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Consultation paper on the Supervisory Statement on ORSA in the context of COVID-19

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INTRODUCTION

1. The European Insurance and Occupational Pensions Authority (EIOPA) provides this Supervisory Statement on the basis of Article 29(2) of Regulation (EU) No 1094/2010 to promote common supervisory approaches and practices.

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In our view, the suggestions in the consultation paper are in line with the current Solvency II requirements.
We would note a number of items specific to the Irish market as follows:
1. the Domestic Actuarial Regime imposes additional requirements on undertakings regulated in Ireland, including the requirement for an opinion from the Head of Actuarial Function on the ORSA. This means that undertakings have less flexibility in the detail and content of their ORSA process, working against the aim of supervisory convergence.
2. in November, the Central Bank of Ireland conducted a thematic assessment on the impact of COVID on certain lines of business. Within this assessment, the CBI asked for details of any stress and scenario testing conducted by each entity surveyed, including results and reports produced, and how the results were being used. As such, the CBI has indicated that it expects entities to have begun to think about the impacts of the pandemic on its reserving, underwriting and capital management.
It should also be noted that the Belgian supervisor asked all undertakings to perform a specific ORSA before EOY20: the scenarios should reflect sufficient uncertainty and assess the solvency, financial but also liquidity positions together with their operational resilience.
In France, the supervisor granted additional time for the submission of the ORSA report in particular to highlight the consequences related to COVID-19.

2. This Supervisory Statement is based on Directive 2009/138/EC (Solvency II) and addressed to the competent authorities, as defined in point (i) of Article 4(2) of Regulation (EU) No 1094/2010.

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3. The COVID-19 pandemic has been affecting economies and societies leading to state and central banking measures being taken to combat its impact. This situation has resulted in a social and economic crisis, the effects of which are being felt throughout the world's and the EU's economy. The financial stress caused, the consequences of which are expected to extend much further in time, has underlined the need for insurance and reinsurance undertakings to assess the impact of the pandemic on their business from a forward looking perspective. The current pandemic is identified clearly as a new risk which needs to be assessed in the risk analysis of undertakings.

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4. The Own Risk and Solvency Assessment (ORSA) was designed and considered as an important and effective tool for risk management. The performance of an ORSA under the current circumstances is to give insight into the potential impact of the COVID-19 pandemic on the undertaking's risk profile. In addition, it promotes the identification and effective management of the undertakings' risks to ensure they have sufficient capital to absorb possible losses and help steer their business through periods of adversity.

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5. The aim of this Supervisory Statement is to promote convergence by guiding undertakings through common supervisory expectations on the ORSA in the current situation triggered by the COVID-19 pandemic, taking into account that the impact on each individual undertaking can differ depending on its specific risk profile.

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ORSA AS A MANAGEMENT TOOL

6. Undertakings should consider the ORSA as one of the fundamental tools in risk management to assess the impact of the COVID-19 pandemic and take the ORSA outcomes into account in the decision making by their administrative, management or supervisory body (AMSB).

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7. The ORSA process and outcomes are expected to be used by the AMSB in any strategic discussion in general and in particular where developments are expected to materially impact the undertaking. The ORSA outcomes can influence strategic decisions on changes for instance to underwriting and pricing practices, to risk mitigation techniques, to investments strategy, to capital management or on improvements of operational and cyber resilience. Also, a review of the insurance contracts' terms and conditions including clarifications of coverage or exclusion clauses and further communication with policyholders might be needed.

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A review of insurance coverage (compulsory extension following court cases or reduction) is under consideration by most insurers and should be, in line with proportionality, part of the ORSA process. The related reinsurance coverage should also be assessed.

TIMING OF THE REGULAR ORSA AND/ OR AD-HOC ORSA

8. EIOPA acknowledges that the regular ORSA is being submitted on an annual basis with different timings across Europe. In accordance with Article 45 of Solvency II, EIOPA expects undertakings to plan their ORSA process in a manner that allows the ORSA outcomes to be embedded in the strategic planning and /or other strategic decisions. This planning should take into account any ad-hoc strategic planning and/or other strategic decisions being taken as a result of the pandemic situation. This will allow undertakings to define the necessary changes to the business model or risk profile.

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9. Undertakings should assess and decide if an ad-hoc ORSA is needed based on the analysis of any material changes to the risk profile. Material changes to the undertaking's risk profile can be observed, for example, due to:

- changes in the undertaking's market or credit risk exposure (including downgrade and/or default scenario);
- material changes in underwriting results in lines of business which are more affected by the pandemic;
- major amendments to business models, products offered, plans and strategies.

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10. EIOPA believes that the current situation should trigger an ad-hoc/non-regular ORSA if the pandemic impacts materially the risk profile of the undertaking, in particular in those cases where the performance of the regular ORSA has not allowed the undertaking to assess and to take into account the impact of the COVID-19 pandemic.

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We would recommend clarifying how to assess whether the regular ORSA could not anticipate COVID-19 impacts. An undertaking has to perform an ad-hoc ORSA in case of a material change of its risk profile (due to COVID-19 pandemic or other event)
Is it based on scenarios that should include a pandemic scenario or back-testing?

11. If there is any indication of a material impact, leading to a significant change in the risk profile, undertakings should perform an ad-hoc /non-regular ORSA to be submitted to the Competent Authority earlier than the regular one if needed. In the course of the evaluation of the need to perform an ad-hoc ORSA, the undertakings might engage in a supervisory dialogue with the relevant Competent Authority.

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12. If the undertaking has taken the decision to develop an ad-hoc ORSA, the undertaking should assess whether the full ORSA is necessary or if the process will focus only on specific areas of the risk profile and its impact, for example on the ongoing compliance with the Solvency Capital Requirement.

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We welcome proportionality and a clear focus.

SCENARIOS USED IN THE ORSA

13. One component of the ORSA process is the forward-looking stress tests (including reverse stressing) and scenario analysis, taking into account the principle of proportionality. The development of the ORSA, either ad-hoc or regular, reflecting the impact of the COVID-19 pandemic, should:

- consider the conditions observed at a given moment and any expected stresses for example on capital markets, claims development for both non-life business (e.g. business interruption, travel, event cancellation, medical malpractice) and life-business (e.g. claims arising from higher mortality, sickness rates), and the impact on operational risks (e.g. digital resilience, business continuity);
- include an assessment of the soundness of the business model from a forward-looking perspective.

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In general, some guidance would be welcome on how to define appropriate stresses in an already stressed situation to avoid any “overstressed” projection depending on the recovery scenarios (e.g. how to calibrate spread shocks on already very high spreads observed in March).
While ORSA provides insight to the management and supervisors under “what-if” scenarios according to some confidence level, a too significant ST applied to the starting position might not be realistic.
Some specific comments to above list include
- Impact on lapses (e.g. liquidity needs) and new business
- Impact on reinsurance coverage and rating
- Adding a specific scenario in case State support would be withdrawn

14. As part of the assessment of the overall solvency needs (Article 45 (1)(a) of Solvency II) undertakings should consider the future impact of the pandemic, including potential litigation with regard to the coverage provided by insurance policies, the limited and comparable statistical data, the role of state support and other public backstops, the limitation of dividends distribution and other capital support in a group structure. Undertakings should use the latest available information from reliable sources in the different areas to be considered.

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We would recommend clarifying whether the capital support in a group structure includes conglomerate (or any other general structure) or should be limited to insurance groups.

15. Given the unprecedented nature of the current pandemic, a number of major uncertainties remain that are decisive for the future. The degree of uncertainty should be assessed for all relevant aspects, including, but not limited to, the volume of premiums, the development of claims, liquidity aspects and investment income. The identification of the sources and levels of uncertainty considered should be documented.

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We would recommend clarifying the documentation w.r.t. uncertainty: some sensitivity tests could be performed to identify the sources of uncertainty and their relationship (e.g. what would be the impact of deferred health care, more health costs and invalidity in the future, change in mortality patterns,…). This would allow to infer some lower and upper bound and support the narrative.

16. Where the undertaking concludes, based on the analysis of its current risk exposure, that it is or could be materially exposed to risks revealed by the pandemic, this should be reflected in the decision of scenarios used and documented in the ORSA process. The undertaking should take into account the uncertainty in the duration and (macroeconomic) impact of the pandemic in its ORSA and, if relevant for its risk profile, consider multiple scenarios to capture this uncertainty in an appropriate manner. In this case the scenarios are expected to include several degrees of severity for the pandemic’s impact on the undertaking’s solvency and capital needs taking into account its individual situation.

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17. The ORSA process includes an assessment of the undertaking’s business exposures related to the risk coverages or guarantees of its insurance products. When performing this analysis, undertakings should include the assessment of possible policyholder actions such as lapses, cancellations, claims and potential litigation over compensation disputes. In case the undertaking anticipates launching new products and/or

stopping or substantially changing products, for example regarding their pricing or availability or application procedure, the ORSA should also contain the impact of this new or amended product portfolio on the overall solvency needs as well as on the regulatory solvency.

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18. In order to ensure adequate risk management, undertakings should carry out scenario analysis covering the short and long term. They are expected to examine the effects of the COVID-19 pandemic on their solvency over a period that reflects the undertaking's risk exposure and to take into account second-order effects that may occur in the longer term. EIOPA expects an analysis over a three-year period as a minimum time horizon for the majority of the insurance undertakings.

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19. As part of the assessment of the compliance with the capital requirements and with the requirements regarding technical provisions (Article 45(1)(b) of Solvency II) undertakings should reflect on and assess the scenarios and assumptions for calculating the technical provisions in order to assess the continuous compliance with the regulatory requirements in the short and long term.

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20. Capital requirements and eligible own funds should be recalculated according to each stressed scenario and to the valuation of assets and technical provisions. If, at any point in time, the solvency ratio should come under pressure or fall below the lower solvency limits set by the undertaking, it is important to formulate risk mitigating measures and/or management actions that can improve the solvency position, while taking into consideration the possible limited availability of those measures and/or management actions under a stressed situation. Undertakings are recommended to assess whether their internally set solvency limits are adequate and sufficient taking into account the applied stresses of the COVID-19 pandemic. The analysis should reflect upon:

· internal risk appetite;

· quantitative or qualitative indicators/measures;

· overall risk tolerance limits;

· metrics used within the risk management system to measure risks;

· stress test framework;

· monitoring process.

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We agree that an undertaking should put in light the possible solvency consequences of the covid-19 pandemic, but we should consider that the crisis is not over yet with potential significant technical and credit losses. We need constant vigilance and monitoring without fully questioning the risk management systems in place that usually work well under normal circumstances and have mostly proven their resilience up to date. We would therefore recommend focusing on the necessary adjustments (action plan and tools) to enrich the framework with the lessons learned from the pandemic.

QUESTIONS TO SUPPORT THE IMPACT ASSESSMENT

In preparing the Supervisory Statement on ORSA in the context of COVID-19, EIOPA took into consideration the general objectives of the Solvency II Directive, namely:

- adequate protection of policyholders and beneficiaries, being the main objective of supervision;
- financial stability; and
- proper functioning of the internal market.

The drafting of the Supervisory Statement is also guided by EIOPA's statutory objectives, as reflected in the Regulation of the Authority, notably:

- improving the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision,
- ensuring the integrity, transparency, efficiency and orderly functioning of financial markets,
- preventing regulatory arbitrage and promoting equal conditions of competition,
- ensuring the taking of risks related to insurance, reinsurance and occupational pensions activities is appropriately regulated and supervised, and
- enhancing customer protection.

To analyse the impact of the proposed supervisory convergence measures, the final impact assessment to be developed ex-post this public consultation foresees that a baseline scenario is applied as the basis for comparing supervisory convergence options. This will help to identify the incremental impact of each action considered in this supervisory statement. The aim of the baseline scenario is to explain how the current situation would evolve without additional intervention promoting a level playing field in supervisory expectations regarding ORSA, in particular addressing the current emerging situation caused by Covid-19 pandemic.
EIOPA is aiming a proper balance between flexibility and acknowledgment of the ORSA as an undertaking own exercise and clarification of supervisory expectations, in particular in specific circumstances.
The answers of the five last questions in the survey will be taken into account when assessing the impact of the suggested convergence practices.

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3.1 If there is any indication of a material impact, leading to a significant change in the risk profile, undertakings should perform an ad-hoc /non-regular ORSA to be submitted to the Competent Authority earlier than the regular one if needed. In the course of the evaluation of the need to perform an ad-hoc ORSA, the undertakings might engage in a supervisory dialogue with the relevant Competent Authority. EIOPA believes that the current situation should trigger an ad-hoc/non-regular ORSA if the pandemic impacts materially the risk profile of the undertaking, in particular in those cases where the performance of the regular ORSA has not allowed the undertaking to assess and to take into account the impact of the COVID-19 pandemic. **Is the suggested convergence approach with regards to ORSA in the context of Covid-19 expected to help undertakings to better incorporate the expected impact of the current situation also in forward looking perspective?**

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We do not see that this approach will have an impact on undertakings; there is an existing requirement to perform an ad-hoc ORSA in the event of a material change in risk profile and for many undertakings the COVID-19 pandemic will be such an event.

3.2 If the undertaking has taken the decision to develop an ad-hoc ORSA, the undertaking should assess whether the full ORSA is necessary or if the process will focus only on specific areas of the risk profile and its impact, for example on the ongoing compliance with the Solvency Capital Requirement. **Is the suggested convergence approach expected to limit the burden of preparing a full ad-hoc ORSA especially with regards to the ongoing compliance with the SCR when considered as not needed and to support the level playing field a national and European level?**

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The current regulations and guidance appear to allow the undertaking to decide whether a full ORSA is required in response to a material change in risk profile, or if it is appropriate to simply consider the risk types impacted by the change. Therefore, we welcome the clarity and flexibility which would allow each entity to tailor the assessment to their individual circumstances and needs.
We would also welcome additional flexibility in relation to the role of the Board in the process; given the reactionary nature of this ad-hoc ORSA, it may not be possible for the Board to direct the process in the same way as for a scheduled ORSA.

3.3 In order to ensure adequate risk management, undertakings should carry out scenario analysis covering the short and long term. They are expected to examine the effects of the COVID-19 pandemic on their solvency over a period that reflects the undertaking's risk exposure and to take into account second-order effects that may occur in the longer term. EIOPA expects an analysis over a three-year period as a minimum time horizon for the majority of the insurance undertakings. The undertaking should take into account the uncertainty in the duration and (macroeconomic) impact of the pandemic in its ORSA and, if relevant for its risk profile, consider multiple scenarios to capture this uncertainty in an appropriate manner. In this case the scenarios are expected to include several degrees of severity for the pandemic's impact on the undertaking's solvency and capital needs taking into account its individual situation. **Is the suggested approach in relation to the analysis over a minimum of a three-year period expected to bring more convergence in terms of undertaking's effective continuous work on examining the effects of COVID-19, the interaction with the NCAs and level playing field at national and European level?**

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The Solvency II directive requires that the time horizon in the ORSA has to be in line with the Business Plan. Projection over 3-5 years is a common approach, and as such, we do not see any likely changes from this recommendation.
However, in prescribing a minimum, there is a risk that this becomes the standard, when ordinarily companies may have chosen a longer horizon.
We also note that prescribing a minimum term may contradict some of the flexibility around the performance of an ad-hoc ORSA, as noted in Q3.2

3.4 Undertakings are recommended to assess whether their internally set solvency limits are adequate and sufficient taking into account the applied stresses of the COVID-19 pandemic. The analysis should reflect upon: internal risk appetite; quantitative or qualitative indicators/measures; overall risk tolerance limits; metrics used within the risk management system to measure risks; stress test framework; monitoring process.

Is the suggested convergence approach in the assessment of the internally set solvency limits in the context of Covid-19 expected to help undertakings to better incorporate the expected impact of the pandemic in the ORSA?

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Solvency limits and other key risk appetite metrics will form part of the undertaking's existing ORSA framework, and so the suggested approach is unlikely to change this thinking.
However, if the undertaking has chosen to undertake a short, limited ORSA update, rather than a full ORSA, then the assessment may not capture each of the metrics outlined above.

3.5 **Is there any other area regarding the supervisory practices and expectations towards undertakings ORSA in the context of the current situation triggered by the COVID-19 pandemic where you believe further supervisory convergence is needed?**

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Some Local GAAP projections might be considered given their impact on specific items. Supervisor's initiatives on LAC DT and conditions for dividend distribution should also be part of the assessment.

Contact

Contact Form