



EIOPA-CP-13/009  
27 March 2013

**Consultation Paper on the  
Proposal for Guidelines  
on  
Forward Looking assessment of the  
undertaking's own risks  
(based on the ORSA principles)**

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## Responding to this paper

EIOPA welcomes comments on the Consultation Paper on the Proposal for Guidelines on Forward Looking assessment of the undertaking's own risks (based on the ORSA principles).

The consultation package includes:

- The Consultation Paper
- Template for comments

Please send your comments to EIOPA in the provided Template for Comments, by email [CP-13-009@eiopa.europa.eu](mailto:CP-13-009@eiopa.europa.eu), by 19 June 2013.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

EIOPA invites comments on any aspect of this paper. Comments are most helpful if they:

- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

### Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with EIOPA's rules on public access to documents<sup>1</sup>. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by EIOPA's Board of Appeal and the European Ombudsman.

### Data protection

Information on data protection can be found at [www.eiopa.europa.eu](http://www.eiopa.europa.eu) under the heading 'Legal notice'.

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<sup>1</sup> [https://eiopa.europa.eu/fileadmin/tx\\_dam/files/aboutceiops/Public-Access-\(EIOPA-MB-11-051\).pdf](https://eiopa.europa.eu/fileadmin/tx_dam/files/aboutceiops/Public-Access-(EIOPA-MB-11-051).pdf)

## **Consultation Paper Overview & Next Steps**

EIOPA carries out consultations in the case of Guidelines and Recommendations in accordance to Article 16 (2) of the EIOPA Regulation.

This Consultation Paper presents the draft Guidelines, explanatory text and a technical annex.

The analysis of the expected impact from the proposed policy is covered under the Annex I (Impact Assessment) and includes the chronology and results of previous consultations.

### **Next steps**

EIOPA will consider the feedback received and expects to publish a final report on the consultation subsequently.

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# 1. Guidelines

## Introduction

- 1.1. According to Article 16 of Regulation (EU) 1094/2010 of 24 November 2010 (hereafter, EIOPA Regulation)<sup>2</sup> EIOPA is issuing Guidelines addressed to national competent authorities on how to proceed in the preparatory phase leading up to the application of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II)<sup>3</sup>.
- 1.2. These Guidelines are based on Article 41, Article 45 and Article 246 of Solvency II.
- 1.3. In the absence of a political agreement on Omnibus II, European national competent authorities may be forced to develop national solutions in order to ensure sound risk sensitive supervision. Instead of reaching consistent and convergent supervision in the EU, different national solutions may emerge to the detriment of a good functioning internal market.
- 1.4. It is of key importance that there will be a consistent and convergent approach with respect to the preparation of Solvency II. These Guidelines should be seen as preparatory work for Solvency II by fostering preparation with respect to key areas of Solvency II in order to ensure proper management of undertakings and that supervisors have sufficient information at hand. These areas are the system of governance, including risk management system and a forward looking assessment of the undertaking's own risks (based on the Own Risk and Solvency Assessment principles, known as ORSA), pre-application for internal models, and submission of information to competent authorities.
- 1.5. Early preparation is key in order to ensure that when Solvency II is fully applicable undertakings and national competent authorities will be well prepared and able to apply the new system. For this, national competent authorities are expected to engage with undertakings in a close dialogue.
- 1.6. As part of the preparation for the implementation of Solvency II, national competent authorities should put in place from 1st of January 2014 the Guidelines as set out in this document so that insurance and reinsurance undertakings take the appropriate steps.
- 1.7. National competent authorities should send to EIOPA, a progress report on the application of these Guidelines by the end of February following each relevant year, the first being by 28 February 2015 based on the period 1 January 2014 to 31 December 2014.
- 1.8. In the preparatory phase national competent authorities are expected to ensure that insurance and reinsurance undertakings take a forward looking view on the risks to which they are exposed similar to what they will have to do once Solvency II will apply. For this, it is expected that insurance and reinsurance

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<sup>2</sup> OJ L 331, 15.12.2010, p. 48–83

<sup>3</sup> OJ L 335, 17.12.2009, p.1-155

undertakings actively prepare and begin the implementation of the forward looking assessment of the undertaking's own risks (based on the ORSA principles) according to Article 45 of Solvency II.

- 1.9. Since this assessment can be undertaken irrespective of what regulatory quantitative requirements are applicable, national competent authorities are expected to ensure that undertakings perform an assessment of their overall solvency needs as of 2014.
- 1.10. The assessment of the continuous compliance with regulatory capital requirements and the requirements on technical provisions according to Article 45(1) (b) and the assessment of the significance of the deviation of the risk profile of an undertaking from the assumptions underlying the calculation of the SCR according to Article 45(1) (c) of Solvency II have a strong connection to Solvency II quantitative requirements which are not yet applicable during the preparatory period. These assessments can only be performed on the basis as if the undertaking would need to comply with these requirements.
- 1.11. As all the issues that would need to be covered by this assessment are already addressed through the pre-application process for internal model users, national competent authorities are not expected to ensure that undertakings which are in the pre-application process perform an assessment of the significance of their risk profile deviating from the assumptions underlying the SCR calculation in their forward looking assessment of the undertaking's own risks.
- 1.12. The Guidelines focus on what is to be achieved by this assessment rather than on how it is to be performed. For example, since the assessment of overall solvency needs represents the undertaking's own view of its risk profile, and the capital and other means needed to address these risks, the undertaking should decide for itself how to perform this assessment given the nature, scale and complexity of the risks inherent in its business.
- 1.13. These preparatory Guidelines include a Guideline for a report on the forward looking assessment of the undertaking's own risks. This report is meant to provide necessary information to the supervisor on the assessment made.
- 1.14. EIOPA acknowledges and supports the developments and achievements on a global scale and national level outside the European Union with regard to setting standards for Own Risk and Solvency Assessments with a forward looking perspective.
- 1.15. It is crucial that the administrative, management or supervisory body (AMSB) of the undertaking is aware of all material risks the undertaking faces, regardless of whether the risks are captured by the SCR calculation and whether they are quantifiable or not. It is also vital that the AMSB takes an active role in the forward looking assessment of the undertaking's own risks by directing and challenging its performance.
- 1.16. In case a group wishes to apply for the use of a single forward looking assessment of the group's own risks document this requires a high level of consistency in processes across the group and the evidence of full compliance

with the requirements of Article 45 of Solvency II at the individual level and Article 246(4) at the level of the group.

- 1.17. The Guidelines apply to both individual undertakings and at the level of the group. Additionally, the Guidelines address issues relevant to the group specificities of the forward looking assessment of the undertaking's own risks, in particular on account of specific risks to the group or risks that could be less relevant at individual level than at group level.
- 1.18. The relevant Guidelines for individual undertakings apply mutatis mutandis to the group forward looking assessment of the undertaking's own risks. Additionally, groups need to take into consideration the group specific Guidelines.
- 1.19. Undertakings applying for the approval of an internal model are expected to use the model in the assessment of their overall solvency needs.
- 1.20. For the purpose of these Guidelines, the following definitions have been developed:
  - a) "forward looking assessment of the undertaking's own risks" which is used in the Guidelines: is meant to be identical to "forward looking assessment of the undertaking's own risks (based on ORSA principles)"
  - b) "group level": means a coherent economic entity (holistic view) comprising all entities in the group as referred to in the Guidelines on the system of governance;
  - c) "group forward looking assessment of the undertaking's own risks": means the forward looking assessment of the undertaking's own risks undertaken at group level;
  - d) "group single forward looking assessment of the undertaking's own risks": means the single forward looking assessment of the undertaking's own risks undertaken at the level of the group and at the level of any subsidiary of the group on the same reference date and period formalised in one document when supervisory agreement is given to do so.
- 1.21. The Guidelines shall apply from 1 January 2014.

## **Section I: General Provisions for preparatory Guidelines**

### **Guideline 1- General provisions for Guidelines**

- 1.22. As part of the preparation for the implementation of Solvency II, national competent authorities should take the appropriate steps in order to put in place from 1 January 2014 the present Guidelines on the forward looking assessment of the undertaking's own risks (based on the ORSA principles).
- 1.23. National competent authorities should ensure that insurance and reinsurance undertakings and groups take the appropriate steps to
- a. build a process to develop a forward looking assessment of their own risks; and
  - b. build qualitative information supporting the forward looking assessment of the undertaking's own risks that will allow national competent authorities to review and evaluate the quality of the information.

### **Guideline 2 - Progress report to EIOPA**

- 1.24. National competent authorities should send to EIOPA, a progress report on the application of these Guidelines by the end of February following each relevant year, the first being by 28 February 2015 based on the period 1 January 2014 to 31 December 2014.

### **Guideline 3: Threshold for the forward looking assessment of the undertaking's own risks**

- 1.25. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the undertaking or the group performs an assessment of its overall solvency needs, starting in 2014.
- 1.26. National competent authorities should require that undertakings representing at least 80% of the market share as defined in Guideline 5 to 7 in the "Guidelines on submission of information to national competent authorities" perform an assessment if the undertaking would comply on a continuous basis with the Solvency II regulatory capital requirements and the requirements on the Solvency II technical provisions starting in 2014.
- 1.27. National competent authorities should require that groups submitting annual quantitative information as defined in Guideline 9 in the "Guidelines on submission of information to national competent authorities" perform an assessment if the group would comply on a continuous basis with the Solvency II regulatory capital requirements and the requirements on the Solvency II technical provisions starting in 2014.
- 1.28. National competent authorities should allow that undertakings and groups which are in the pre-application process for an internal model make use of this

model for the purpose of the assessment, provided that the undertaking concerned also performs the assessment for preparing for the eventuality that the application to use the internal model under Solvency II would be rejected by the national competent authority.

- 1.29. Where an undertaking which is not in the pre-application process for an internal model falling with the threshold referred to in the paragraph 1.26 and a group falling with the threshold referred to in paragraph 1.27, for the calculation of the Solvency II regulatory capital requirements, and provided that the technical specifications for the calculation of the Solvency II regulatory capital requirements have been provided, the national competent authority should require the undertaking or the group to perform an assessment of the significance of the deviation of its risk profile from the assumptions underlying the Solvency II Solvency Capital Requirement calculation, starting in 2014.

## **Section II: General considerations**

### **Guideline 4 –Proportionality**

- 1.30. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the undertaking develops its own processes for the forward looking assessment of the undertaking's own risks, tailored to fit into its organisational structure and risk-management system with appropriate and adequate techniques, taking into consideration the nature, scale and complexity of the risks inherent to the business.

### **Guideline 5 – Role of the administrative, management or supervisory body: top-down approach**

- 1.31. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the administrative, management or supervisory body of the undertaking takes an active part in the forward looking assessment of the undertaking's own risks, including steering, how the assessment is to be performed and challenging the results.

### **Guideline 6 – Documentation**

- 1.32. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the undertaking has at least the following documentation on the forward looking assessment of the undertaking's own risks:
- a) The policy for the forward looking assessment of the undertaking's own risks;
  - b) record of each forward looking assessment of the undertaking's own risks;
  - c) an internal report on each forward looking assessment of the undertaking's own risks; and

- d) a supervisory report of the forward looking assessment of the undertaking's own risks.

**Guideline 7 – Policy for the forward looking assessment of the undertaking's own risks (based on the ORSA principles)**

1.33. In accordance with Articles 41 and 45 of Solvency II, national competent authorities should ensure that the administrative, management or supervisory body of the undertaking approves the policy for the forward looking assessment of the undertaking's own risks. This policy should include at least:

- a) a description of the processes and procedures in place to conduct the forward looking assessment of the undertaking's own risks;
- b) a consideration of the link between the risk profile, the approved risk tolerance limits and the overall solvency needs; and
- c) information on:
  - (i) how and how often stress tests, sensitivity analyses and reverse stress tests are to be performed;
  - (ii) data quality standards; and
  - (iii) the frequency of the assessment itself and the justification of its adequacy particularly taking into account the undertaking's risk profile and the volatility of its overall solvency needs relative to its capital position as well as the timing for the performance of the forward looking assessment of the undertaking's own risks and the circumstances which would trigger the need for a forward looking assessment of the undertaking's own risks outside of the regular time-scales.

**Guideline 8 – Record of each forward looking assessment of the undertaking's own risks (based on the ORSA principles)**

1.34. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the undertaking appropriately evidences and internally documents each forward looking assessment of the undertaking's own risks and its outcome.

**Guideline 9 – Internal report on the forward looking assessment of the undertaking's own risks (based on the ORSA principles)**

1.35. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the administrative, management or supervisory body (AMSB) communicates to all relevant staff at least the results and conclusions regarding the forward looking assessment of the undertaking's own risks, once the process and the results have been approved by the AMSB.

**Guideline 10 – Supervisory Report of the forward looking assessment**

### **of the undertaking's own risks (based on the ORSA principles)**

1.36. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the undertaking submits the supervisory report of the forward looking assessment of the undertaking's own risks within 2 weeks of concluding the assessments. The supervisory report should present at least the following:

- a) the qualitative and quantitative results of the forward looking assessment and the conclusions drawn by the undertaking from those results;
- b) the methods and main assumptions used; and
- c) where applicable according to the thresholds introduced, a comparison between the overall solvency needs, the regulatory capital requirements and the undertaking's own funds.

## **Section III: Specific features regarding the performance of the forward looking assessment of the undertaking's own risks (based on the ORSA principles)**

### **Guideline 11 – Valuation and recognition of the overall solvency needs**

1.37. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the undertaking, if it uses recognition and valuation bases that are different from the Solvency II bases in the assessment of its overall solvency needs, explains how the use of such different recognition and valuation bases ensures better consideration of the specific risk profile, approved risk tolerance limits and business strategy of the undertaking, while complying with the requirement for a sound and prudent management of the business.

1.38. National competent authorities should ensure that the undertaking quantitatively estimates the impact on the overall solvency needs assessment of the different recognition and valuation bases.

### **Guideline 12 – Assessment of the overall solvency needs**

1.39. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the undertaking assesses its overall solvency needs and then expresses the overall solvency needs in quantitative terms and complements the quantification by a qualitative description of the material risks.

1.40. Where appropriate, national competent authorities should ensure that the undertaking subjects the identified material risks to a sufficiently wide range of stress test or scenario analyses in order to provide an adequate basis for the assessment of the overall solvency needs.

### **Guideline 13 – Forward-looking perspective of the overall solvency**

## **needs**

1.41. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the undertaking's assessment of the overall solvency needs is forward-looking, including a medium term or long term perspective as appropriate.

### **Guideline 14 – Regulatory capital requirements**

1.42. In accordance with Article 45 of Solvency II and in accordance with Guideline 3 on the threshold for the forward looking assessment of the undertaking's own risks, national competent authorities should ensure that as part of the forward looking assessment of the undertaking's own risks the assessment if the undertaking would comply on a continuous basis with the Solvency II regulatory capital requirements includes at least:

- a) the potential future material changes in the risk profile;
- b) the quantity and quality of its own funds over the whole of its business planning period; and
- c) 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.

### **Guideline 15 – Technical provisions**

1.43. In accordance with Article 45 of Solvency II and in accordance with Guideline 3 on the threshold for the forward looking assessment of the undertaking's own risks, national competent authorities should ensure that as part of the forward looking assessment of the undertaking's own risks the actuarial function of the undertaking provides input if the undertaking would comply continuously with the requirements regarding the calculation of technical provisions and the risks arising from this calculation.

### **Guideline 16 – Deviations from assumptions underlying the SCR calculation**

1.44. In accordance with Article 45 of Solvency II and in accordance with Guideline 3 on the threshold for the forward looking assessment of the undertaking's own risks, national competent authorities should ensure that the undertaking assesses whether its risk profile deviates from the assumptions underlying the Solvency II Solvency Capital Requirement calculation and whether these deviations are material.

### **Guideline 17 – Link to the strategic management process and decision-making framework**

1.45. In accordance with Article 45 of Solvency II, national competent authorities should ensure that the undertaking takes into account the results of the forward looking assessment of the undertaking's own risks

and the insights gained during the process of this assessment in at least:

- a) its capital management;
- b) its business planning; and
- c) its product development and design.

#### **Guideline 18 – Frequency**

1.46. In accordance with Articles 45 and 246 of Solvency II, national competent authorities should ensure that the undertaking performs the forward looking assessment of the undertaking's own risks at least annually.

### **Section IV: Specificities of the Group in the forward looking assessment of the undertaking's own risks (based on the ORSA principles)**

#### **Guideline 19 – Scope of group forward looking assessment of the undertaking's own risks (based on the ORSA principles)**

1.47. In accordance with Articles 45 and 246 of Solvency II, national competent authorities should ensure that the entity responsible for fulfilling the governance requirements at group level designs the group forward looking assessment of the undertaking's own risks to reflect the nature of the group structure and its risk profile. All of the entities that fall within the scope of group supervision should be included within the scope of the group forward looking assessment of the undertaking's own risks. This should include insurance, reinsurance, non-insurance and non-reinsurance undertakings, and both regulated and non-regulated entities, situated in the EEA and outside the EEA.

#### **Guideline 20 – Reporting to the supervisory authorities**

1.48. In accordance with Articles 45 and 246 of Solvency II and in case the entity responsible for fulfilling the governance requirement applies for a single document of the forward looking assessment of the undertaking's own risks:

- a) The group supervisor should form a view whether to allow the group to perform a single forward looking assessment of the undertaking's own risks document, if there is no other decision process in force in the college, and if no member that would otherwise receive an individual forward looking assessment of the undertaking's own risks document disagrees; and
- b) where one or more of the subsidiaries has its head office in a Member State whose official languages are different from the languages in which the single forward looking assessment of the undertaking's own risks document is reported, the supervisory

authority concerned should consult with the group supervisor, the college of supervisors and the group itself before requiring the undertaking to translate the part of the forward looking assessment of the undertaking's own risks document that concerns the subsidiary into an official language of the Member State in which the subsidiary has its head office.

**Guideline 21 – Assessment of the impact of group specific risks on overall solvency needs**

1.49. In accordance with Articles 45 and 246 of Solvency II, national competent authorities should ensure that the entity responsible for fulfilling the governance requirements at group level in the group forward looking assessment of the undertaking's own risks adequately identifies, measures, monitors, manages and reports the impact of all group specific risks and interdependencies within the group as well as, and the impact of these risks and interdependencies on the overall solvency needs, taking into consideration the specificities of the group and the fact that some risks may be scaled up at the level of the group.

**Guideline 22- General rule for group forward looking assessment of the undertaking's own risks (based on the ORSA principles)**

1.50. In accordance with Articles 45 and 246 of Solvency II and in accordance with Guideline 7 on policy for the forward looking assessment of the undertaking's own risks, national competent authorities should ensure that the entity responsible for fulfilling the governance requirements at group level includes in the record of the group forward looking assessment of the undertaking's own risks at least a description on how the following factors were taken into consideration:

- a) The identification of the sources of own funds within the group if there is a need for additional new own funds;
- b) the assessment of availability, transferability or fungibility of own funds;
- c) references to any planned transfer of own funds within the group, which would have a material impact on any entity of the group, and its consequences;
- d) alignment of individual strategies with the ones established at the level of the group; and
- e) specific risks the group could be exposed to.

**Guideline 23 – Specific requirements for a single forward looking assessment of the undertaking's own risks (based on the ORSA principles) document**

1.51. In accordance with Articles 45 and 246 of Solvency II, national competent authorities should ensure that the entity responsible for

fulfilling the governance requirements at group level, when applying to submit a single forward looking assessment of the undertaking's own risks document, provides an explanation of how the subsidiaries are covered and how the AMSBs of the subsidiaries are involved in the assessment process and approval of the outcome.

#### **Guideline 24 – Internal model users**

1.52. In accordance with Articles 45 and 246 of Solvency II, national competent authorities should ensure that, in the case of an internal model pre-application, the entity responsible for fulfilling the governance requirements at group level, calculates the group Solvency Capital Requirement under Article 230 or under Article 231 of Solvency II. National competent authorities should ensure that in the group forward looking assessment of the undertaking's own risks the entity responsible for fulfilling the governance requirements at group level reports the related undertakings within the scope of the group, which would not use the internal model for the group to calculate their Solvency Capital Requirement and the reasons for this.

#### **Guideline 25 – Integration of related third-country insurance and re-insurance undertakings**

1.53. In accordance with Articles 45 and 246 of Solvency II, national competent authorities should ensure that the entity responsible for fulfilling the governance requirements at group level assesses in the group forward looking assessment of the undertaking's own risks the risks of the business in third countries in the same manner as it does for EEA-business with special attention to the assessment of transferability and fungibility of capital.

### **Compliance and Reporting Rules**

- 1.54. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, Competent Authorities shall make every effort to comply with guidelines and recommendations.
- 1.55. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
- 1.56. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, by [dd mm yyyy].
- 1.57. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting.

## 2. Annex I – Impact Assessment

### **Preliminary analysis of the opportunity of issuing preparatory Guidelines**

- 2.1. Before analysing pros and cons of the proposed groups of Guidelines with respect to the baseline, it is necessary, on a logical basis, to justify the choice of issuing Guidelines now or not, but instead doing nothing and waiting till the application of Solvency II.
- 2.2. For this null option it is possible to identify the following costs and benefits:

#### **Option 0, not issuing preparatory Guidelines:**

- 2.3. With regard to costs on the side of undertakings:
- a) Potential compliance costs may arise in case undertakings start doing investments, purchasing systems and implementing processes, which may need to be changed later due to changes in the negotiations;
  - b) In the absence of preparatory Guidelines, practices may evolve differently with respect to other financial market sectors, provoking adjustment costs later (EBA issued Guidelines in 2012 and IAIS have issued “Core Principles on Governance”);
  - c) The risks, which insurers can be confronted with due to their specifics, can have a huge impact on the overall risks of the insurance undertaking or the whole group. Not taking them into account at an early stage can have a huge cost impact for the insurer at later time when the risks materialise.
  - d) Another source of costs could be the final rush to set up systems right before the implementation date of Solvency II. During the rushing errors are also easier to happen.
- 2.4. With regard to costs on the side of national competent authorities:
- a) Member States have already started updating their legislation regarding the assessment of risks, so if they go further there will be the risk of inconsistent approaches;
  - b) In the absence of preparatory Guidelines, supervisory practices may evolve differently with respect to other financial market sectors, provoking adjustment costs later (EBA issued guidelines in 2012 and IAIS have issued “Core Principles on Governance”);
  - c) Another source of costs could be the necessity to supervise undertaking during the final rush right before the implementation date of Solvency II. During the rushing errors are also easier to happen.
- 2.5. With regard to benefits on the side of undertakings:
- a) The advantage for the industry could be that, in structuring its forward looking assessment of its own risks, undertakings have not to take into account any new aspects or further elements encompassed by these Guidelines.

- b) In fact some member states might not have required fulfilling any forward looking assessment of the undertakings' own risks (based on ORSA principles).
- c) However, one can argue if that (not having guiding principles) is really an advantage.

2.6. With regard to benefits on the side of national competent authorities:

- a) The advantage for national competent authorities could be that they do not have to take into account new aspects or further elements in the process of supervision of the compliance by undertakings.
- b) However, one can argue if that (not having guiding principles) is really an advantage.

2.7. For consumers

- a) No immediate advantage as any costs that may be reflected on policyholders would also happen with normal preparation of Solvency II.
- b) But a better understanding of its own risk by the insurance undertaking (and therefore a better risk management) is a huge advantage for policy holders and should come as early as possible. This brings a good reason for issuing preparatory guidelines.

2.8. The balancing between cons and pros led to the final evaluation that is beneficial for all providing now preparatory Guidelines, to help undertakings and national competent authorities in taking decisions and organising during the preparation phase.

## **1: Procedural issues and consultation of interested parties**

2.9. The Impact assessment was prepared in the course of the policy drafting process, with the contribution of experts from different national competent authorities and EIOPA.

2.10. Selected stakeholders were pre-consulted in the preparation of the Guidelines.

## **2: Problem definition**

2.11. Supervisory requirements with regard to risk management, including where applicable a forward looking assessment of undertaking's own risks, vary widely across Member States. These differing requirements impose unnecessary costs on the undertakings and groups and do not provide a level playing field. Therefore new requirements should harmonise and streamline supervisory requirements with regard to a forward looking assessment of undertaking own risks, based on ORSA principles.

2.12. From past and current experience with Solvency I it became evident that a formal and harmonised framework for a risk management system, focusing on the identification, assessment, managing, monitoring and reporting of risks, including a forward looking assessment of the undertaking's own risks and solvency needs, was needed and that the Administrative, Management or

Supervisory Body (AMSB) had to be more involved in the processes of risk management and the forward looking assessment of the undertaking's own risk and solvency needs. Accordingly, the requirement for the undertaking to perform its own risk and solvency assessment should improve risk and capital management and help align regulatory and industry practice. However, due to some uncertainty regarding supervisory expectations on the ORSA there was a general consensus that harmonised Guidelines were needed.

2.13. Regulatory measures will tackle this problem by introducing the Solvency II; however there is still no political agreement on Omnibus II. However, further details on a forward looking assessment of undertaking's own risks, based on ORSA principles are needed to ensure harmonisation and streamline supervisory reporting requirements among Member States.

2.14. The "Opinion of EIOPA on interim guidelines regarding Solvency II", issued on the 20 December 2012, stresses the importance of having a consistent and convergent approach with respect to the preparation of Solvency II. In the run-up of the new system, some key areas of Solvency II need to be addressed in order to ensure proper management of undertakings and to ensure that Supervisors have sufficient information at hand. A forward looking assessment of undertakings own risks and solvency is among these key areas. These preparatory Guidelines aim at guiding undertakings in their preparation of their risk management system and forward looking assessment of their own risks.

2.15. Regarding the ORSA, EIOPA has already publicly consulted stakeholders. After having analysed all comments received during pre-consultation in winter 2010/2011, EIOPA conducted an impact assessment based on issues highlighted by stakeholders. In the public consultation conducted from November 2011 until January 2012 stakeholders did not raise any issues that EIOPA had not already addressed following the pre-consultation, but EIOPA revisited the options chosen and decided that they were still valid. This impact assessment represents a revisit of the previous ones and was amended also in order to illustrate the potential consequences of applying the Guidelines during the preparatory phase.

## **Proportionality**

2.16. National competent authorities are expected to ensure that the provisions described in the Opinion are applied 'in a manner which is proportionate to the nature, scale and complexity inherent in the business of the insurance and reinsurance undertaking'. The approach taken aims to ensure that this expectation can be met, and this is reflected in the drafting of the Guidelines in two principal ways:

- a) In most cases, the Guidelines are principle based or drafted with a view to the outcome or supervisory objective that should be met;

- b) The level of detail and scope of the Guidelines reflects the fact that the Guidelines are issued in order to prepare for Solvency II and not for its full application.
- 2.17. For the overall approach to proportionality on the preparatory Guidelines under consultation, please see the "Cover note for the Consultation Paper on Guidelines on preparing for Solvency II".
- 2.18. The forward looking assessment based on ORSA principles is an area where there is a significant change between the existing regulatory requirements and those under Solvency II. EIOPA, therefore, believes that it is not appropriate for national competent authorities to expect that all the provisions in these areas are met in the same way by all undertakings during the preparatory phase, and a number of thresholds are proposed in the Guidelines.
- 2.19. It is important to underline that the thresholds have been designed for use during the preparatory phase, as part of taking a proportionate approach. It does not indicate that requirements in these areas will not be in place for all undertakings within the scope of Solvency II once it is fully applied. Consequently, for those undertakings that are not within the thresholds national competent authorities are still expected to ensure that these undertakings begin to prepare and develop appropriate plans.
- 2.20. EIOPA intends for a high proportion of the market to be within the provisions in these areas within each member state. This is in order to ensure that the benefits of consistent preparation set out above are met. EIOPA has also taken into consideration the latest discussions on OMDII with regard to reporting, so as to ensure that the thresholds for the preparatory phase do not capture a greater share of the market than can be expected when Solvency II is applied.
- 2.21. With regard to the forward looking assessment, it is considered appropriate for all undertakings to conduct an assessment of their own risks and solvency needs, but given the greater complexity associated with the assessment of compliance with regulatory capital requirements, a threshold is proposed for the other two aspects of the assessment. It is also not considered appropriate for national competent authorities to expect undertakings or groups which are in the pre-application process for an internal model to perform the assessment of deviations from the assumptions underlying the standard formula calculation.

## **Baseline Scenario**

- 2.22. When analysing the impact from policies, the methodology foresees that a baseline scenario is applied as the basis for comparing policy options. This helps to identify the incremental impact of each policy option considered. The aim of the baseline scenario is to explain how the current situation would evolve without additional public intervention.

2.23. For the analysis of the potential related costs and benefits of the proposed Guideline on the information to supervisors, EIOPA has applied as a baseline the current practice for regulatory reporting including any preparation that has been made for implementing Solvency II.

### **3: Objective pursued**

2.24. The main objective of the Guidelines is to actively prepare undertakings and national competent authorities for performing the forward looking assessment of the undertaking's own risks according to Article 45 of Solvency II. The EIOPA Opinion cited above states in item 9 that "undertakings which will be well-governed and which, in particular measure correctly, mitigate and report the risks which they face will be more likely to be prepared for the new regulatory framework and act in the interests of policyholders".

2.25. The aim of the Guidelines on a forward looking assessment of undertaking's own risks is to provide guidance to undertakings to prepare their own risks assessment in the light of the future entering in force of Solvency II.

### **4: Policy Options**

2.26. This Impact Assessment is based on the Issues paper from 2008, and comments received from public consultation (for the comments received from stakeholders responding to this consultation visit EIOPA website: <https://eiopa.europa.eu/consultations/issues-papers-surveys-and-questionnaires/index.html>). A feedback statement was issued to inform stakeholders of the understanding from EIOPA on the ORSA as well as how EIOPA interpreted the requirements in the draft Solvency II proposal from 2008 ([https://eiopa.europa.eu/fileadmin/tx\\_dam/files/consultations/Issues-Paper-ORSA-%20Feedback.pdf](https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/Issues-Paper-ORSA-%20Feedback.pdf)).

2.27. The focal point of the issues paper from 2008 was the ORSA on the individual undertaking level but after the pre-consultation it became evident that group issues for the ORSA were a major concern for stakeholders. Later on it also became clear that guidance on the interaction between ORSA and partial/full internal models was an important issue that needed to be addressed.

2.28. Based on this, EIOPA developed draft Guidelines on ORSA combining individual and group ORSA and addressing their respective specificities as well as issues regarding the ORSA of insurance undertakings using internal models for the calculation of their SCR.

2.29. These draft Guidelines were pre-consulted in winter of 2010/2011 with AMICE, CEA (now Insurance Europe), Group Consultative, CRO Forum, CFO Forum and FEE.

2.30. The main results of the pre-consultation were that the consulted stakeholder groups agreed that the focus of the guidance should be on what

needs to be achieved by the ORSA rather than on how it is to be performed. Stakeholders also agreed that the ORSA process is an important process within undertakings as a self-assessment tool for the undertaking and should be left with sufficient room for the individual approach within the undertaking. Undertakings should perform the assessment in accordance with the nature, scale and complexity of their business. It is important that the overall process is internally planned, performed and documented before reporting to the supervisor in order to give the supervisor the most current picture of the undertaking's risk profile and overall solvency needs. The emphasis should primarily be on the adequacy of the process for providing the AMSB with insight in the risks of the undertaking as well as improving risk management and better understanding the undertaking's overall solvency needs.

2.31. It is acknowledged that undertakings should perform the assessment in accordance with the nature, scale and complexity of the risks inherent to their business. Although consulted stakeholders agreed that the proportionality principle is not on different requirements but on different ways to fulfil the requirements they would also prefer more details on the application of the principle. However, as the proportionality principle should be reflected in the process and not on what is to be achieved this made it difficult to address the application of the principle in the previous draft of the guidelines. Efforts have been made in this regard and EIOPA believes that the draft published in July 2012 reflects an improvement on the previous draft.

2.32. After EIOPA decided to publish preparatory Guidelines on ORSA it was necessary to introduce changes to the Guidelines that accommodate the postponement of the Pillar I issues. The changes are not extensive but the introduction was amended to explain the scope of the Guidelines during the preparatory phase.

2.33. As preparation for ORSA is influenced by the fact that not all elements of the ORSA can be performed in a regime that quantitatively is not yet in the Solvency II world, EIOPA discussed whether some requirements should not be applied the same way during the preparatory phase. E.g. EIOPA considered whether reporting of the forward looking assessment of undertaking's own risks outcome to the supervisory authority was applicable. It was decided that an forward looking assessment of undertaking's own risks Supervisory Report should be submitted to supervisory authorities and encompass the assessment of overall solvency needs as well as - for the undertakings required to perform these based on the threshold for reporting - the assessments of the continuous compliance with the Solvency II capital requirements/technical provisions requirements and the significance of the deviation from underlying assumptions.

2.34. Since the requirement to report on the outcome of the ORSA is prescribed in Article 45 of Solvency II a decision to forego the report for the preparatory phase was not considered to be optional. EIOPA also believes that it is important that supervisory authorities get the information on the forward

looking assessment of undertaking's own risks to improve insight into the risk profile of undertakings and – with regard to the two assessments only to be reported by some undertakings - to be able to monitor the preparation for Solvency II quantitative requirements.

2.35. The current IA focus on two different areas. It includes three specific issues for the preparatory phase and three issues applicable not only at preparatory phase but also for future ORSA requirements, following from comments received in previous papers.

2.36. In the light of the specific characteristics of these preparatory Guidelines, it was agreed to describe policy options not Guideline by Guideline, neither group by group of Guidelines, but to proceed by areas. In fact, the Guidelines are all strictly linked and interrelated, and analysing them one by one would have ended up in a too fragmented and partial description. It has been judged more appropriate to present directly policy options EIOPA considered, and then offer motivations about the preferred final choice.

2.37. EIOPA has identified six policy options that were considered. The options are based on what EIOPA believes could have the most significant impact on undertakings and the level of protection for policyholders as well as beneficiaries. The focal point is how an underlying problem could evolve, all things being equal, if such options were not decided upon. The policy options described below are not competing with one another, but are proposed as a solution to different aspects of the lack of harmonisation in this area.

2.38. During the policy development process the focus was on the main policy questions listed below. On the basis of the following policy questions the ensuing policy options were considered:

#### **Specific areas for the preparatory phase:**

1. Whether the performance of an assessment on the continuous compliance with regulatory capital requirements and on the requirements on technical provisions as well as an assessment of the significance of the deviation of an undertaking's risk profile should be required during the preparatory phase.
2. Whether to provide preparatory Guidelines and examples on a forward looking assessment of undertakings own risks and solvency supervisory report.
3. Whether to keep the possibility during the preparatory phase to allow groups to produce a single forward looking assessment of undertaking's own risks document.

#### **General areas for the preparatory phase and future ORSA guidelines:**

4. Whether to detail a forward looking assessment of undertakings own risks and solvency policy.
5. Whether to require a quantitative assessment for all deviations from the standard formula regardless of their significance.

6. Whether the use of the internal model should be allowed for the assessment of the continuous compliance with regulatory capital needs for undertakings in the pre-application process.

Section 5 in this Annex outlines the pros and cons for each option and the respective analysis. Section 6 concludes which options have been preferred and which have been discarded and why.

## **5: Analysis of the Policy Options**

2.39. In this section we aim to describe the different options and the respective expected positive and negative effects from the considered policy options regarding the main groups of stakeholders. The analysis considers the expected effect on insurance and reinsurance undertakings and groups (undertakings), national competent authorities and policyholders.

2.40. As a consequence of the choice of describing options not Guideline by Guideline, nor group by group of Guidelines, but by areas, it was agreed to give to this chapter a structure symmetric to the structure of the previous chapter. For each option, arguments are constructed to prepare the selection of the preferred one. In the next chapter, these pro and cons are compared and the final choice.

### **Specific areas for the preparatory phase:**

#### **1. Whether the performance of an assessment on the continuous compliance with regulatory capital requirements and on the requirements on technical provisions as well as an assessment of the significance of the deviation of an undertaking's risk profile should be required during the preparatory phase**

2.41. While the assessment of the overall solvency needs assessment can be performed irrespective of the regulatory capital regime in place, the assessments of the continuous compliance with regulatory capital requirements and the requirements on technical provisions according to Article 45 of Solvency II are strongly connected with Solvency II quantitative requirements. EIOPA discussed whether these assessments should be applied anyway during the preparatory period as if the Solvency II quantitative requirements already were in force to provide information about the undertakings potential situation in a Solvency II context for the undertakings themselves and for supervisors.

2.42. Expecting undertakings to perform the assessments according to Articles 45(1)(b) and (c) of Solvency II already during the preparatory phase as if Solvency II requirements were fully applicable would increase implementation costs for undertakings for the moment as they cannot put off introducing a process covering all elements of the ORSA as set out in Article 45 of Solvency II until the full Solvency II application. They would also have to perform an assessment of compliance with future capital requirements while still having to continue assessing and ensuring that they are able to meet the solvency

requirements of the current supervisory regime. As for the assessment of the deviation between the undertaking risk profile and the assumption of the standard formula, the assessment would serve to indicate to undertakings and national competent authorities whether the Solvency Capital Requirement of an undertaking potentially is not fully captured by using the standard formula and would enable early discussion about how this could be resolved.

2.43. The assessment of the continuous compliance on the other hand would render more reliable information about potential difficulties for undertakings to meet the future Solvency II quantitative requirements if it could be based on finalised Solvency II technical specifications but would still be useful even if those were not available: as undertakings have to prepare themselves for the requirements of the new regime they would have to use whatever information is available to determine their future regulatory capital requirements according to the new rules ahead of the introduction of the new capital regime anyway in order to ensure that they are able to meet the new requirements as of day one. Asking that the continuous compliance assessment already be performed therefore requires a preparation for Solvency II quantitative requirements that undertakings would have to accomplish in the run up to the full introduction of Solvency II in any event, however in a more organised and exacting way than might be the case otherwise. But forming an opinion on the preparation for Solvency II capital requirements in this more organised and systematic form could serve to help undertakings with implementing the necessary processes and procedures for the undertaking's own risk and solvency assessment under real Solvency II conditions.

2.44. As the outcome of the assessment has to be reported to the supervisory authority, the performance of the assessment would also give the national competent authorities the opportunity to not only assess the preparedness of undertakings for meeting the Solvency II capital requirements but also that they are sufficiently advanced in implementing the operational structures needed to ensure that risk management and capital management are appropriately linked. Performing such an assessment ahead of the Solvency II introduction is an opportunity to discover weaknesses in processes and procedures and take remedial steps when undertakings are still in the dry run phase and deficiencies do not yet call for other supervisory measures than more intensive communication with the undertakings concerned. However, from a supervisory point of view good preparation is to be considered more important for the assessment of the continuous compliance with requirements than for the assessment of the significant deviation from the assumptions underlying the Solvency Capital Requirement calculation. Performing the latter for undertakings and assessing this performance for national competent authorities is also a task that is demanding, for the undertakings even when information about the underlying assumptions on which the calculation is based is being made available by EIOPA

2.45. EIOPA believes that these assessments are worthwhile during the preparatory period in order to show their own preparedness to undertakings.

As no supervisory action is envisaged after conducting the assessments, in which a link to quantitative parts of Solvency II is inherent, EIOPA encourages a clear and transparent dialogue between the undertaking and the national competent authority concerned. This dialogue aims for better preparedness of the undertaking and a better understanding on the supervisory side about the actual risks the insurance company is facing. Future supervisory measures once full Solvency II will be implemented can be avoided on a less costly base for undertakings and consumers.

## **2. Whether to provide guidelines and examples on a forward looking assessment of undertakings own risks and solvency supervisory report**

- 2.46. It is expected that some requirements regarding the level of detail for the ORSA supervisory report will be set out in the Level 2 Implementing Measures. As the Guidelines need to stand without Level 2 implementing measures it was discussed if the Guidelines should include a forward looking assessment of undertaking's own risks supervisory report, including whether a detailed description or an actual example of a structure and content should be provided to ensure a common baseline and a minimum level of detail.
- 2.47. How an undertaking wants to document the process, procedures and results is very undertaking specific and EIOPA's concerns are that a structured report could influence the reporting of the forward looking assessment of undertaking's own risks. Moreover detailed Guidelines could affect the way the undertaking develops these processes and hence its overall forward looking assessment of undertaking's own risks performance and subsequently the internal documentation and the reporting to the national competent authority. Accordingly, providing a template for a structured report could compromise the undertaking's own assessment. On the other hand, by not providing a structure there might be lack of harmonisation even though later Level 2 Implementing Measures on reporting requirements are expected to give some minimum requirements for the undertakings' ORSA Supervisory Report. This non-harmonised structure makes comparison between undertakings as well as information sharing between supervisors and in colleges more difficult.
- 2.48. EIOPA not providing an example on a structured report gives the undertaking the opportunity to design its own reporting template that fits the nature, scale and complexity of the risks inherent in the business of the undertaking and ensures the involvement of the AMSB to develop a template it believes provides sufficient information internally and to supervisory authorities. Additionally, a non-structured report allows the undertaking to use its internal reporting as a basis for the forward looking assessment of undertaking's own risks supervisory report, if deemed adequate by the AMSB.
- 2.49. A main focus is to ensure that supervisory authorities get current information on all forward looking assessment of undertaking's own risks performed by all undertakings.

2.50. Based on this EIOPA believes that it would not be helpful to give an example on a structured report, but rather give the undertaking the opportunity to develop its own reporting template for the forward looking assessment of undertakings own risks and solvency supervisory report to ensure the involvement of the AMSB and that it contains what they want reported.

### **3. Whether to keep the possibility during the preparatory phase to allow groups to produce a single document of the forward looking assessment of the undertaking's own risks**

2.51. For the college of supervisors, allowing the group to produce a single document is a decision that has an impact on every supervisor of the entities in the scope of the single document as the information received as a supervisory report of the forward looking assessment of the undertaking's own risks will be different or at least presented differently. Article 246 of Solvency II explains that the decision to allow the group to perform the single document is taken by the group supervisor after consultation of the college. Nevertheless, it is not clearly explained what influence the group supervisor, and the member of the college have on the final decision.

2.52. During the preparatory phase, the group supervision will still be regulated by the Sienna and Helsinki protocols and the functioning of colleges of supervisors will not be the same as when Solvency II will be in force. That means for example that probably in most colleges there will be no process in force to take a decision like allowing the group to produce a single forward looking assessment of undertaking's own risks. It is nevertheless possible that a coordination arrangement is already in force in the college during the preparatory phase.

2.53. It was discussed if EIOPA should keep the option for groups to make the single forward looking assessment of undertaking's own risks document and then if EIOPA should provide the college with a Guideline for decision making in the college on that issue in case there was not an existing one.

2.54. EIOPA believes that it should be possible during the preparatory phase, for the group, to have the opportunity to undertake the forward looking assessment of undertaking's own risks at the level of the group and at the level of any subsidiary in the group at the same time and produce a single document covering all the assessments.

2.55. As it will be in any case a demand from the group, the cost and benefits, in term of scale economies and rationalisation of the process for the forward looking assessment of undertaking's own risks within the group as well as with the relationship with the supervisory authorities and the college can essentially be positive for the group. The outcome of the analysis will be especially positive if risks are made more transparent which lay in the structure of the group and / or escalate on group level.

- 2.56. On the other hand, for the national supervisory authorities concerned, the single forward looking assessment of undertaking's own risks document instead of a dedicated individual forward looking assessment of undertaking's own risks supervisory report may represent a constrain as the information provided is not specifically designed for each national supervisory authority concerned but for the group as a whole.
- 2.57. This special case can pose additional costs for the undertaking concerned, but these costs do not differ in the preparatory period.
- 2.58. The impact on consumers and policyholders can be valued neutral in general terms. Risks on group level will be more transparent and therefore the protection for policyholders will increase in this respect. On the other hand a single document of the forward looking assessment of the undertaking's own risks has a less granular approach on entity level, which resolves in slightly less policyholder protection.

### **General areas for the preparatory phase and future ORSA guidelines:**

#### **4. Whether to detail a forward looking assessment of undertakings own risks and solvency policy**

- 2.59. A written policy is required by Solvency II for the risk management system and since the forward looking assessment is a part of the risk management system, a policy on this area needs to be included. It was discussed whether EIOPA should define the minimum requirements of this policy for the forward looking assessment of undertakings own risks.
- 2.60. As EIOPA believes that this assessment is one of the most important processes under the Solvency II regime and as it requires the input from various sources within the undertaking and from external sources as well, it is important that an undertaking ensures that all relevant information is taken into account.
- 2.61. The assessment as part of the risk management system is required in Article 41(3) of Solvency II, should be approved by the AMSB and properly implemented by the undertaking to achieve an effective system of governance.
- 2.62. EIOPA is aware that developing a proper policy that contains the right information to ensure a proper performance of the forward looking assessment could be time consuming. But this policy is required to give insight to and oversight of the decision making process and risk understanding inside the AMSB as well as ensuring the undertaking has a comprehensive picture of all the risks it is exposed to. It also ensures the necessary level of responsibility by the AMSB and a policy will help them in deciding the level of documentation needed, the allocation of responsibilities and workflows and identifying the undertaking's core business with regard to its risk management system as well as what they believe is important for such a process.

2.63. Hence, EIOPA believes it is necessary to set out the policy in such detail as to ensure proper governance and subsequently good results. This is a requirement of Articles 41(3) and 45 of Solvency II, and this particular process requires a higher standard for the internal documentation as well as input for the supervisory report of the forward looking assessment. Accordingly, by requiring such a policy, EIOPA emphasizes that an appropriate level of detail is expected depending on the nature, scale and complexity of the risks inherent to the business of the undertaking.

2.64. With proper processes laid down in the policy of the forward looking assessment the undertaking ensures a better degree of quality for the assessment itself. Vice versa an assessment will be of less quality if important and significant sources of information will be overseen or if the responsibility of the AMSB is not clearly set out in the policy. This will be more costly for the undertaking at the beginning when setting up the policy. But as only good processes for the assessment will lead to good assessments it can be expected that in the long run this will cost less time and resources for the undertaking.

2.65. Therefore for the preparatory phase EIOPA considers appropriate to develop a forward looking assessment of undertaking's own risks policy.

## **5. Whether to require a quantitative assessment for all deviations from the standard formula regardless of its significance**

2.66. An assessment of the deviation from the standard formula is required, in order to determine whether the deviation is significant. The question was whether the quantitative assessment of the deviation should be a Guideline to all deviations or only for significant deviations. This would entail that an initial qualitative assessment would be acceptable as an indication for the significance of the deviation.

2.67. EIOPA believes that the most appropriate approach to the assessment of the deviations is to perform a qualitative assessment as a first step, so that undertakings do not have to do a potential burdensome quantitative assessment for all deviations. EIOPA will expect quantification as a second step, only if the qualitative assessment indicates a significant deviation from the assumptions underlying the Solvency Capital Requirement calculation.

2.68. On the other hand, the qualitative assessment of the deviation could be sufficient as a starting point, as quantification may be time consuming and costly and cannot be taken as definite anyway but there is an increased possibility of error, since the qualitative assessment may indicate that the deviation is not significant when in fact it is. EIOPA is aware of that quantification can be rather burdensome, especially if the undertaking during the preparatory phase has made use of the freedom to not apply Solvency II principles to the overall solvency assessment in which case switching to Solvency II is necessary before quantification.

2.69. EIOPA accepts the error margin and only requires quantitative assessment when qualitative assessment indicates that deviation is significant and will have a material impact.

2.70. The same approach is taken on forward looking assessment of undertaking's own risks during the preparatory phase.

## **6. Whether the use of the internal model should be allowed for the assessment of the continuous compliance with regulatory capital needs for undertakings in the pre-application process**

2.71. With the assessment of the overall solvency needs being an undertaking's own assessment of the risks it is or could be exposed to and how they should be managed or covered with capital, it is understood that for undertakings seeking supervisory approval for an internal model that they have developed, this model is used in the assessment. If the undertaking did not trust its own model sufficiently to use it for its overall solvency needs assessment this would provide a strong reason to refuse approval of the model. However, for the assessment of the continuous compliance with regulatory capital needs that is to be performed by undertakings within the 80% market share threshold it is not obvious that use of the not yet approved internal model should be allowed instead of the use of the standard formula. EIOPA consequently discussed whether it is appropriate that potential internal model users should be required or should have the possibility to employ their internal model for this assessment.

2.72. Undertakings within the 80% market share threshold are expected to perform the assessment of the continuous compliance with regulatory capital requirements under Solvency II conditions in order to prepare for the change in capital needs that will follow the introduction of the quantitative requirements of the Solvency II regime. Undertakings that are in the pre-application phase for the internal model cannot be sure that their internal model will eventually be approved by the supervisory authority – at least not without some changes. There always remains an element of uncertainty as to whether the steps taken by an undertaking to comply with the requirements on internal models are sufficient and appropriate with regard to the individual circumstances of the undertaking and the modelling it has chosen. If these undertakings were allowed to use their internal model for assessing continuous compliance with Solvency II capital requirements this would entail the risk that their preparation for the Solvency II regime could be based on expectations that do not come to pass as approval of the internal model is refused. This could be avoided if they used the standard formula for the assessment but in this case they could miss out on a better preparation for the use of the internal model during the pre-application period that they would benefit from where the assessment to be based on the internal model output. The use of the standard formula while providing information that could be useful for the pre-application process would also have serious drawbacks from the supervisory perspective as the supervisory authority loses a good opportunity to form a view about the

appropriateness of the internal model the undertakings intend to submit for approval. On the other hand, if the internal model could not be approved as applied for it would be important to know what would be the outcome if the standard formula were to be used. Indeed for the supervisory authority it would be most advantageous to have both the information on the assessment based on the standard formula and the internal model as input to the pre-application process.

2.73. The same approach is taken on forward looking assessment of undertaking's own risks during the preparatory phase.

## **6: Comparing the options**

2.74. Weighing the complexity of the assessments and the resources they would bind for undertakings and national competent authorities alike against the usefulness of the information these would render and the helpfulness of practicing the assessments in a dry run, EIOPA has come to the conclusion that these assessments should not be required from all undertakings but should be limited to undertakings which are also subject to submission of information as these assessments are even more challenging than providing the information for the purposes of submission of information. Hence, Guideline 3 introduces a threshold that is consistent with the threshold for submission of information on annual basis. Taking into account that for undertakings that have entered the pre-application phase for an internal model all relevant issues that are to be addressed in the assessment will be dealt with in the pre-application process, the Guideline further excludes undertakings which are in the pre-application process from any requirement to perform this assessment even where the undertaking concerned is within the threshold.

2.75. EIOPA believes that the proposed policy options help achieve the objectives pursued in enhancing the protection of policyholders and beneficiaries and improving the international competitiveness of EU insurers and reinsurers, in an efficient and effective way. A specific characteristic of the policy options proposed, and which contributes to an effective and efficient result is that they allow for supervisory practices to be applied in a proportionate manner with respect to risks.

2.76. EIOPA appreciates that issuing these Guidelines may have an economic impact for undertakings. However the benefits of having a common understanding of the forward looking assessment of undertaking's own risks between undertakings and supervisors are a vital step to ensure a level playing field and the much needed transparency. Hence, a common understanding on how an undertaking should assess its own risks on a continuous basis and how to use this information to ensure good governance within the undertaking.

2.77. The same applies for the option on whether to detail a policy on the forward looking assessment of undertaking's own risks. Article 41 (3) of Solvency II already requires a written policy for the risk management system and since the forward looking assessment is an integrated part of that, it

makes most sense to require a policy on how to perform, manage, monitor and document this assessment as well as ensuring the AMSB's involvement in and understanding of the process.

2.78. The option of whether to provide a structure for the forward looking assessment of undertaking's own risks supervisory report was, that a certain level of harmonisation will be provided by draft Level 2 Implementing Measures, and EIOPA found it better to give undertakings the flexibility of deciding what they find to be the relevant information that should be documented and disclosed to supervisors. The forward looking assessment of undertaking's own risks can be a very complex process that involves most of the undertaking and it requires the AMSB to be involved in all policies, processes and procedures– especially their risk exposure and how to assess it. Furthermore is an undertaking-specific tool, which has to take into account the nature, scale and complexity and level of documentation undertakings prefer. Consequently, the option of providing a structure for the report was discarded, since it would be difficult to make a one-size-fits-all structure for the supervisory report.

2.79. Whether it is better for an undertaking to use the internal model it means to apply for or the standard formula in the assessment of the continuous compliance with capital requirements eventually depends on whether the internal model is approved as applied for or not. As it is not possible to predict at this point in time whether most internal model applications will be fully successful or not, the decision about the option cannot be based on what is likely to be the better solution for the majority of undertakings. It also does not seem appropriate to let the supervisory authority determine on an individual basis whether an undertaking should be allowed to use the internal model for the assessment. This could be taken as predetermining the outcome of the approval process which is something the national competent authority should not do. Expecting the assessment on both bases, the internal model and the standard formula, while avoiding the drawbacks of both solutions increases the costs for undertakings as they would have to dedicate more resources in the preparation for the use of the internal model and the standard formula. The costs for the national competent authorities increase as well; as the range of the analysis for the undertaking grows more resources are needed to assess the undertaking's analysis. However, bearing in mind that the pre-application process is not a pre-approval process so that undertakings cannot rely on their internal model being approved as applied for and need to prepare for the eventuality that they may have to use the standard formula in any case by way of contingency planning, EIOPA decided to allow the use of the internal model for the assessment with the provision that the undertaking has then to explain the effect if it turns out the undertaking has to use the standard formula as approval for the model is refused. The increase in time and effort this costs the supervisory authority is balanced by the fact that the additional information enables the supervisory authority to make a better decision whether the application of the undertaking for the internal model should be approved. Consequently, GL 24 states that during the preparatory phase

national competent authorities should allow internal model users to perform the assessment of the continuous compliance with capital requirements based on their internal model provided that the undertaking is able to explain the effect on capital needs if the standard formula were to be used instead.

2.80. Finally EIOPA had the option of whether to require a quantitative assessment for all deviations or only when the qualitative assessment showed that there was a significant deviation from the assumptions underlying the Solvency Capital Requirement calculation.

2.81. EIOPA have accepted the error margin and will only require quantitative assessment when qualitative assessment indicates that deviation is significant and could have a material impact on the risk and capital management.

## **7: Concluding remarks**

2.82. The largest part of costs related to forward looking assessment of undertaking's own risks arises directly from preparation to comply with Solvency II. Taking into account there are no Implementing Measures for ORSA, EIOPA Guidelines aim at detailing requirements already introduced by Article 45 of Solvency II, so promoting a harmonized interpretation among undertakings and supervisors. Costs and benefits of EIOPA Guidelines can be summarized as in the following breakdown.

### ***Undertakings***

2.83. Additional costs for undertakings can be evaluated of a much minor scale with respect to those introduced by preparation for Solvency II:

- a) The request for a written forward looking assessment of undertaking's own risks policy is a specification of what Solvency II already states for the ORSA under the overall risk-management system (article 41 of Solvency II). Therefore there are no significant costs in relation to the preparatory Guidelines for undertakings;
- b) The same consideration can be valid for the supervisory report, which is required by Articles 35 and 45 of Solvency II, and for which EIOPA decided not to set a predefined structure, but rather give the undertaking the opportunity to develop its own appropriate format;
- c) As for deviations from assessments based on the standard formula, also in this case EIOPA opted for a balanced interpretation of Solvency II, asking for quantification only in the case a first qualitative analysis indicates that the deviation is significant;
- d) The group-perspective applies *mutatis mutandis* and EIOPA just specified this perspective for the forward looking assessment of undertaking's own risks, at the same time allowing the national competent authority of subsidiaries to require a translation into its language of the part of the group information regarding the entity concerned (when different from the language of the group in which the document for the forward looking assessment is written);

- e) The decision to perform a forward looking assessment of undertaking's own risks at least annually (if no other relevant changes happen in the meanwhile), though a specification added by EIOPA, aligns to the normal frequency undertakings have to respect for budget purposes and capital requirement calculations;
- f) Finally, EIOPA Guideline to record each process or the forward looking assessment and produce an internal forward looking assessment of undertaking's own risks report, to favour sharing information within the undertaking, should be seen as a straightforward consequence of the request in Solvency II to insert the forward looking assessment in the overall risk-management system with a management benefit for the understanding.

2.84. In front of minor additional costs arising from EIOPA Guidelines, undertakings would gain benefits:

- a) Help in organising forward looking assessment of undertaking's own risks processes and linking it to the other parts of governance;
- b) Prevent possible errors in the risk management and solvency needs and therefore costly adjustments for the undertaking;
- c) Give the basis of a common European understanding for all undertakings about the relevance of risk management and solvency needs, strengthening soundness and transparency of the market, and promoting best practices across countries;
- d) Can simplify the interactions between undertakings and supervisory authorities, so allowing avoiding costs connected to other supervisory review and / or possible revisions of the regulation set.

2.85. All possible costs arising from the Guidelines have an on-going nature, related to the periodical assessments.

### ***Supervisory Authorities***

2.86. Also on the side of supervisory authorities, the largest part of costs related to the forward looking assessment of undertaking's own risks arises directly from preparation for Solvency II. In particular, Authorities will be asked to analyse, at least year by year, supervisory reports, in order to verify, for each undertaking, overall solvency needs and possible effects of deviations from the underlying assumptions of the standard formula. Cost added by EIOPA Guidelines can be considered of a much minor scale. However, the choice not to give a unique predefined template to the supervisory report can, at least to some extent, complicate the functions of national competent authorities. The same consideration can be repeated also for the choice to require quantitative evaluations of deviations from the standard formula not in every case, but only when a qualitative analysis has indicated possible significant differences. This option could imply more attention by national competent authorities in verifying qualitative arguments proposed by undertakings.

- 2.87. In front of these minor additional costs, authorities will surely benefit from the overall package of Guidelines for the preparatory phase, by gaining a far better insight into the risk and capital situation of an undertaking. Moreover, the forward looking perspective can serve as an indicator of future supervisory reviews and measures. Assuring that supervision and controls will apply to a more homogeneous and harmonized set of regulation within each country and across countries is another benefit from the Guidelines. The functions of national competent authorities will be simplified, favouring cooperation among supervisors and, as for undertakings, the emergence of best practices.
- 2.88. Also on the side of national competent authorities, costs arising from the Guidelines have an on-going nature, related to the periodical assessments.

### **Policyholders**

- 2.89. While the overall costs of implementing the forward looking assessment of undertaking's own risks could be, at least to some extent, transferred from undertakings to consumers depending on market conditions prevailing in each country, no additional costs are expected for consumers directly from EIOPA preparatory Guidelines. Consumers will surely benefit from the sounder governance and the higher level of transparency associated with formal own risk assessments, well inserted inside the overall risk-management system.
- 2.90. EIOPA believes that the application of the proposed preparatory Guidelines ensures a harmonised and comparable basis for undertakings' risk and capital management as well as for the risk-based supervisory assessment. Moreover EIOPA is convinced that the application of these Guidelines will ensure common understanding and a level playing field.