in this space by Italian insurers in the latter half of 2015 in advance of full Solvency II implementation, and beyond. Italian insurers should be able to utilise some of the approaches outlined in Section 2.4 above to improve this assessment in the future.

6.4. USE OF THE ORSA AND THE ROLE OF THE BOARD

The Italian NSA introduced regulations in 2008 in relation to governance of insurance undertakings. These regulations required undertakings to set up risk management functions, develop risk policies, and evaluate their risk profiles, amongst other things. While these regulations generally resulted in the Boards of Italian insurers having a better understanding of their overall risk exposures, they still struggled to fully engage with the FLAOR process in 2014 and 2015.

While the Board was required to approve the FLAOR process in 2014 and 2015, actual Board involvement through the whole process was limited in most circumstances. This was partly due to the deadlines imposed by IVASS in respect of submission of the FLAOR reports. The requirement to base the FLAOR on a valuation date of 31 December 2014 and submit reports to IVASS on 30 June 2015 limited the timelines to six months for the 2015 FLAOR. This was particularly onerous as undertakings were also required during this time period to prepare their financial statements, perform their normal solvency reporting under the current regime, and meet the Solvency II preparatory guidelines in respect of submission of information. As a result, Boards did not have a significant amount of time in early 2015 to improve on the levels of engagement in the FLAOR process relative to 2014 and their involvement mainly focused on the business plans rather than embracing the whole FLAOR.

It is now expected that Board engagement and embedding the ORSA into the business planning process will be a focus for the remainder of 2015. Board training sessions can be an efficient way to increase understanding of the ORSA process and to stimulate Board engagement. In addition, ORSA policy documents were required to be finalised and approved by the Board by end June 2015. The policy documents aid in embedding the ORSA into the business planning process of the undertaking and should document how the Board will steer the ORSA process. Going forward into 2016, Italian undertakings should be able to use the ORSA policy documents to work through the ORSA process. The policy documents should outline the exact requirements of the Board in respect of the ORSA, including initial engagement in discussions regarding the stress and scenario tests and regular updates at Board meetings, and they should support the challenge and discussion of the ORSA results at Board meetings before final approval of the ORSA.

If the end June deadline continues to be imposed by IVASS following full Solvency II implementation, undertakings may need to rethink the ORSA process to ensure that some tasks are carried out in the latter half of the year, i.e. undertakings should consider the ORSA as a continuous cycle rather than a discrete process. For example, during the latter half of the year the Board can begin to steer the ORSA process for the following year by discussing and approving the stress and scenario tests to consider. Undertakings may also need to revisit their business planning timelines to ensure that the ORSA can be embedded into this process.

6.5. DOCUMENTATION AND REPORTING REQUIREMENTS

Unlike many other national supervisory authorities, IVASS outlined specific details of what it wanted undertakings to include in the FLAOR report in 2014 in an Annex to its initial letter to the insurance industry. While all of these requirements should form part of the FLAOR process, undertakings in other countries had the freedom to decide whether they should be documented in the FLAOR report or in one of the other documents, e.g. the record of the ORSA.

In preparing the report, undertakings were allowed to refer to relevant information in documents already submitted to IVASS. In addition, IVASS requested that the FLAOR report submitted to the regulator be approximately 30 pages in length (we understand that this is before allowing for references to other documents). Italian undertakings generally struggled to meet the proposed length, with many insurers producing much longer FLAOR reports.

For the 2014 FLAOR, IVASS requested that undertakings include the following in the report:[15]

- Details of the processes and procedures used in the forward looking assessment
- Description of the methodology and assumptions used in the forward looking assessment, including details on the source and quality of data used
- Details of long term guarantee measures used and their impact on technical provisions, SCR, MCR, and own funds
- Commentary on the conclusions from the results of stress and scenario tests, with an indication of management actions undertaken or planned
- Analysis of the connections between the results of the stress and scenario tests and the own solvency requirements and risk tolerance of the undertaking and the strategies of the company, including management strategies, own funds, business planning, product development, etc.
- Requirements for group FLAOR reports

Most undertakings used this list as the starting point for their 2014 FLAOR reports, although it was a challenge to meet all the requirements. IVASS subsequently added to this list its feedback on the 2014 FLAORs, issued in 2015. We have already discussed most of the items included in the feedback above. In addition to more information on data sources and quality, stresses on government bonds, and increased focus on the results and outcome of the analysis, IVASS also requested that undertakings provide information on the following items in the 2015 FLAOR:[16]

- Information on the FLAOR process and procedures as adopted in the ORSA policy
- Explicit indication, with a greater level of detail, of the connections between the results of the stress and scenario tests and the own solvency requirements and risk tolerance of the undertaking and the strategies of the undertaking or group
- In the context of group ORSAs, consideration of the risk exposures of all group companies, including those that are unregulated and those based in non-EEA countries

It is not clear whether IVASS will continue to set out specific requirements for the report following full implementation of Solvency II. Such prescriptive requirements could be seen to undermine the 'own' aspect of the own risk and solvency assessment. However, IVASS has stated that it wants to maintain the spirit of the personalised format of the FLAOR/ORSA. The explanatory text in the Final Report on the Level III Guidelines states that some of this information should be included in the record of the ORSA, so there may be a significant amount of overlap between these two documents if this information also needs to be included in the ORSA supervisory report.

The end June submission deadline may be more of a concern, as such a restrictive deadline may place limitations on undertakings with regard to Board engagement (as mentioned above), as well as increasing workloads during the first half of the year.

15 Note that this is not the full list of information requested but just gives a flavour of the level of detail specified by IVASS.
16 Note that this is not the full list of information requested but just gives a flavour of the additional information requested by IVASS.

7. SPAIN

7.1. INTRODUCTION

In Spain, the national supervisory authority, the Dirección General de Seguros y Pensiones (DGFSP), did not issue any formal requirements in respect of the FLAOR for 2014, just a general indication to the market to comply with EIOPA's guidelines for the preparatory phase. All the largest undertakings in the Spanish market performed a FLAOR during 2014.

We understand that no specific feedback has been received by undertakings that submitted a FLAOR report to the DGFSP in respect of 2014 and the supervisor has not released any general feedback to the insurance industry as of yet.

7.2. OWN RISK ASSESSMENT AND OVERALL SOLVENCY NEEDS

In general, most undertakings in Spain based their 2014 FLAORs on the Solvency II balance sheet. In some cases, the balance sheet did not fully comply with Solvency II requirements but the most significant components of the balance sheet were generally calculated on a Solvency II basis.

Most undertakings only included single factor stress tests in the forward looking assessment of capital needs, generally focusing on interest rate risk or sometimes spread risk. A small number of undertakings also performed stress testing on both economic and non-economic factors. While most undertakings calculated their own solvency needs with reference to the Pillar I SCR calculation, we are aware of one undertaking at least that calculated its capital requirements on a more stringent basis (based on a higher confidence level).

Most undertakings included a description of their material risks in the 2014 FLAOR reports, but in some cases the risks were not analysed either quantitatively or qualitatively. Where material risks were analysed this was generally in the context of existing analysis performed previously in the day-to-day operations of the company, e.g. asset liability management studies, review of complaints handled, and other operational risk measures. In Spain, undertakings have generally not analysed risk exposures that are commonly considered to be difficult to analyse or quantify, such as reputational risks, the risk of competition, loss of market share, or future risk exposures.

There are also some material risks associated with regulatory uncertainty which are not considered in great detail in the FLAOR, specifically relating to the application of Solvency II in Spain. One of the main uncertainties is in respect of the approval of the matching adjustment in all relevant portfolios as expected, as this is a significant long term guarantee measure for the Spanish market. In most cases, undertakings did not consider the impact of non-approval of the matching adjustment in their 2014 FLAORs.

Another uncertainty relates to the application of contract boundaries for annually renewable term risk products, where the DGFSP has officially indicated that certain actions need to be taken by undertakings to ensure that all future premiums can be included within the contract boundaries (e.g. communication to policyholders of their renewal rights). In addition, there is also some uncertainty in relation to funeral expense insurance, which is a significant product line in the Spanish market. The DGFSP has indicated that specific regulations will exist for this business, but they have yet to be finalised or fully tested.

Some undertakings considered or analysed future management actions that could be taken to address the impact of the stresses in the 2014 FLAOR, such as risk management techniques or solutions not related to capital. Some examples include making a decision to stop selling certain lines of business, to change the features of a certain product, or to rebalance the asset portfolio to better match the liabilities.

The most common approach to projecting the future SCR in the Spanish market is through the application of proxy modelling techniques. The majority of undertakings use approximations in order to layer on the technical provisions associated with future new business. In Spain, there is a wide spectrum of model sophistication which does not always correlate with company size. While models have been implemented to calculate the Pillar I technical provisions and capital requirements at the valuation date, work is still required to develop these models to operate efficiently and this has been prioritised relative to the development of ORSA modelling capabilities.

While the DGFSP is yet to comment on the improvements that need to be made for the 2015 FLAOR and beyond, we can opine on the areas that we expect undertakings to focus on, based on our experience in the market. For example, where undertakings were part of larger groups, the stress tests considered in the 2014 FLAOR were generally driven by the group FLAOR requirements. Going forward, it will be important that subsidiaries of groups consider stress and scenario tests that are relevant to the local risk exposures and market.

Most undertakings focussed on market stress tests in 2014, but other risks may have a significant impact on the Solvency II balance sheet, such as longevity and persistency risk. In addition, most of the stresses considered in the 2014 FLAOR were point-in-time stresses on the balance sheet at the valuation date. Whilst some undertakings performed stresses beyond the valuation date, this was generally limited to subsidiaries of large insurance groups. As some undertakings have not developed their ORSA models to perform stresses beyond the valuation date and are unlikely to be able to do so before full implementation, we expect that some undertakings will focus on providing more point-in-time stresses for now. Such stresses can provide valuable insights into the behaviour of an undertaking's business following a shock event and should aid undertakings to better understand the dynamics of the Solvency II balance sheet. Models can be developed in the future to perform stresses beyond the valuation date where appropriate.

7.3. CONTINUOUS COMPLIANCE AND ASSESSING RISK PROFILE DEVIATIONS

Continuous compliance with the SCR and technical provisions

There are differing interpretations by Spanish undertakings on how to meet the continuous compliance requirements. The spectrum of approaches taken varies from being able to prove, at any point in time, compliance with the SCR and technical provisions to having a longer-term view that over the business planning horizon the forward looking assessment shows adequate coverage.

In addition, the evolution of the own funds over the business planning horizon is being considered by most undertakings to some degree as part of this assessment, although many undertakings have not yet assessed their ability to raise capital of an appropriate quality, within appropriate timescales, and in a stressed environment. We expect that this is an area that undertakings will need to develop further over 2015 and beyond.

As part of the assessment of continuous compliance, we expect that, at a minimum, undertakings should perform adequate stress testing in order to understand the sensitivity of the coverage ratio to events which could occur between successive full calculations of capital requirements. A few companies have taken this approach. Other companies plan to use simplified indicators to monitor whether or not they may be moving toward breaching the SCR.

In respect of technical provisions, the larger insurers in the market are already calculating the BEL on a quarterly basis (or more regularly in some cases). Input from the Actuarial Function is being considered by some undertakings in order to assess continuous compliance of technical provisions. All undertakings will need to consider this in the future in line with the Level III Guidelines.

Assessing risk profile deviations compared with the SCR

To date, only a few undertakings have carried out this assessment, generally based on a high-level comparison of the standard formula with an internal economic capital model. Such assessments have identified various deviations for market risks, but for mortality risk it seems that the assessments to date suggest that mortality risk in the Spanish market is lower than the calibration for this risk module in the Solvency II standard formula.

Many Spanish insurers will carry out this assessment for the first time in 2015. We expect that this will not be a simple task as most undertakings have not developed modelling techniques to perform this kind of analysis. Furthermore, many undertakings are still concentrating on implementing their models for the standard formula Pillar I capital calculations, so this type of analysis may not be a priority.

Another area of concern is with regard to how much information to include in relation to deviations in the risk profile, which is due to uncertainty over how the DGFSP will use this information. While this assessment should not automatically lead to a capital add-on, there is still some fear within the Spanish insurance industry that significant deviations will result in capital add-ons.

We expect that this assessment will be a key area of development for Spanish undertakings in the future in order to fully comply with the Solvency II requirements.

7.4. USE OF THE ORSA AND THE ROLE OF THE BOARD

Board engagement was generally limited to high-level involvement in the 2014 FLAORs, but we expect that most undertakings will work on improving this going forward. It will, more than likely, involve a couple of iterations of the process before the level of Board engagement is up to the Solvency II standard and the ORSA is embedded into the business planning process.

However, we are aware of some Spanish undertakings that achieved active Board involvement for the 2014 FLAOR, in the form of review and challenge of the results. To achieve this, undertakings generally invested in formal and regular training for Board members and senior management to ensure that they understood the ORSA process and were able to interpret the results. In some cases, the training process was long and intensive but was beneficial in encouraging Board members to actively participate in the 2014 process, and to challenge, and finally approve, the 2014 FLAOR results.

Another way to achieve Board engagement is to include the Board in important aspects of the ORSA at early stages in the process, such as in defining the stress and scenario tests to consider and highlighting the link between the ORSA results and business decisions. However, few Spanish undertakings have yet managed to integrate the FLAOR and business planning process by clearly linking the FLAOR results and process back to strategic decisions in respect of capital management, product development and pricing, and budgeting and planning. This may require a change in mind-set within the undertaking to ensure that capital and risk are considered as part of the business planning process. This will be a further area for development in 2015 and beyond.

In particular, many undertakings have not yet linked the ORSA with capital management. Undertakings seem to be taking the view that a significant buffer is required in the coverage ratio in order to allow for compliance with the SCR/MCR after a shock event, rather than developing plans on what to do if a breach occurred. A key challenge for undertakings will be how to formulate plans to access additional capital in a stressed economic environment. The assessment of continuous compliance should aid undertakings' understanding of this aspect of the ORSA.

Most undertakings in Spain have made it clear that their current FLAOR processes are on a best-efforts basis. One of the main areas for improvement that undertakings have cited is that the process is very time-consuming, which is due to the number of departments and teams involved. Formalising the process in the ORSA policy should improve this issue, but this is only a first step. Embedding the ORSA process into the day-to-day decision making will continue to be a challenge for some time.

7.5. DOCUMENTATION AND REPORTING REQUIREMENTS

At a recent industry seminar, representatives from the DGFSP indicated their discomfort with the use of an external standardised template (or the 'copy and paste' approach) used by a number of undertakings in respect of their FLAOR reports. This resulted in some of the content of the FLAOR reports being the same across these undertakings, in particular the descriptions and assessments of own risks and the system of governance. The DGFSP expects to be provided with more undertaking-specific evidence on these descriptions going forward.

Other issues included some instances of reports in which the description of the undertaking's risk profile was not sufficiently detailed, where little or no information was provided on the calibration of the stress or scenario tests, or where management actions were not considered for material stresses or scenarios.

We expect that one of the main improvements that undertakings will make this year is in respect of updating the description of the undertaking's risk profile to be more detailed (and undertaking-specific). The description should include details of material risk exposures, including quantitative analysis where appropriate, and identify those risks that are most significant. The documentation should also include information on how these risks are managed or will be managed in the future.

8. THE NETHERLANDS

8.1. INTRODUCTION

The preparatory guidelines for the FLAOR came into effect in the Netherlands on 1 January 2014. The guidelines were quite similar to the Eigen Risico Beoordeling (ERB, or own risk assessment), which was introduced by the Ministry of Finance in 2013 following the delay of the introduction of Solvency II. The aim of the ERB was to move toward more risk-orientated and forward-looking supervision of Dutch insurers within the existing Solvency I regime. While insurers were allowed to assess their solvency position on a Solvency I basis under the ERB, they were also allowed to use a Solvency II approach (based on the ORSA), if this was already developed in preparation for the introduction of Solvency II.

The first ERB reports were due at the end of 2013 and most Dutch insurers based their ERBs on the Solvency II ORSA report. Many insurance companies had already begun to develop ORSA processes and procedures, as they had been invited by the Dutch NSA, De Nederlandsche Bank (DNB), in 2012 to participate in an early ORSA exercise. The 2012 exercise was a follow-up to an ORSA pilot that was launched in 2011 for a limited number of insurance undertakings. Although it was not a requirement to participate in the 2012 exercise, most insurers felt obliged to do so in response to the invitation from the DNB. As a result, most of the insurance companies in the Netherlands have carried out an ORSA since 2012, with some of the major players completing their first ORSAs under the pilot program in 2011. This means that Dutch insurers have much more experience with the ORSA to date relative to their neighbours in other European countries.

Feedback from the earlier ORSA exercises was generally provided by the DNB on a confidential basis to each insurance undertaking. However, the overall conclusion was that smaller insurance undertakings, with relatively limited product offerings (e.g. health insurers), were most prepared for the ORSA, in terms of both process and reporting standards.

As Dutch insurers already had experience with the ORSA process, no exceptions were made for the 2014 and 2015 FLAORs. Therefore, all insurance companies are required not only to calculate their overall solvency needs but also to assess continuous compliance and to assess deviations of their risk profiles relative to the assumptions underlying the standard formula in 2014.

The DNB provided general feedback on the 2014 FLAORs to insurance undertakings at a Solvency II update meeting in early 2015, following a review of each FLAOR compared with the draft Level III Guidelines on ORSA published by EIOPA. Each FLAOR received a score of 1 to 4 for compliance with each of the guidelines.

An overall score for each FLAOR was also provided to undertakings, based on the score per guideline. In 2014, 66% of FLAORs were ranked with a 1 or 2 (in 2013 48%), i.e. no further improvements were required or further improvements were required but not strictly necessary, and only 4% of FLAORs were ranked with a 4 (in 2013 15%), i.e. significant improvements are necessary. This shows that undertakings have been using the preparatory phase to improve and develop their ORSA processes, which has probably been aided by the earlier introduction of the ERB. We expect that the scores will continue to improve in 2015 and beyond.

8.2. OWN RISK ASSESSMENT AND OVERALL SOLVENCY NEEDS

Most Dutch undertakings used the Solvency II balance sheet in the assessment of the overall solvency needs in the 2014 FLAOR. Insurers that were still using a Solvency I balance sheet for the 2014 FLAOR received feedback from the DNB stating that it was necessary to carry out the 2015 assessment on a Solvency II balance sheet.

In general, Dutch undertakings selected stress and scenario tests based on risk assessments performed by senior management and the Board. Most undertakings included multifactor scenario tests as well as reverse stress tests. Future management actions were generally considered for scenarios where the SCR (or target SCR) was breached.

Feedback from the DNB in respect of the 2014 FLAOR stated that some of the scenarios considered were not severe enough. This could be due to a lack of experience or knowledge of the Solvency II dynamics in stressed conditions. The DNB's feedback included some information on what it considered to be best practice in respect of the stress and scenario tests. For example, they stated that undertakings should consider sufficiently severe shocks, including 'impossible' shocks. In addition, there should be diversity in the types of shocks considered, including:

- Generic scenarios
- Company-specific scenarios
- Slow-acting scenarios (e.g. low interest rates)
- Rapidly developing scenarios (e.g. catastrophe)

The DNB stated that these should be considered in both single factor stress tests and multifactor scenarios and that the results should be shown before and after future management actions. Management actions should be realistic, taking into account the economic conditions in the shocked scenario and also the timelines involved in initiating the actions.

The DNB also stated that undertakings should provide a sufficient level of detail on the assumptions used in the base scenario of the forward looking assessment, for example details on how the yield curves are derived, investment returns by asset category, and information on allocation of investments and rebalancing during the projection term, etc.

In addition to the DNB's feedback on best practice, an ORSA Working Group of the Dutch Association of Insurers also published a document in respect of best practice in 2012.[17] This document also described how the forward looking assessment could be performed, after the scenarios were determined. It stated that the forward-looking solvency projections should not necessarily use an overly complex approach, as this could create a false sense of assurance because no one can predict the future.

According to the working group's document, undertakings should use the Solvency II market-consistent balance sheet and SCR as at the valuation date as the starting point. They should be able to utilise best estimate (accounting) projections from the internal business planning process, generally referred to as the Medium Term Planning (MTP) process to project forward the Solvency II balance sheet.

The MTP figures can easily be used to project technical provisions and cash surpluses, which can then be used to project the market value of assets and the undertaking's own funds. The SCR can then be projected using scaling techniques or risk driver approaches. These techniques were commonly used by undertakings in the 2014 FLAOR.

8.3. CONTINUOUS COMPLIANCE AND ASSESSING RISK PROFILE DEVIATIONS

Continuous compliance with the SCR and technical provisions

Most Dutch insurers do not perform a full calculation of the technical provisions, SCR, and MCR more often than on a quarterly basis. In general, full calculations at the end of each half-year or year are most common, with estimates being prepared at the interim quarters. The frequency of the calculation is often also influenced by the fact that the process of a full calculation is still a time-consuming and burdensome task for undertakings.

Estimates for interim periods between successive full calculations are often based on proxy modelling techniques, e.g. where only the changes in interest rates and spreads are taken into account. Full SCR calculations are generally only carried out in the interim period if a trigger event occurs, e.g. a new acquisition or sale of a portfolio.

In the review of the 2014 FLAOR, the DNB focused on each undertaking's ability to raise own funds of an appropriate quality if required, and within an appropriate timescale. In assessing this, undertakings have to regard their own access to capital markets, the economic environment at the time at which own funds may be required, the undertaking's dependence on a particular investor base including other members of its group, and the impact of other undertakings seeking to raise own funds at the same time. We expect that this is an area that the DNB will continue to focus on and may lead to supervisory actions if undertakings are not able to demonstrate compliance. Therefore, it is recommended that undertakings improve this assessment to look beyond daily solvency monitoring and increase focus on the development of own funds over time.

Assessing risk profile deviations compared with the SCR

The DNB reported in its general feedback that a lot of the undertakings have difficulties with the assessment of the deviation from the standard formula, with some insurers arguing that the only proper way to carry out such an assessment is to develop an internal model. Based on the preparatory phase guidelines, undertakings may initially assess deviations on a qualitative basis. If this assessment indicates that the undertaking's risk profile deviates materially from the assumptions underlying the standard SCR calculation, then the undertaking should quantify the significance of the deviation.

For the 2014 FLAOR, most Dutch insurers focused on the qualitative aspect of this assessment, with few undertakings carrying out quantitative analysis. It is not yet clear if undertakings will develop the quantitative analysis further for their 2015 FLAORs.

The DNB has indicated the allowable level of deviation by referencing Article 279 of the Delegated Acts, which refers specifically to capital add-ons. As outlined in this article:

- The risk profile of an insurer significantly deviates from the assumptions outlining the standard formula if the deviation is 10% or more of the total SCR, unless strong evidence exists that this is not the case (based on the factors outlined in Article 276 of the Delegated Acts).

- The risk profile of an insurer significantly deviates from the assumptions outlining the standard formula if the deviation is 15% or more of the total SCR.

While the DNB has not specifically stated that capital add-ons will be imposed in the case of significant deviations, it may be implied to some extent through the reference to this article in the Delegated Acts. This is an area of concern for Dutch insurers.

17 Vision on Own Risk and Solvency Assessment (ORSA) Good Practice by ORSA Working Group of the Dutch Association of Insurers ('Verbond van Verzekeraars').

8.4. USE OF THE ORSA AND THE ROLE OF THE BOARD

In most cases, the Board was requested to approve the stress and scenario tests and suggest management actions for the FLAOR and the results of the FLAOR were presented in an internal FLAOR report which was also approved and signed off by the Board. Where the DNB was not satisfied with the level of Board engagement, it provided specific individual feedback to undertakings in this regard.

In most undertakings, the ORSA process is part of the business planning process, as the MTP is generally used as an input to the forward looking assessment. However, the MTP and ORSA processes are often not fully integrated and in some cases undertakings have found it difficult to completely align the input of the MTP process with the projections in the valuation models used in the ORSA process.

While the Risk Management Function is generally responsible for the ORSA, the DNB provided some comments in respect of the Actuarial Function's role in the FLAOR as part of its general feedback on 2014 FLAORs. It stated that it was best practice to document the role of the Actuarial Function in the ORSA process, that the Actuarial Function should provide comments on the conclusions of the ORSA for inclusion in the ORSA report, and that the Actuarial Function should specifically comment on uncertainties, for example in respect of data quality, reliability of estimations, and so on.

8.5. DOCUMENTATION AND REPORTING REQUIREMENTS

The DNB has not provided a significant amount of feedback in respect for the documentation and reporting requirements, other than stating that it is best practice to include some information on data quality in the reports.

Most undertakings had set up their ERB reports with a standard table of contents, which was copied for the 2014 FLAOR reports. Undertakings have tended to leave this unchanged from year to year to ensure consistent periodic reporting to the DNB. The format of the report has, so far, generally been updated only to reflect comments from the regulator or other external factors.

9. IRELAND

9.1. INTRODUCTION

In Ireland, the national supervisory authority, the Central Bank of Ireland (CBI), issued guidelines in November 2013 that largely mirrored the preparatory guidelines issued by EIOPA, with the application of the guidelines limited in some cases based on the CBI's risk rating of Irish financial institutions, known as the Probability Risk and Impact System (PRISM).[18] For example, undertakings that are classified as low or medium-low impact under the PRISM rating scale are subject to less onerous requirements than firms that are classified as high or medium-high impact. The application for groups was limited based on the thresholds outlined in EIOPA's guidelines.

The key differences in the application of the FLAOR guidelines for solo undertakings, compared with EIOPA's guidelines, are as follows:

- The requirement to perform an assessment of whether or not the undertaking would comply on a continuous basis with the Solvency II regulatory capital requirements and the technical provisions does not apply to low and medium-low impact undertakings.

- The requirement to perform an assessment of the significance of the deviation of their risk profiles from the assumptions underlying the Solvency II SCR calculated with the standard formula does not apply to low and medium-low impact undertakings.

- Low and medium-low impact undertakings are required to use an online template to submit the results of the FLAOR process to the CBI, while high and medium-high impact undertakings are required to submit individual FLAOR reports to the supervisor.

Undertakings are free to use any valuation basis to prepare their overall solvency needs assessment for the FLAOR, including the current solvency regime. However, if a valuation basis other than Solvency II is used, undertakings are required to explain why the valuation basis used ensures a better consideration of risk profile, approved risk tolerance limits, and business strategy than Solvency II.

A Milliman survey conducted in early 2015 of a number of life insurers in the Irish market suggested that approximately 25% of undertakings surveyed in the low and medium-low impact categories chose to assess their overall solvency needs for the 2014 FLAOR based on the current solvency regime. This indicates that there is likely to be a significant level of development work required by low and medium-low PRISM-rated undertakings in 2015 to move toward a Solvency II basis, as it is expected that it will be more difficult to justify using the current solvency regime as the basis for the financial projections in 2015.

In general, the feedback from the CBI has been relatively positive in respect of the 2014 FLAORs. The CBI stated at its Solvency II Forum in April 2015 that it was 'reasonably satisfied with the quality of FLAOR documents' submitted in 2014. Following the Forum, a public letter[19] was issued outlining general feedback in respect of what the CBI expected undertakings to consider when preparing the 2015 FLAOR. This letter included comments on the following, which are discussed in more detail below:

- Board ownership
- Assessment of key risks
- Assessment of overall solvency needs
- Assessment of continuous compliance with the SCR
- Time horizon

In addition to the general feedback, the CBI also provided specific feedback to some undertakings. This specific feedback provided further detail on items that the CBI wanted those undertakings to improve on for their 2015 FLAORs, for example the inclusion of reverse stress tests, consideration of risk-mitigating techniques and management actions, and shifting the emphasis to local entity risk exposures, amongst other things.

9.2. OWN RISK ASSESSMENT AND OVERALL SOLVENCY NEEDS

In its feedback to undertakings, the CBI highlighted the fact that the assessment of overall solvency needs should represent the undertaking's own view of material risk exposures and that undertakings should use this assessment to establish and justify an appropriate level of capital, allowing for the limitations of the SCR in respect of the undertaking.

In preparing the FLAOR for 2014, the majority of Irish undertakings used the SCR calculations (either standard formula or internal model) to assess their overall solvency needs, with little consideration for their actual economic capital requirements relative to their specific risk exposures. Many undertakings expressed their overall solvency needs in terms of a percentage of the SCR, based on the results of various stress tests.

18 Under the PRISM rating scale, financial institutions, including insurers, are classified into different risk groups based on impact and probability. There are four main groupings: high (including ultra-high), medium-high, medium-low, and low.

19 Letter issued on 13 May 2015 with the subject 'Forward Looking Assessment of Own Risks.'

In considering what risk exposures to assess, undertakings generally focused on the risks used in the SCR calculations, and in particular the market risk sub-modules. Some of the more advanced undertakings stressed additional risk exposures on a quantitative basis and others considered some non-quantifiable risks on a qualitative basis. However, on the whole, the consideration of other risks was limited in most cases, with undertakings generally ignoring risks which were difficult to quantify, such as reputation and strategic risk.

This is echoed in the CBI's feedback, which highlighted that in some cases significant risks were not considered in this assessment, in particular if they were not already captured in the SCR or were not quantifiable. The CBI provided the following examples of key risk exposures that were generally not considered in the 2014 FLAOR: 'pension risk, reputational risk, group risk, liquidity risk, operational risk, cyber risk, expense risk, and strategic risks.' The feedback also states that undertakings should describe all 'material quantifiable and non-quantifiable risks and appropriate mitigants' in this assessment. We expect that risks that are difficult to quantify such as reputational risk and strategic risks can be assessed on a qualitative basis. Undertakings should also consider whether they have other material risk exposures in addition to those risks outlined by the CBI.

In the Milliman survey mentioned above, undertakings identified a number of risks not covered by the standard formula that they were going to consider in the 2015 FLAOR. Almost all survey participants said that they will address liquidity risk, reputational risk, and legal environment risk, and over half of the undertakings surveyed have indicated that they will address investment market volatility, sovereign credit risk, and contagion risk in the 2015 FLAOR. In addition to single factor stress tests, undertakings should also consider scenario tests and reverse stress tests. We understand that the CBI specifically referred to the need to include scenario tests and reverse stress tests in its individual feedback to a number of undertakings.

For the 2014 FLAOR, Irish subsidiaries of large groups generally performed the same assessment and stress tests as those considered by the parent undertaking. However, the ORSA is supposed to consider the undertaking's specific risk profile. In many cases, the risk exposures of the subsidiary may be different from those of the group, for example where the subsidiary sells a specific line of business or targets a niche market. The local FLAOR should be driven by the local Board and therefore should reflect the risk exposures of the local subsidiary rather than the group. During 2015, many Irish subsidiaries will need to update their processes to ensure that the FLAOR captures risk exposures specific to the local undertaking rather than the group. The CBI noted this in its feedback, stating that 'where the Group FLAOR is used for a local undertaking, it must adequately capture the material risks arising from the local undertaking in question.'

In addition to assessing the overall solvency needs of the undertaking, the ORSA should also describe mitigation of material risk exposures where appropriate, in particular where the stress and scenario tests considered in the ORSA result in a breach of the SCR. The 2014 FLAORs prepared by Irish undertakings provided little detail in this area. Management actions should be considered by the undertaking where a breach of SCR or MCR is projected to occur under a specific scenario, and in other scenarios too if they are expected to reduce risk exposures. Irish undertakings will need to develop this area of the ORSA further in advance of full Solvency II implementation. This was also echoed in the CBI's feedback.

The CBI also provided feedback on the projection term used in the 2014 FLAOR, stating that the time horizon considered by many undertakings was not sufficient as it focused on the short term. It has stated that the 'assessment of the overall solvency needs should be forward-looking, including a medium-term or long-term perspective as appropriate.' While the CBI did not provide any additional guidance in its public feedback on the projection term that undertakings should consider in the medium-term or long-term perspective, we understand that it has communicated to some undertakings that a projection term of three years is not sufficient given the undertaking's risk profile.

9.3. CONTINUOUS COMPLIANCE AND ASSESSING RISK PROFILE DEVIATIONS

Continuous compliance with the SCR and technical provisions

In 2015, Irish high and medium-high PRISM-rated undertakings will be required to assess continuous compliance with the SCR and technical provisions in their FLAOR for the first time. While low and medium-low rated undertakings are not formally required to do this, our survey results indicated that a number of such undertakings may attempt this assessment for the first time this year also.

Continuous compliance is not something that Irish undertakings have had to demonstrate before and, as a result, many undertakings may struggle with this assessment. As mentioned in Section 2.3 above, the explanatory notes in the Level III ORSA Guidelines provide some detail on how this assessment can be performed.

We know that some Irish undertakings are currently developing methods to demonstrate regular solvency monitoring, but this assessment goes beyond simply monitoring the solvency ratio as highlighted by the Level III Guidelines. Therefore it is likely that some Irish undertakings may fall short of meeting all of the requirements of this assessment in 2015 and may need to develop this further in 2016.

Assessing risk profile deviations compared with the SCR

Even though this assessment was not required by the CBI in 2014, the results of our recent survey indicate that some high and medium-high PRISM-rated undertakings did actually carry out this assessment in 2014. The CBI feedback commented on the quality of this analysis in the 2014 FLAORs, stating that the deviation in risk profile was 'not appropriately assessed.' The CBI describes this assessment as an important aspect of the ORSA, given that the reliance placed by Irish undertakings on the standard formula or internal model capital requirements is very high, and requests that it is fully discussed in the 2015 FLAOR. The results of our survey indicate that all high and medium-high impact undertakings will undertake this assessment in 2015 and that a high proportion of low and medium-low rated undertakings will carry out this assessment in 2015, even though it is not formally required by the CBI.

Many undertakings may not have considered how to conduct this analysis before now. As mentioned in Section 2.4 above, the explanatory notes to the Level III ORSA Guidelines provide some information on what EIOPA expects this analysis to entail. We asked survey participants to what extent they would carry out some of the assessments outlined in the Level III Guidelines. The survey results show that most undertakings will carry out an analysis of the company's risk profile and an assessment of why the standard formula is appropriate, including a ranking of risks and an analysis of how the results of the standard formula will be used in the decision-making process. In addition to this, many undertakings have also stated that they will provide an explanation of the nature, scale, and complexity of the risks to justify any simplifications used, at least on a qualitative basis.

Unlike other supervisors, the CBI did not specify what constitutes a significant deviation from the assumptions underlying the SCR, so undertakings will need to define this for themselves before carrying out quantitative assessments.

We expect that many Irish undertakings will find it challenging to carry out a detailed assessment of the deviations in their risk profiles from the standard formula in 2015, in addition to improving their own risk and solvency assessments following the CBI feedback (although there should be some overlap between the two assessments). Undertakings should be able to use some of the steps outlined in Section 2.4 above to improve this assessment in future years. In addition, we expect that the CBI will issue feedback on these initial assessments next year, which should further insurers' understanding of exactly what it wishes to see in this assessment.

9.4. USE OF THE ORSA AND THE ROLE OF THE BOARD

Many Irish undertakings struggled to meet all of the requirements in respect of Board engagement in 2014. In most cases, the Board's role was that of a reviewer rather than being actively involved in the process. As undertakings were grabbling to understand the FLAOR requirements, in many cases the Board approved the ORSA policy at the same meeting as the 2014 FLAOR report. Undertakings will need to take a number of steps during 2015 to ensure that the Boards are actively involved in the process and that they are able to demonstrate this to the CBI. These have been discussed in detail in Section 2.5 above.

The CBI's feedback also highlights this point, stating that many Boards acted as 'reviewer' of the 2014 FLAOR rather than being actively involved in the process. This is a key area of focus by the CBI. The NSA has indicated that for the ORSA to become part of business as usual it is not deemed sufficient for the risk function to present the Board with a finished ORSA for approval. Going forward, the ORSA should be a top-down process, with active consideration from the Board. In addition, the Board will need to be able to demonstrate to the CBI that it has been actively engaged in the ORSA process, while the undertaking will need to demonstrate that the ORSA process is embedded into the risk management framework.

The CBI emphasised that the ORSA represents a huge opportunity for undertakings to integrate existing infrastructure and processes in relation to risk management, capital management, and business planning. Proper use of the ORSA should lead to improved information flow throughout the organisation which, in turn, should result in more risk-focused decision making, based on comprehensive and accurate information.

9.5. DOCUMENTATION AND REPORTING REQUIREMENTS

The CBI did not provide explicit feedback in relation to the content or format of the FLAOR reports received in 2014. However, it was noted that the reports varied considerably in content within similar sectors. While this is a cause for concern for the CBI, it also points to the fact that undertakings are making genuine efforts to prepare unique documents.

The general feedback suggests that the CBI wishes to see more evidence of Board ownership, whether this is captured in the report itself or the record of the ORSA. In addition, for undertakings that are part of large groups, the CBI has stated that the FLAOR report should be undertaking-specific, instead of being largely driven by the group.

The CBI developed an online reporting template for undertakings classified as low and medium-low under the PRISM framework, which it will continue to use under full Solvency II implementation. While the template itself was quite prescriptive, low and medium-low rated undertakings were generally satisfied with this approach, with the exception of some minor teething problems. Undertakings using the reporting tool must provide information under the following headings:

- Link to strategic decision-making framework
- Frequency of ORSA
- Role of Board of Directors
- Documentation
- Overall solvency needs
- Forward looking assessment
- Compliance on a continuous basis
- Deviations from assumptions underlying SCR calculation
- Internal model users
- Undertaking's conclusions and actions from the ORSA

The existence of this reporting tool does not remove the requirement for these undertakings to prepare full FLAOR/ORSA reports. The CBI has stated that such reports will be reviewed periodically as part of the supervisory review process.

10. THE NORDICS

10.1. INTRODUCTION

All national supervisory authorities in the Nordic countries implemented the EIOPA preparatory guidelines in respect of the FLAOR in 2014. In most territories, this was the first time that the supervisor required undertakings to carry out the ORSA process. However, the Danish supervisor, Finanstilsynet (Danish FSA), has been taking steps to move toward a risk-based capital regime for a number of years now and, as part of this transition, ORSA-like requirements were introduced in Denmark a number of years ago. Undertakings in Iceland have also been submitting ORSA-like reports to the Icelandic supervisor, Fjármálaeftirlitid (FME), since 2011.

The Swedish supervisor, Finansinspektionen (FI), stated that the work that it carried out over the past few years should have helped prepare undertakings for Solvency II, particularly larger insurers. However, the results of a survey conducted by the FI in 2014 on the preparation for Solvency II showed that Swedish insurers still consider the ORSA to be one of the key challenges of Solvency II.

Milliman conducted a survey covering a number of Nordic life insurers in 2015, focusing on the FLAOR process. While the survey results provide a reflection of the FLAOR process in the Nordic regions as a whole, at least from a life perspective, the level of preparedness varies by country as highlighted by the feedback from the various supervisory authorities.

The Finnish Financial Supervisory Authority (FIN-FSA) provided some observations on the FLAOR process at an industry seminar in May 2015, based on a high-level review of some of the 2014 FLAOR reports. The FI included some feedback on the Swedish 2014 FLAOR in its annual report on insurance supervision. The Norwegian supervisor, Finanstilsynet (Norwegian FSA), provided written feedback on the 2014 FLAOR to all insurers that participated in the process, focusing on the overarching principles of EIOPA's guidelines. In Iceland, the FME carried out a detailed assessment of the 2014 FLAOR reports and submitted feedback to the Boards of insurance undertakings. The Danish FSA has also commented on some emerging patterns in the ORSA experience in Denmark over the past number of years.

The results of the Milliman survey, combined with the feedback from the national supervisiors, are discussed in more detail throughout this section of the paper.

10.2. OWN RISK ASSESSMENT AND OVERALL SOLVENCY NEEDS

The Milliman survey results, combined with the NSAs' supervisory feedback, indicate that the majority of undertakings in the Nordic regions carried out the assessment of overall solvency needs on a Solvency II basis. It is expected that few undertakings will make any adjustments to this basis, with less than 20% of survey participants saying that they will vary the approach taken in the ORSA by adjusting such items as the volatility adjustment, contract boundaries, risk-free yield curve extrapolation, or the confidence interval and time horizon in their assessments of overall solvency needs. The results also indicate that survey participants considered a variety of stress and scenario tests in their 2014 FLAORs, as well as reverse stress tests.

Many undertakings did not consider risk exposures that are not defined in the standard formula in the 2014 FLAOR, such as reputational risk or liquidity risk. Where undertakings did consider such risks, it was generally on a qualitative basis. However, there are some exposures, such as market volatility risk and the credit risk associated with EU government bonds, that are not considered in the standard formula and should be considered on a quantitative basis in the overall solvency needs assessment if they are material. The feedback from the supervisory authorities also highlights these weaknesses.

As regards the overall assessment of risk, the FIN-FSA noted that most undertakings provided a qualitative assessment of risk exposures in their 2014 FLAOR reports. However, this was often a theoretical description of the risk and was generally not clearly linked back to the specific exposures of the undertaking. Some of the better prepared undertakings provided details on risk mapping, risk measures, and risk management techniques.

The Danish FSA noted that insurers still put too much focus on the risks defined in the standard formula and do not consider risks that are not as easy to quantify, such as competitors' moves, reputational risk, and emerging risks. Sometimes there is a disconnect between the undertaking's current performance and the budget and assumptions underlying future years' projections. For example, insurers investing in high-yielding EU government bonds did not always consider that there is no capital charge for these investments under the standard formula and that the risk exposure was understated as a result.

In Sweden, the FI noted that the majority of undertakings based their overall solvency needs on the Solvency II Pillar I calculations, instead of focusing on the undertaking's specific risk exposures. In addition, the FI noted that several undertakings had only included one stress or scenario test in their 2014 FLAORs. The FI has requested that undertakings improve this assessment for the 2015 FLAOR. The results of the survey conducted by the FI in 2014 show that undertakings intend to pay particular attention to the following areas during the preparatory phase: the establishment of financial planning processes over an appropriate time horizon, the controls surrounding own risk exposures, appropriate methods to assess solvency needs, stress tests, and the time horizon of the forward-looking projection, especially for long-term insurance risk exposures.

Based on the feedback from the supervisory authorities, it is clear that insurers in the Nordics have some steps to take to improve on the assessment of overall solvency needs in the 2015 FLAOR, and in future years. In its feedback to the insurance industry, the FIN-FSA provided some questions that undertakings should consider when working through their ORSA processes, including:

- Does the ORSA address all the undertaking's significant risks?
- Does the ORSA outline the undertaking's risk management strategies?
- Will the ORSA provide the Board with a comprehensive understanding of the undertaking's risk exposures and solvency position?
- Are the scenarios and stress tests considered in the ORSA sufficiently comprehensive?

In addition to the feedback from the supervisors, undertakings in the Nordic regions should be able to use some of the steps outlined in Section 2.2 above to improve their assessments of own risk and overall solvency needs going forward.

10.3. CONTINUOUS COMPLIANCE AND ASSESSING RISK PROFILE DEVIATIONS

Continuous compliance with the SCR and technical provisions

This assessment was not required under EIOPA's preparatory guidelines in 2014 so it is expected that most insurers in the Nordics will be carrying it out for the first time in 2015. However, some of the survey respondents said that they carried out this assessment in the 2014 FLAOR, noting that they intend to use the following techniques to monitor compliance with the SCR and technical provisions on a continuous basis:

- Full recalculation of SCR if there is a trigger event
- Daily/weekly solvency monitoring
- Sensitivity analysis
- Key indicators
- Proxy modelling

All undertakings that took part in the survey have indicated that they will carry out this assessment in 2015, although some have indicated that it will be on a qualitative basis only. This suggests that undertakings in the Nordic regions still have some development to do in this space, as part of this assessment will require quantitative analysis. Section 2.3 above provides details on what undertakings can do to meet the Solvency II requirements with regard to this assessment.

Assessing risk profile deviations compared with the SCR

While the Milliman survey results indicated that some undertakings did carry out this assessment last year, 2015 is likely to be the first year that the majority of undertakings compare their risk profile with the assumptions underlying the SCR.

Our survey asked undertakings to provide details on how they were going to meet this requirement, based on the techniques outlined in the explanatory text of the Level III Guidelines on ORSA. All undertakings surveyed intend to carry out an analysis of the risk profile and an assessment of the reasons why the standard formula is appropriate, including a ranking of risks (with most indicating that they will do so on a quantitative basis). In addition, all undertakings intend to analyse how the results of the standard formula are used in the decision-making process, mainly on a qualitative basis. The majority of undertakings have also indicated that they will carry out an analysis of the sensitivity of the standard formula to changes in the risk profile, an assessment of the sensitivities of the SCR to the main parameters, to justify any simplifications used.

None of the national supervisory authorities provided much specific feedback on this assessment based on the 2014 FLAOR. However, the FIN-FSA noted that some undertakings had still not developed processes to carry out this assessment. Where Finnish undertakings had looked at deviations in their risk profiles in the 2014 FLAOR, it was generally performed by comparing the results of an economic capital model, or other risk model, with the standard formula calculation.

Nordic undertakings should be able to use the steps outlined in Section 2.4 above to develop processes and procedures to carry out this assessment going forward.

10.4. USE OF THE ORSA AND THE ROLE OF THE BOARD

The survey results indicate a mixed approach to Board engagement in the 2014 FLAOR. In some cases, Boards were not heavily involved in steering how the FLAOR was performed, or in setting the stress and scenario tests to consider. In general, Boards tended to be more involved in challenging the results and reviewing and approving the ORSA process. However, it is likely that this involvement is still not sufficient to fully meet Solvency II requirements.

A key area for development is in respect of the use of the ORSA in relation to strategic decision making. The survey results indicate that most undertakings expect the Board to use the 2015 FLAOR as part of the business planning process, to determine investment policy, and for capital management purposes. However, it remains to be seen if this will be achieved in 2015.

The Danish FSA noted that the ORSA is often viewed as a regulatory compliance exercise rather than something that could be beneficial to the insurance undertaking. While it has received feedback from insurers that the ORSA has increased the understanding of the business, there is still a weak connection between strategic planning and capital needs. Even though undertakings in Denmark have been required to carry out an ORSA-like process for a number of years now, this disconnect still exists. For example, while the projections in the ORSA will generally reflect recent assumptions regarding future changes to the business plan, the Danish FSA has noted that some insurers have made strategic decisions without assessing the impact on capital needs by considering these changes in the ORSA process. In addition, undertakings do not always view the ORSA as a tool to identify new risks and assess how to monitor or manage those exposures. One way to resolve this is to view the ORSA as an ongoing cycle rather than a discrete process — as is the intention behind the ORSA anyway — and to update the ORSA to reflect any potential changes to the business plan or new risk exposures.

The FIN-FSA noted that the Board's role in the ORSA process has not been sufficiently established by Finnish insurers. It has urged insurers to consider whether the Board is sufficiently involved in the ORSA process in the future and also to ensure that the Board fully understands the details in the ORSA report.

10.5. DOCUMENTATION AND REPORTING REQUIREMENTS

Many of the supervisory authorities in the Nordic regions provided feedback to undertakings in respect of the content of the 2014 FLAOR reports.

The FIN-FSA stated that there was a wide variety in the ORSA reports received, both in terms of content and writing style. The reports varied in length from six to 60 pages, with the FIN-FSA noting that the quality of the reports did not necessarily increase with length. It also provided an example of an ORSA report table of contents as follows:

- Executive Summary
- Risk appetite and risk tolerance
- Main results of the risk mapping
- Current solvency position
- Forward looking assessment:
  - Base scenario
  - Other scenarios
  - Sensitivity analysis, stress tests, etc.
- Review of technical provisions
- Review the quantity and quality of own funds
- Summary
  - The overall solvency position
  - Recommendations for action
- Attachments

It is not fully clear whether FIN-FSA wants undertakings to use this format for future ORSA reports or if this was simply provided as a guide during the preparatory phase. In any case, it should provide undertakings with an example of the type of information that the FIN-FSA wants to see in the report.

In a public letter to insurance undertakings on the implementation of Solvency II, the Norwegian FSA has requested that undertakings aim to make the ORSA report as concise as possible, focusing on the specific assessments and conclusions.

The Danish FSA noted a trend toward a more standardised reporting process. Some of the largest insurers have designed processes in-house, which have been used to formalise the table of contents of the ORSA reports, while the majority of smaller undertakings have tended to use templates provided by external advisors. In the Danish FSA's opinion, this standardisation has improved the quality of both the ORSA process and the report, in particular amongst the smaller insurers.

11. CENTRAL AND EASTERN EUROPE

11.1. INTRODUCTION

National supervisory authorities in Central and Eastern Europe (CEE) implemented the preparatory guidelines to some extent, but the approach taken varied by country. In some countries, supervisory authorities were limited in their ability to compel undertakings to meet the guidelines without updating legislation and/or regulations. For example, in Hungary the Magyar Nemzeti Bank (MNB) updated the Act on Insurance to reflect some of the guidelines. Similarly, in Latvia, the Finansu un Kapitala Tirgus Komisija (FKTK) made changes to the legislation and introduced new regulations to enforce the preparatory guidelines. In Slovenia, however, the Agencija za Zavarovalni Nadar (AZN) requested that undertakings comply with the guidelines through recommendations and one-on-one discussions, rather than updating the current legislation.

A small number of supervisors made some changes to the EIOPA guidelines, or required insurance undertakings to carry out additional stress tests. In Poland, for example, the Komisja Nadzoru Finansowego (KNF) selected some specific undertakings to carry out the assessment of continuous compliance and assessment of deviations in risk profile compared with the standard formula in 2014 (although this was not specifically required in 2014 by EIOPA). In Romania, the Autoritatea De Supraveghere Financiara (ASF) required undertakings to take part in a balance sheet review and stress test exercise in early 2015 in addition to meeting the FLAOR preparatory guidelines. In the Czech Republic, the Ceska Narodni Banka (CNB) introduced the FLAOR preparatory guidelines gradually. The CNB prepared a phasing-in plan (or road map), stipulating when each specific guideline should be implemented and how insurance undertakings could meet the requirements of each guideline.

Rather than summarising the experience in countries that adopted the general EIOPA requirements, this section focuses mainly on the countries in which supervisory authorities requested that undertakings do something slightly different (as is the case in Poland, Romania, and the Czech Republic).

11.2. OWN RISK ASSESSMENT AND OVERALL SOLVENCY NEEDS

In Poland, most insurers carried out the assessment of overall solvency needs on a Solvency II basis for the 2014 FLAOR. The majority of undertakings calculated their overall solvency needs based on the Pillar I standard formula calculation, which met some criticism from the KNF. The KNF has suggested that undertakings look at their three most significant risk exposures under the standard formula and consider the calibration of these shocks based on their own individual risk exposures for the 2015 FLAOR. Some undertakings may argue that it is impossible to carry out this assessment without developing an internal model. However, this request is linked to the assessment of deviations in risk profile compared with the assumptions underlying the standard formula, which undertakings are required to analyse for the first time in 2015. Section 2.2 of this paper outlines some information on how undertakings can complete this assessment.

In the 2014 FLAOR, few Polish undertakings considered the requirement for a forward looking assessment of overall solvency needs, with most undertakings simply stressing the opening balance sheet position. Of the undertakings that did prepare balance sheet projections, most did so because the KNF had requested that they also carry out the assessment of continuous compliance. In its feedback to the insurance industry, the KNF criticised the lack of a forward-looking perspective in the 2014 FLAOR.

The KNF also stated that the 2014 FLAOR did not provide sufficient qualitative detail on the undertaking's own risk assessment. In most cases this assessment was very high-level and few undertakings provided details of their risk appetites or risk tolerances. The lack of information on risk management techniques or management actions was also noted as a weakness by the KNF.

The feedback from the KNF shows that Polish undertakings have significant steps to take with regard to the assessment of own risk and overall solvency needs in advance of full Solvency II implementation. Undertakings should be able to use this feedback though in order to improve their FLAOR processes for 2015 and in future years.

In the Czech Republic, undertakings were required to carry out their own risk and overall solvency needs assessments in Q4 2014 as part of the phasing-in approach. However, undertakings were not required to do this with a forward-looking perspective in 2014. Undertakings in the Czech Republic are required to carry out a full FLAOR for the first time during Q3 and Q4 2015.

Romanian balance sheet review and stress test

In Romania, in addition to meeting the preparatory phase guidelines in respect of the FLAOR, some undertakings were also required to take part in a national balance sheet review and stress test exercise, instigated by the ASF and EIOPA in 2015. The initial review comprised 13 undertakings, covering a total market share of 80%. One of the aims of this assessment was to evaluate the solvency and capital position of undertakings before the introduction of Solvency II. The overall findings of this review were published in July 2015 and indicated that the Romanian insurance sector is not sufficiently capitalised for Solvency II. Some undertakings have already implemented measures to ensure compliance by January 2016, with the ASF having indicated an August 2015 deadline for submission of action plans.

The stress tests covered two economic and financial market scenarios and two insurance scenarios focusing on earthquake and flood risks (risks to which Romanian insurers tend to be significantly exposed). The severe calibration of the stress tests has come under criticism from some industry commentators, in particular the scenario that combined an earthquake with a reinsurer default. Undertakings have argued that this scenario is especially onerous where the reinsurance exposure is in respect of intragroup counterparties with high credit ratings.

The balance sheet review has since been extended to cover a further 21 undertakings, with the purpose of supporting compliance with the Solvency II requirements.

As the focus has been on the results of the balance sheet review and stress tests and follow-up action plans, the ASF had not provided any public feedback on the 2014 FLAOR process at the time of writing this paper. However, it is likely that the 2015 FLAOR and future ORSAs will be useful tools for the ASF to monitor the progress of various undertakings' action plans and their projected solvency positions for future years.

11.3. CONTINUOUS COMPLIANCE AND ASSESSING RISK PROFILE DEVIATIONS

The KNF wrote to undertakings in late June 2015 setting out the requirements for the 2015 FLAOR. As most Polish undertakings had not begun work on their 2015 FLAORs before this, it is not fully clear how undertakings plan to carry out these assessments in 2015.

However, as mentioned above, the KNF asked some specific undertakings to carry out these assessments in the 2014 FLAORs, even though they were not required under the EIOPA preparatory guidelines. The KNF included some comments on these assessments in its general feedback to industry on the 2014 FLAORs, which indicated that the analysis carried out as part of the 2014 FLAOR process was not sufficient.

Continuous compliance with the SCR and technical provisions

In the 2014 FLAORs, Polish undertakings tended to assess continuous compliance by projecting the SCR and own funds into the future, generally over a three year period, providing details of the projected balance sheet at each year-end. However, the KNF stated that undertakings should also provide a description of the mechanisms in place to ensure continuous compliance during the interim periods.

In addition, the Polish 2014 FLAORs did not provide sufficient detail on the assessment of continuous compliance with the technical provisions. In most cases, undertakings generally only described the role of the Actuarial Function as part of this assessment. However, the KNF stated that this assessment should also include details on the uncertainties involved in the technical provisions, including details on any possible errors in the calculation.

In the Czech Republic, undertakings are required to carry out the assessment of continuous compliance for the first time during Q3 and Q4 2015, as part of the phasing-in process adopted by the CNB.

Assessing risk profile deviations compared with the SCR

The KNF was not satisfied with the assessment of deviations in risk profiles compared with the standard formula included in the 2014 FLAORs. However, it did not provide any further feedback, though this is obviously an area in which undertakings will need to improve in the 2015 FLAOR and future ORSAs.

It is expected that Polish undertakings will struggle to meet all the requirements of this assessment in 2015, as this is the first year that most undertakings will be required to carry out this analysis. There is a significant amount of work involved in this assessment and most undertakings have not yet developed processes to carry out this analysis. However, undertakings should be able to utilise some of the methods noted in Section 2.4 above to carry out this assessment. Any developments made in this space during 2015 will benefit undertakings in meeting the full ORSA requirements from 2016 onwards.

Undertakings in the Czech Republic are required to carry out the assessment of deviations in the risk profile for the first time during Q3 and Q4 2015 as part of the gradual introduction of the guidelines adopted by the CNB.

11.4. USE OF THE ORSA AND THE ROLE OF THE BOARD

The KNF did not provide any specific feedback in respect of Board engagement in the 2014 FLAOR. In Poland, Board engagement is slowly improving, as the impact of Solvency II is becoming clearer and the implementation date is fast approaching. However, there is still work to do in this area as the focus is generally still on profitability rather than risk management.

The majority of insurers in Poland are part of larger European groups. The undertakings that are most prepared for the ORSA requirements are those that have defined group processes and procedures in place in respect of Board engagement and use of the ORSA. However, the level of preparedness varies significantly. This is particularly the case where the Polish entity is considered to be immaterial in the wider group context. However, all undertakings within the scope of Solvency II will need to meet these requirements, regardless of their relative size within the group.

As part of the phasing-in approach, undertakings in the Czech Republic were requested to consider the guideline on the role of the Board during Q2 2014, before the assessment of overall solvency needs was required in Q4 2014. As a result, it is expected that undertakings in the Czech Republic should have had some time to involve the Board in the early stages of the 2014 FLAOR.

In Romania, it is likely that the results of the balance sheet and stress tests will have increased Board awareness of the impacts of Solvency II. It is expected that this will result in improved Board engagement in the future. In addition, undertakings were to submit action plans to the ASF in August 2015. These action plans should form the basis for future ORSAs and aid in embedding the ORSA into the business planning process.

Undertakings in the CEE should be able to take some of the steps mentioned in Section 2.5 above to improve Board engagement and the use of the ORSA within the organisation going forward.

11.5. DOCUMENTATION AND REPORTING REQUIREMENTS

The KNF noted that there was a huge amount of diversity in the FLAOR reports received in 2014, with the documents varying in length from one page to 50. However, they did not provide any more general feedback on the documentation other than what is already mentioned above.

In the Czech Republic, the CNB's phased approach also applied to the ORSA documentation. Undertakings were asked to consider the overarching guideline on documentation during Q2 2014 and also prepare the first draft of the ORSA policy during this time (although undertakings were not required to comment on data quality or the forward-looking perspective in this initial draft). Undertakings were asked to prepare the first record of the ORSA during Q4 2014, as they were working through the FLAOR process, and the first internal and supervisory reports were due in January 2015.

Czech undertakings were requested to update and finalise the ORSA policy in Q2 2015 (to cover all of the requirements of this document). During Q3 and Q4 2015, undertakings are requested to prepare the record of the ORSA as they are working through the full 2015 FLAOR process. The 2015 internal and supervisory reports are also due in Q4 2015. This phased approach should enable Czech undertakings to gradually develop the ORSA documentation, such that all of the requirements are met by the time Solvency II is implemented in full.

12. REFERENCES

Actuary Magazine (February 2015). *Final countdown to Solvency II*.

Actuary Magazine (28 May 2015). *Solvency II: Standard formula will fit most UK firms but should not be default option.*

ACPR (2014). *Préparation à Solvabilité II Enseignements de l'exercice d'ORSA pilote 2013.*

ACPR (2015). *Analyse et syntheses. Analyse de l'exercice 2014 et préparation à Solvabilité II.*

ACPR (2015). *Préparation à Solvabilité II. Les indications pour l'exercice ORSA 2015.*

ASF (2015). *Balance Sheet Review and Stress Test of the Romanian Insurance Sector.*

ASF (2015). *Press release: ASF extends the valuation program of insurance undertakings.*

BaFin (2014). *Vorbereitung auf Solvency II: Beurteilung des Gesamtsolvabilitätsbedarfs und allgemeine Anforderungen für den ORSA.*

BaFin (2014). *Vorbereitung auf Solvency II: Beurteilung der gesetzlichen Kapitalanforderungen und der versicherungstechnischen Rückstellungen.*

BaFin (2015). *Vorbereitung auf Solvency II: Berechnung der Solvabilitätskapitalanforderung (SCR) Beurteilung der Signifikanz der Abweichung des Risikoprofils von den Annahmen, die der Berechnung der Solvabilitätskapitalanforderung (SCR) zugrunde liegen.*

CNB (2014). *Harmonogram požadavků vyplývajících z obecných pokynů aplikovaný ČNB.*

CBI (2013). *Central Bank of Ireland Guidelines on Preparing for Solvency II – Forward Looking Assessment of Own Risks.*

CBI (13 March 2015). *Re: Forward Looking Assessment of Own Risks.*

CBI (20 April 2015). *Address by Sylvia Cronin, Director of Insurance, at the Central Bank of Ireland Solvency II Forum.*

DNB (April 2015). *Solvency II update-sessie (presentation).*

EIOPA (2013). *Guidelines on Forward Looking assessment of own risks (based on the ORSA principles).*

EIOPA (2014). *Replies received from Member States regarding compliance with the Guidelines on Forward Looking assessment of own risks (based on the ORSA principles).*

EIOPA (2014). *The underlying assumptions in the standard formula for the Solvency Capital Requirement calculation.*

EIOPA (2015). *Final Report on Public Consultation No. 14/017 on Guidelines on own risk and solvency assessment.*

European Commission (2014). *Commission Delegated Regulation (EU) 2015/35 'Delegated Acts.'*

European Parliament and Council (2009). *Directive 2009/138/EC (recast) 'Solvency II Directive.'*

Finansinspektionen, Sweden (2015). *Enkätundersökning om förberedelse inför Solvens 2.*

Finansinspektionen, Sweden (2015). *Supervision of Insurance Undertakings.*

FIN-FSA (2015). *Valvottavatilaisuus 4.5.2015 ja 5.5.2015 Solvenssi II.*

Finanstilsynet, Norway (2015). *Annual Report 2014.*

Finanstilsynet, Norway (2015). *Gjennomføringen av Solvens II.*

Fjármálaeftirlitid, Iceland (2015). *Annual Report of the Financial Supervisory Authority 2015.*

Insurance Europe (2014). *European Insurance in Figures (Statistics N°50).*

IVASS (15 April 2014). *Solvency II – applicazione degli Orientamenti EIOPA in materia di sistema di governance, di valutazione prospettica dei rischi (sulla base dei principi ORSA), di trasmissione di informazioni alle Autorità Nazionali competenti e di procedura preliminare dei modelli interni.*

IVASS (24 March 2015). *Solvency II – pubblicazione linee-guida EIOPA in materia di sistema di valutazione prospettica dei rischi e conseguenti chiarimenti per la preparazione a Solvency II.*

KNF (June 2015). *Przeprowadzanie ocen FLAOR/ORSA I raportowanie wyników dla organów nadzoru (presentation).*

Milliman Briefing Note (2013). *Key Challenges in Producing the Forward Looking Assessment of Own Risk.*

Milliman Briefing Note (2015). *Survey of 2014 FLAOR Submissions.*

Milliman Briefing Note (2015). *Survey of 2015 FLAOR Plans to Assess Standard Formula Appropriateness.*

Milliman Research Report (2013). *ORSA – An International Requirement.*

ORSA Working Group of the Dutch Association of Insurers (2012). *Vision on Own Risk and Solvency Assessment (ORSA) Good Practice.*

PRA (2013). *Supervisory Statement SS4/13 Solvency II: Applying EIOPA's preparatory guidelines to PRA-authorised firms.*

PRA (15 June 2015). *Solvency II: Own Risk and Solvency Assessment.*

Solvency II Wire (11 March 2015). *Emerging ORSA patterns.*

ABOUT MILLIMAN

Milliman is among the world's largest providers of actuarial and related products and services. The firm has consulting practices in life insurance and financial services, property & casualty insurance, healthcare, and employee benefits. Founded in 1947, Milliman is an independent firm with offices in major cities around the globe.

MILLIMAN IN EUROPE

Milliman maintains a strong and growing presence in Europe with 250 professional consultants serving clients from offices in Amsterdam, Brussels, Bucharest, Dublin, Dusseldorf, London, Madrid, Milan, Munich, Paris, Stockholm, Warsaw and Zurich.

milliman.com

Verschoyle House
28/30 Lower Mount Street
Dublin
2 IE