ACTUARIAL ASSOCIATION OF EUROPE
ASSOCIATION ACTUARIELLE EUROPÉENNE

4 PLACE DU SAMEDI

B-1000 BRUSSELS, BELGIUM

TEL: (+32) 22 17 01 21 FAX: (+32) 27 92 46 48

E-MAIL: info@actuary.eu
WEB: www.actuary.eu

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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TABLE OF CONTENTS

Preface 3
Introduction 4
Section 1. General 5
Section 2. Definitions 7
Section 3. Appropriate Practices 8
3.1 Considerations in relation to the ORSA process 8
3.2 Considerations in relation to the model(s) supporting the ORSA methodology 10
3.3 Considerations in relation to "Business as Usual" (using ORSA) 12
3.4 Considerations in relation to Governance 13
3.5 Special issues specific to group ORSA 15

DRAFT

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 three verbs that embody the concepts of "must", "should", and "may", as described in paragraph 1.6. Language of ESAP 1, even if such verbs are not the literal translation of "must", "should", and "may".

This ESAP is binding upon an actuary only if so directed by the actuary's standard-setting body or if the actuary states that some or all of the work has been performed in compliance with this ESAP (e.g., if the actuary is directed by the principal to comply with this ESAP).

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 3.4.2 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 1.7;*
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 1.7.]*

Introduction

The Own Risk and Solvency Assessment (ORSA) process is envisaged as a key component of the Solvency II framework providing the administrative, management or supervisory body (AMSB) with information that can be used in strategic decision-making at the group and/or undertaking level. Also, the supervisor will be keen on learning the processes and their results in a report. Actuaries across firms and member states will play a role in the ORSA process; in some cases the actuaries' contribution will be a significant one, in other cases it may only be minor. Nevertheless actuaries will have a role both as members of the actuarial function and serving other functions of the group and/or undertaking.

This European Standard of Actuarial Practice (ESAP) provides guidance to actuaries when performing actuarial services in relation to the processes of the group or undertaking ORSA as required under the Solvency II framework.

It is envisaged that non-actuaries may also consider adherence to the guidance of this ESAP (or the actuarial standards adopted by the national standard setters) so that their own services to the ORSA process can also be compliant with this guidance, and hence contributing to a harmonized application of ORSA across member states, firms and functions within firms.

DRAFT

Section 1. General

1.1	**Purpose** – This ESAP provides guidance to actuaries when performing actuarial services in relation to the processes of the group or undertaking Own Risk and Solvency Assessment (ORSA) as required under the Solvency II framework 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 their needs, are presented clearly and understandably, and are complete in the context of the Solvency II framework; and • the assumptions and methodology (including, but not limited to, models and modelling techniques) used are disclosed appropriately.	
1.2	**Scope –** This ESAP applies to all actuarial services performed by an actuary in relation to the ORSA process. An actuary who is performing these actuarial services may be acting in one of several capacities, such as an employee, management, director, external adviser, auditor, or supervisory authority of the entity. Regardless of the role the actuary has within the group or the undertaking (e.g. a member of the actuarial function, the risk management function, any other key functions or any other roles), the guidance in this ESAP applies to the actuary in so far as the actuary provides actuarial services in relation to the ORSA process. When a team is performing certain tasks in relation to the ORSA process and the actuary has a certain role in performing actuarial services within that team then the actuary should identify which member of the team is responsible for those tasks and consider that member of the team to be the principal. In most cases, it is expected that this person will be the team leader.	
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** – Where 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 applying equally to this ESAP 3, where appropriate.	
1.5	**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).	
1.6	**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 consider the guidance in this ESAP to the extent it remains relevant and appropriate.	
1.7	**Effective Date** – This ESAP is effective for {actuarial services performed/actuarial services	

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	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	**Actuarial Services** – Services, based upon actuarial considerations, provided to intended users that may include the rendering of advice, recommendations, findings, or opinions.
2.2	**Actuary** – An individual member of one of the member associations of the AAE.
2.3	**Communication** – Any statement (including oral statements) issued or made by an actuary with respect to actuarial services.
2.4	**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.
2.5	**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).
2.6	**AAE** – Actuarial Association of Europe
2.7	**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.
2.8	**Law** – Applicable acts, statutes, regulations, or any other binding authority (such as accounting standards and any regulatory guidance that is effectively binding).
2.9	**ORSA cycle** – The entirety of tasks to be performed regularly for the ORSA process.
2.10	**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.
2.11	**ORSA-triggering event** – A material change in the nature of the uncertainties or exposures thereto, or in the understanding of those uncertainties or exposures.
2.12	**Principal** – The party who engages the provider of actuarial services. The principal will usually be the client or the employer of the actuary.
2.13	**Professional Judgement** – The judgement of the actuary based on actuarial training and experience.
2.14	**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.
2.15	**Uncertainties –** Things which happen in the larger world (e.g. movements in the equity markets, lapses, policyholder behaviour, etc) or within the entity itself (e.g. operational or control issues) which we commonly refer to as "risks".
2.16	**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.

DRAFT

Section 3. Appropriate Practices

The scope (or exclusion from scope) of the work should cover the sub-section (e.g. 3.1) within this Section. Where the scope includes an individual sub-heading (e.g. 3.1.1), the guidance within each relevant subheading applies to the actuary.

3.1	**Considerations in relation to the ORSA process**
3.1.1	Establishing a structured and documented approach to uncertainty. The ORSA process typically takes the form of recurring tasks to be done at least in an annual cycle. Where the scope of the work requires the actuary to establish (or contribute to establishing) a structured and documented approach to the ORSA process, he or she should ensure (or contribute to ensuring, whichever is appropriate) that the process: • enables the maintenance and increased understanding and management of the areas of uncertainties ("risks") and the evolving exposures to those risks; • facilitates identification of all material risks to be covered by the ORSA, to which the underlying group or entity is or will be exposed, considering the nature and level of risk, and thereby classifying risks to be quantified using models or treated using qualitative methods; • enables new areas of uncertainty to be incorporated as they are identified, even if they are not material but potentially growing (emerging risks); • enables the evolving nature of the interactions of the risks and exposures to be understood; • enables the changes to the understanding of risk, or the approach thereto, to be incorporated; • enables the assumption setting process to consider potential future management actions appropriately; • enables back-testing of past assumptions versus experience to be properly carried out and the consequences to be properly incorporated into assumptions for the future; and • facilitates the effective maintenance and transfer of the knowledge of risks, exposures and the ORSA process to other interested parties.
3.1.2	Considerations for consistency with or deviation from Solvency II requirements. The actuary should document or contribute to documenting, whichever is appropriate: • to what extent the ORSA process is consistent with, or deviates from, the principles and the rules of Solvency II and the consequences of any deviations; and • the extent to which the ORSA supports the intended business uses and takes account of the limitations, and the differences from the Solvency II Internal Model / Standard Formula, which should be understood and communicated to the stakeholders.

DRAFT

3.1.3	Considerations for the business-planning period and the interactions among risk, capital, and value.
	
	In considering the structure and process of the ORSA, the actuary should ensure or contribute to ensuring, whichever is appropriate, that the business-planning period takes account of:
	• The evolution of the risk profile including:
	  ○ the run-off of the existing business;
	  ○ the run-off of the new business acquired in the future;
	  ○ expected changes in the environment; and
	  ○ unexpected changes in the environment;
	• the appropriateness of the business-planning period, with special attention to the consideration of whether the business-planning period is sufficiently long to capture all implications of the current and evolving risk profile;
	• the interaction of risk, capital and value over the business-planning period, with proper attention to shorter term requirements and the longer term run-off of the businesses; and
	• expected and stressed effects of the business plan on various stakeholders over the business-planning period, considering both shorter term and long term requirements.
	
	The actuary should document how he or she is satisfied that these issues have been considered.

3.1.4	Involvement of the business in the ORSA process. The actuary should seek to work with relevant business units to identify, understand, quantify or qualify, monitor, manage and report on all the identified areas of uncertainty and the exposures so that these can be properly considered in the ORSA. The actuary should record their interactions with these other business units and recommend how these interactions could be improved.
3.1.5	Risk management and the ORSA. The actuary should document or contribute to documenting, whichever is appropriate, his or her: • understanding of the extent to which the risk management strategy and the day-to-day risk management practices are reflected in the ORSA; • understanding of the extent to which any current risk management actions may be contraindicated or be inefficient relative to the assumptions of ORSA or its output; • understanding of the extent to which the Enterprise Risk Management (ERM) framework is incorporated, supported, and consistent with the ORSA or its outputs; and • review of the ORSA process for appropriateness.
3.1.6	Events triggering an ORSA run. In addition to Business as Usual (BAU), an ORSA run is required when an ORSA-triggering event occurs. The actuary should consider and document or contribute to documenting, whichever is appropriate, whether the processes are appropriate to identify the type of occurrence and level of materiality of an event which would trigger another ORSA run.

DRAFT

3.1.7	Effectiveness of the model(s) supporting the ORSA methodology as a risk management tool. The actuary should consider and document or contribute to documenting, whichever is appropriate: • how the ORSA provides useful information to decision-making; • the extent to which the ORSA supports the ERM framework; and • any areas where it might be worth improving the ORSA methodology in order to increase the effectiveness of the process.
3.2	**Considerations in relation to the model(s) supporting the ORSA methodology**
3.2.1	ORSA methodology and structure – connections with Solvency Capital Requirement (SCR) methodology. At the beginning of the process the actuary should consider the ORSA methodology and structure. In the case of the former, the actuary should consider how the ORSA time horizon and risk measure is consistent with that used in the SCR to ensure multi-year projections are coherent. There should be a coherent link between the ORSA, the strategy of the entity (as reflected in the output of the business-planning process), and the decision-making framework. The methodology should also consider the significance of the risks being modelled, the extent to which the risks may be modelled reliably, and the level of proportionality that could be applied to modelling these risks. The methods applied should show an assessment of the compliance, on a continuous basis, with the capital requirements along the entire time horizon used for the ORSA projections. The actuary must assess the significance with which the risk profile of the undertaking or group concerned deviates from the assumptions underlying the Solvency Capital Requirement. The actuary should document how the above factors have been considered.
3.2.2	Risk coverage considerations for the model(s) supporting the ORSA methodology. The actuary should consider that there may be risks which, although capable of being captured quantitatively, are better managed using qualitative methods only (see subsection 3.2.3). In identifying and quantifying (to the extent possible) the risks in the ORSA, the actuary should consider the risk appetite and the full risk profile of the business throughout the entire time horizon used for the ORSA projections. The actuary should also consider to what extent these risks are covered within the Solvency II balance sheet and the SCR. The conclusions of this process should be documented. For all risks to which the underlying group or the entity has or could have during the time horizon of the ORSA, material exposures should be taken into consideration in the ORSA. For each risk, the actuary should consider the nature and level of uncertainty associated with the risk itself as well as the extent of exposure (e.g. the extent of potential losses due to changes in this risk). The actuary should consider whether to include the risk within the ORSA models. This should form part of an on-going process as the actuary's understanding of the risk changes and the nature of the (re)insurer's exposure to that risk changes.

DRAFT

3.2.3	Combining quantitative and qualitative risks coherently. The actuary should determine which risks can and should be quantified and which cannot easily or should not be quantified. In the case of the latter, the actuary should be aware of the qualitative tools to identify, describe and report those risks and should consider whether it would be appropriate to carry out separate scenario tests to demonstrate the effect of particular scenarios on the group or entity. The actuary should ensure or contribute to ensuring, whichever is appropriate, that these scenarios are coherent and can allow for management actions. These scenario tests should include scenarios the entity can survive and which it cannot. Consideration should be given to the ultimate use or users of aggregated risk information and how the inclusion of qualitative risks may affect this. Subject to 3.2.2, the actuary should quantify risks to the extent possible, taking account of the precision required for the intended purposes. Where the required precision is not possible, risks should be handled qualitatively. The qualitative measurement thereof should consider the nature of the remaining uncertainty as well as the need for precision (proportionality). With regard to incorporating qualitative risks coherently within the ORSA: • professional judgement should be used when incorporating qualitative risks into the ORSA or the models supporting the ORSA; • material risks which cannot be quantified reliably should be incorporated into the ORSA using qualitative methods; similarly, when quantification of a risk is not sufficient in comparison to qualitative methods and qualitative methods manage the risk more efficiently, the actuary should use those qualitative methods for the purposes of the ORSA; • the inclusion of such risks and exposures should not introduce spurious accuracy into the ORSA; and • when risks could be captured quantitatively but are captured only qualitatively, then a proper explanation should be given and documented. The actuary should document the process involved and justification for his or her conclusions.
3.2.4	Considerations for stress-testing, reverse stress-testing, and scenario-testing. The projections, or point-in-time stresses, used in the ORSA process should include a base scenario and several plausible adverse scenarios. Each scenario should take into account not only in-force policies but also the policies assumed to be sold during the projection period (where applicable). The base scenario should reflect a realistic set of assumptions used to forecast the expected financial position over the projection period. However, the actuary should be cognisant that the past relationships between assumptions may be different from those applicable in the future. In determining the stresses and scenarios to be considered, the actuary should consider the exposures of the particular entity to risk concentrations. Where there is a significant risk exposure, the actuary should also consider stresses and scenarios that may be considered more extreme in the current environment or that have not occurred in the recent past. In determining the stresses and scenarios to be considered, the actuary should be aware that: • risk measures exhibit non-linear behaviour, especially when various individual risks are aggregated; and • the value-at-risk measure required for calculating the SCR is not sub-additive.

DRAFT

	For the appraisal of some risks, the projections can be on a deterministic basis. However, the actuary should consider, depending on the circumstances and nature of the risk profile, whether stochastic techniques should be used to exhibit the variability in outcomes that could take place in the future. The actuary should document the approach used and its justification. The actuary should also set out his or her justification for the use of particular scenarios. Reverse stress tests should be considered to identify various combinations of risks that may lead to the failure of the business, whether that failure is defined as insolvency, loss of a certain credit rating, parental difficulties or other outcome. These reverse stress tests may be more extreme than plausible scenarios. In testing variations in the outcomes above, the actuary should allow for plausible management actions. The actuary should pay heed to stress and scenario tests issued by insurance and/or banking supervisors and other relevant bodies.
3.2.5	Time horizons: business-planning period and risk-specific timeframes. Normally, the base scenario should be consistent with the business plan, unless those assumptions are so inconsistent or unrealistic that the resulting ORSA report would be misleading. If this is the case, the reasons should be documented.
3.2.6	Understanding and documenting the key similarities and differences between the real world and the modelled world from an ORSA point of view (i.e. the world implicitly assumed within the model(s) supporting the ORSA). The actuary should evidence his or her understanding of (and document) the key similarities and differences between the real world and ORSA model.
3.3	**Considerations in relation to "Business as Usual" (using ORSA)**
3.3.1	Entity interactions with business processes and business units. The actuary should include the risk owners (within relevant business units) in any risk profile assessment considering the risk appetite, risk tolerances and limits, and the organizational structures of the business units for the time horizon of the ORSA. The actuary should be clear about the level of materiality they are working to and why that level is appropriate. Where the work concerns a particular business unit, the actuary should also consider that, from the group perspective, materiality may not be the same as from the perspective of the business unit locally. The actuary should consider, where applicable, whether risks in relation to the undertaking and its major branches should be first assessed individually and then aggregated or if they should be assessed as one unit. The actuary should seek to ensure or contribute to ensuring, whichever is appropriate, that the AMSB takes an active part in the ORSA process by, for example, steering how the assessment is to be performed and challenging its results. The implementation of ORSA should be consistent with the Business Plan used by the group or undertaking and the Business Plan should consider the risk appetite, the expected and stressed risk

DRAFT

	profile and the cost of capital generated as elements for the strategy definition process. The actuary should document his or her interactions with the business units and business processes. He or she should note the areas where interactions could be improved and where further information would be helpful.
3.3.2	The ORSA run: set-up, reproducibility, and documentation. The actuary should review the scenario and projection process in order to form a view on the extent to which the ORSA run can be achieved within a periodic, annual or more frequent, ORSA cycle or upon an ORSA-triggering event. The actuary should review this triggering event and how it is defined and regularly monitored. The actuary should ensure or contribute to ensuring, whichever is appropriate, that the following documentation on the ORSA is in place: • the ORSA policy; • the record of each ORSA cycle in such detail that, together with the ORSA policy, the material methods, assumptions and results are captured; and • the ORSA report, or reports if there is a difference between the internal report and the supervisory report, suitable for decision-making and follow-up. The ORSA report should include at least the following: o identification of the risk profile; o assessment of the overall solvency needs and stress test for principal risks in a forward-looking perspective in light of the risk appetite; o reconciliation of the overall solvency needs with the regulatory capital requirements, if relevant; o compliance, on a continuous basis, with the capital requirements; o deviations from assumptions underlying the SCR, if relevant; o analysis of deviations from previous evaluations of the same year; and o professional judgements used and the reasons for them.
3.4	**Considerations in relation to Governance**
3.4.1	Processes for design, use and monitoring. The actuary should evidence that he/she has considered the following items when designing, selecting, using/applying, communicating and monitoring ORSA processes: • the need for the ORSA process to be aligned with the business-planning process including the consistency of the risk profiles considered; • the need to have appropriate processes to identify and monitor changes in the risk profile; • the need to have triggers for detecting significant change in the risk profile of the entity or group that requires a recalculation of the SCR; • the need for the scenarios that are developed, applied and updated to be appropriately adverse but realistic;

DRAFT

	• the need for the ORSA process to yield itself to verification/review/audit; • the need for processes that allow for regular updates to the ORSA; • the need to develop and maintain an ORSA policy; and • the need for all information required by law and by the ORSA policy to be dealt with proportionately and appropriately in both the internal and the external ORSA reports.
3.4.2	Communication and consultation with stakeholders. In applying the ESAP 1 section 4 Communication: • The actuary should ensure or contribute to ensuring, whichever is appropriate, that the ORSA consists of a cycle of sub-processes and should be designed in a way requiring data and opinion from all relevant units of the undertaking or group. • The ORSA is primarily intended to help decision-making by the AMSB and/or senior management and therefore the main intended users of the work will be the AMSB and/or the senior management of the undertaking or group.
3.4.3	Review and update of appropriateness of methodologies, model structures and model output, including risk coverage of the model(s) supporting the ORSA methodology and emerging risks. The actuary should review and update the appropriateness of the ORSA process, including: • the ORSA policy; • the applied methodologies; • model structures; • data used; • assumptions made, including any management actions; • scenarios designed; • model output and reports; and • any other shortcomings. Where relevant, the actuary should seek feedback from all relevant units of the entity focusing on the input from the AMSB and/or senior management. The result of the actuary's review should be documented.
3.4.4	Review and update of users and uses of the ORSA output and the suitability thereof considering the difference between real world and modelled world. Throughout the ORSA cycles, the actuary should evidence that he or she has considered: • the previous ORSA and real world developments; • feedback from users of the ORSA, especially if recommendations approved earlier have been implemented properly; • to what extent the results of the ORSA have been used in decision-making; • the implications of the changes in relevant factors affecting the users and uses of the ORSA output, such as consequences of the changes in the organization, responsibilities, management

DRAFT

	information systems and risk appetite; and • the tolerances and limits versus the risk profile of the undertaking or group, overall and in the relevant segments.
3.5	**Special issues specific to group ORSA**

3.5.1	For the group ORSA, the actuary should ensure or contribute to ensuring, whichever is appropriate, that:
	• the scenarios are consistent across the group;
	• there is proper allowance for fungibility constraints/tax issues;
	• specific risks within subsidiaries and branches (but which are not group wide) are covered;
	• risks in business units which are:
	  ○ non-regulated;
	  ○ regulated outside the Solvency II scope but in jurisdictions deemed equivalent to Solvency II; or
	  ○ regulated outside the Solvency II scope, in jurisdictions not deemed equivalent to Solvency II
	are covered properly; and
	• allowance is made for implied guarantees on subsidiary capital.

DRAFT