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Draft of the

EXPOSURE DRAFT OF

EUROPEAN STANDARD OF ACTUARIAL PRACTICE 3

(ESAP 3)

Actuarial practice in relation to the ORSA process under Solvency II

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Preface

This European Standard of Actuarial Practice (ESAP) is a model for actuarial standard-setting bodies to consider.

The Actuarial Association of Europe (AAE) encourages relevant actuarial standard-setting bodies to maintain a standard or set of standards that is substantially consistent with this ESAP to the extent that the content of this ESAP is appropriate for actuaries in their jurisdiction. This can be achieved in many ways, including:

- adopting this ESAP as a standard with only the modifications in the Drafting Notes;
- customizing this ESAP by revising the text of the ESAP to the extent deemed appropriate by the standard-setting body while ensuring that the resulting standard or set of standards is substantially consistent with this ESAP;
- endorsing this ESAP by declaring that this ESAP is appropriate for use in certain clearly defined circumstances;
- modifying existing standards to obtain substantial consistency with this ESAP; or
- confirming that existing standards are already substantially consistent with this ESAP.

A standard or set of standards that is promulgated by a standard-setting body is considered to be substantially consistent with this ESAP if:

- there are no material gaps in the standard(s) in respect of the principles set out in this ESAP; and
- the standard or set of standards does not contradict this ESAP.

If an actuarial standard-setting body wishes to adopt or endorse this ESAP, it is essential to ensure that existing standards are substantially consistent with ESAP 1 as this ESAP relies upon ESAP 1 in many respects. Likewise, any customization of this ESAP, or modification of existing standards to obtain substantial consistency with this ESAP, should recognize the important fact that this ESAP relies upon ESAP 1 in many respects.

If this ESAP is translated for the purposes of adoption, the adopting body should select verbs that embody the concepts of "must" and "should", as described in paragraph 1.5 (following the language of ESAP 1), even if such verbs are not the literal translation of "must" and "should".

This ESAP is a model standard of actuarial practice and, as such, is not binding on any actuary.

This ESAP was adopted by the AAE General Assembly on [day month year].

[Drafting Notes: when an actuarial standard-setting organization adopts this standard it should:

1. *Replace "ESAP" throughout the document with the local standard name, if applicable;*
2. *Modify references to ESAP 1 in paragraphs 1.3, 1.4 and 1.5 to point to the local standard(s) that are substantially consistent with ESAP 1, rather than referring to ESAP 1 directly, if appropriate;*
3. *Choose the appropriate phrase and date in paragraph 1.8;*
4. *Review this standard for, and resolve, any conflicts with the local law and code of professional conduct; and*
5. *Delete this preface (including these drafting notes) and the footnote associated with paragraph 1.8.]*

Section 1. General

Comment [HD(-E1]: Hyperlinks and formatting to be finalised before issuing for consultation

1.1	**Purpose** – This ESAP provides guidance to actuaries who have a material involvement in or responsibility for the design or performance of the ORSA process, in order to give intended users confidence that: • actuarial services are carried out professionally and with due care in compliance with the Solvency II framework; • the results are relevant to intended users' needs, are presented clearly and understandably, and are sufficient in the context of the Solvency II framework; and • the assumptions and methodology (including, but not limited to, models and modelling techniques) are appropriate, and are used appropriately.	
1.2	**Scope –** This ESAP applies only to actuarial services performed by an actuary in relation to the ORSA process, insofar as the actuary has a material involvement in or responsibility for the design or performance of the ORSA process. Wider adoption of this ESAP is encouraged, particularly amongst those actuaries who provide actuarial services in support of those actuaries who have material involvement in or responsibility for the design or performance of the ORSA process. It is recognised that undertakings have adopted a variety of approaches for complying with the ORSA requirements. These include carrying out an identifiable set of activities specifically developed to constitute the ORSA process (as envisaged in this ESAP) as well as identifying and linking specified practices and calculations, that are embedded in the undertaking's management processes, which collectively satisfy the ORSA requirements. Whilst the requirements set out in this ESAP are expressed in relation to the former approach, this does not mean that the latter approach does not comply with ORSA requirements. However, when performing ORSA-related actuarial services for an undertaking that does not undertake a separate, explicit ORSA process, any actuary who has a material involvement in or responsibility for these ORSA-related actuarial services should ensure that the substance of the requirements of this ESAP are adhered to as appropriate in his or her work. It is envisaged that non-actuaries may also consider where appropriate following the principles set out in this ESAP, in order to support a consistent application of the ORSA requirements across member states, undertakings, groups and individual functions within undertakings.	
1.3	**Compliance** – [For this ESAP, this paragraph replaces paragraph 1.3. in ESAP 1] An actuary may fail to follow the guidance of this ESAP but still comply with it where the actuary:	
	1.3.1	Complies with requirements of law that conflict with this ESAP;
	1.3.2	Complies with requirements of the actuarial code of professional conduct applicable to the work that conflict with this ESAP; or
	1.3.3	Departs from the guidance in this ESAP and provides, in any report, an appropriate statement with respect to the nature, rationale, and effect of any such departure.
1.4	**Relationship to ESAP 1** – Insofar as possible, this ESAP does not repeat guidance already provided in ESAP 1. Any actuary who asserts compliance with this ESAP (as a model standard) must also comply with ESAP 1. References in ESAP 1 to "this ESAP" should be interpreted as	

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	applying equally to this ESAP 3, where appropriate.
1.5	**Language** – Notwithstanding paragraph 1.3, this ESAP adopts the practice of ESAP 1 in intending that the following verbs are to be understood to convey the actions or reactions indicated: a) "must" means that the indicated action is mandatory and failure to follow the indicated action will constitute a departure from this ESAP; and **b)** "should" (or "shall") means that, under normal circumstances, the actuary is expected to follow the indicated action, unless to do so would produce a result that would be inappropriate or would potentially mislead the intended users of the actuarial services. If the indicated action is not followed, the actuary should disclose that fact and provide the reason for not following the indicated action. In this ESAP, bold font is used to highlight the text involving the verb "must".
1.6	**Defined Terms** – This ESAP uses various terms whose specific meanings are defined in Section 2. These terms are highlighted in the text with a dashed underscore and in blue, which is a hyperlink to the definition (e.g. actuary).
1.7	**Cross references** – This ESAP refers to the content of the Solvency II Directive (Directive 2009/138/EC as amended on 23. 05.2014) and the Commission Delegated Regulation (EU) 2015/35 as published in the Official Journal on 17.01.2015 in compliance with the Solvency II Directive. If the Solvency II Directive or the Commission Delegated Regulation is subsequently amended, restated, revoked, or replaced after the dates mentioned above, the actuary should apply the principles in this ESAP to the extent they remain relevant.
1.8	**Effective Date** – This ESAP is effective in relation to {actuarial services performed/actuarial services commenced/actuarial services performed relevant to an event}[1] on or after [Date].

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[1] *[Phrase to be selected and date to be inserted by standard-setter adopting or endorsing this ESAP.]*.

Section 2. Definitions

The terms below are defined for use in this ESAP.

2.1	**AAE** – Actuarial Association of Europe.
2.2	**Actuarial Services** – Services, based upon actuarial considerations, provided to intended users that may include the rendering of advice, recommendations, findings, or opinions.
2.3	**Actuary** – An individual member of one of the member associations of the AAE.
2.4	**AMSB** – Administrative, Management or Supervisory Body.
2.5	**Communication** – Any statement (including oral statements) issued or made by an actuary with respect to actuarial services.
2.6	**Entity** – The subject, in whole or in part, of the actuarial services, including an enterprise, an insurer, a pensions or benefits plan, a social security scheme, an individual, a government department or agency, a group, etc.
2.7	**Exposures –** The nature and extent to which an entity is exposed to areas of uncertainty (e.g. increases in reserves, gains and losses, liquidity events, reputation, etc).
2.8	**Intended User** – Any legal or natural person (usually including the principal) whom the actuary intends at the time the actuary performs the actuarial services to use the report.
2.9	**Law** – Applicable acts, statutes, regulations, or any other binding authority (such as accounting standards and any regulatory guidance that is effectively binding).
2.10	**ORSA cycle** – The entirety of tasks to be performed regularly for the ORSA process.
2.11	**ORSA process –** The framework of activities an entity has put in place in order to satisfy the requirements of Article 45 of the Solvency II Directive.
2.12	**ORSA run** – Those parts of the ORSA cycle that consist of making the risk assessment, setting the assumptions, running the models and drawing the conclusions from the results.
2.13	**ORSA-triggering event** – A material change in the nature of the uncertainties or exposures thereto, or in the understanding of those uncertainties or exposures.
2.14	**Principal** – The party who engages the provider of actuarial services. The principal will usually be the client or the employer of the actuary.
2.15	**Professional Judgement** – The judgement of the actuary based on actuarial training and experience.
2.16	**Report** – The actuary's communication(s) presenting some or all results of actuarial services to an intended user in any recorded form, including but not limited to paper, word processing or spreadsheet files, e-mail, website, slide presentations or audio or video recordings.
2.17	**Uncertainties –** Things which happen in the larger world (e.g. movements in the equity markets, lapses, policyholder behaviour, natural catastrophes, accidents etc) or within the entity itself (e.g. operational or control issues) which are commonly referred to as "risks".
2.18	**Work** – All actuarial activities performed by an actuary related to actuarial services. It usually includes acquisition of knowledge of the circumstances of the assignment, obtaining sufficient and reliable data, selection of assumptions and methodology, calculations and examination of the reasonableness of their result, use of other persons' work, formulation of opinion and advice, documentation, reporting and all other communication.

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Section 3. Appropriate Practices

Before presenting work as being compliant with this ESAP, the actuary should confirm with his or her principal the extent to which the scope of his or her work includes the topics addressed within the sub-sections (e.g. 3.1.1) within this Section. Where the scope includes the topic addressed within an individual sub-section, the requirements within that sub-section all apply to the actuary.

3.1	**Design of the ORSA process** Where the actuary has material involvement in, or responsibility for, the design of the ORSA process, it is envisaged that the scope of his or her work will cover each of the sub-sections within 3.1.
3.1.1	Establishing a structured approach to uncertainty. **The actuary must take reasonable steps to ensure that the ORSA process follows an appropriately structured approach to uncertainty.** In assessing whether the ORSA process follows an appropriately structured approach to uncertainty, the actuary should consider whether it: • facilitates sufficient understanding and effective management and communication of areas of uncertainty ("risks"), of evolving exposures to risks, and of the ORSA process; • facilitates the coherent identification and quantification or, if appropriate, qualitative assessment of all material risks relevant to the ORSA, taking account of the undertaking's risk appetite and risk profile, and how the latter may change over the time period considered under the ORSA; • provides appropriate clarity around which material risks are subject to qualitative assessment and which to quantitative assessment and that, in both cases, appropriate mechanisms and resources are in place in order that the assessment should be fit for purpose; • enables new and emerging risks, and approaches to risk, to be incorporated as they are identified; • enables understanding of the interaction between risks and exposures as they evolve; • enables the assumption setting process to take account of relevant management actions; • ensures appropriate scenario- and stress-testing is carried out, including reverse stress testing, considering also relevant management actions; • ensures appropriate back-testing is carried out of past assumptions in light of actual experience and that the results are properly incorporated into assumption-setting for the current ORSA cycle; • ensures appropriate ongoing review and updating of the ORSA process; • facilitates the effective triggering and operation of an ORSA run within a periodic, annual or more frequent ORSA cycle, and as a result of an appropriately defined ORSA triggering event; and • enables coherent integration of the ORSA process within the undertaking's wider business units and processes, and within the relevant decision making of its AMSB.

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	The actuary must be in a position to explain and justify the approach he or she has taken to this assessment, if reasonably requested to do so.
3.1.2	Deviation from Solvency II balance sheet approach and methodology. **Where the ORSA process involves an approach to any aspect of balance sheet asset or liability measurement and/or risk quantification that deviates significantly from that used by the undertaking for its supervisory reporting of solvency capital requirement coverage, the actuary must document the extent of that difference, the rationale for it and its potential consequences.** In considering the significance of any such deviation, the actuary should consider: • the extent to which the approach is consistent with, or deviates from, the principles and rules of Solvency II; • the likely consequences of any such deviation, with particular attention paid to the extent to which the financial projections included in the ORSA will facilitate the identification of any material risks to the ability of the undertaking to cover its SCR during the projection period chosen; • the extent to which the ORSA is suitable for its intended business use; and • the extent to which the ORSA takes reasonable account of any such deviation having regard to its intended use. **The actuary must take reasonable steps to ensure that any such deviation and its implications are communicated appropriately to those directly reliant upon the ORSA for the purposes of exercising significant decision making responsibility.**
3.1.3	The ORSA consideration period. **The actuary must take reasonable steps to ensure that the period considered under the ORSA process is appropriate for its intended purpose.** In determining the appropriateness of the time period selected for the ORSA process, the actuary should consider the projection period used for business planning purposes and the evolving risk profile of the undertaking, including: ○ the possible future run-off of existing business; ○ the possible run-off of any new business acquired in the future; ○ expected changes in the economic environment; and ○ unexpected changes in the economic environment. **The actuary must be in a position to explain and justify the selection of the time period considered under the ORSA, if reasonably requested to do so**.

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3.1.4	Inconsistency with the undertaking's risk management approach. **Where the actuary has reasonable grounds for believing that there is material inconsistency between the ORSA process and the undertaking's approach to risk management, the actuary must ensure that such inconsistency is appropriately communicated.**
3.2	**Performance of the ORSA process**
3.2.1	Financial projections **The actuary must take reasonable steps to ensure that the projections used in the ORSA process are appropriate for its intended purpose.** In assessing whether the projections are appropriate, the actuary should consider the extent to which: • Any calculation simplifications or approximations adopted (relative to the approach taken for published financial results) might result in an inappropriate indication of the significance of a material risk driver; • Assumptions used are appropriate, with sufficient clarity over their derivation; and • Scenario-, stress- and sensitivity-testing included are sufficient to indicate the significance of material risk drivers. **The actuary must be in a position to explain and justify the approach he or she has taken to this assessment of appropriateness, if reasonably requested to do so.** **Where the actuary has reasonable grounds for believing that there is a material shortcoming in the projections that renders the ORSA unsuitable for its purpose, then the actuary must ensure that such shortcoming is appropriately communicated.**
3.2.2	Qualitative risk assessment **The actuary must take reasonable steps to ensure that the qualitative risk assessments used in the ORSA process are appropriate for its intended purpose.** In assessing whether the qualitative risk assessments are appropriate, the actuary should consider the extent to which the assessments: • Make use of relevant past data both from within the undertaking and from other appropriate sources; • Take into account an appropriately-wide range of relevant scenarios; and • Have been subject to a sufficiently rigorous internal review process. **The actuary must be in a position to explain and justify the approach he or she has taken to this assessment of appropriateness, if reasonably requested to do so.** **Where the actuary has reasonable grounds for believing that there is a material shortcoming in the qualitative risk assessments that renders the ORSA unsuitable for its purpose, then the actuary must ensure that such shortcoming is appropriately communicated.**

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