

EUROPEAN STANDARD OF ACTUARIAL PRACTICE 3 (ESAP3)

Actuarial practice in relation to the ORSA process under Solvency II

EXPOSURE DRAFT

Approved as a model standard by the General Assembly of the
ACTUARIAL ASSOCIATION OF EUROPE
on 2 August 2017

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on xx Month 2023

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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;
- customising 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 ESAP1 as this ESAP relies upon ESAP1 in many respects. Likewise, any [customisation](#) of this ESAP, or modification of existing standards to obtain substantial consistency with this ESAP, should recognise the important fact that this ESAP relies upon ESAP1 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 1.5.1 Language of this ESAP, even if such verbs are not the literal translation of “must”, “should”, and “may”.

This ESAP uses various terms whose specific meanings are defined in the document “Glossary of defined terms used in European Standards of Actuarial Practice” (the [AAE Glossary](#)).

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 originally adopted by the [AAE](#) General Assembly on 2 August 2017. This revision was adopted by the [AAE](#) General Assembly on [xx Month 2023](#).

Commented [JKvS(2)]: Note that links have been removed as these pointed to definitions that are no longer in ESAP3 but in the AAE Glossary.

Commented [JKvS(3)]: Note that spelling has changed to the spelling used in ESAP2 (“customisation” and “recognise” instead of “customization” and “recognize”).

Commented [JKvS(4)]: “may” added and reference to 1.5 updated. [copied from ESAP2]

Commented [JKvS(5)]: Added as definitions have been removed. [copied from ESAP2]

Commented [JKvS(6)]: The statement that the ESAP3 is non-binding as it is a model standard has been updated using the text used in ESAP2.

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

1. *Replace “ESAP” throughout the document with the local standard name, if applicable;*
2. *Modify references to ESAP1 in paragraphs 1.3, 1.3.1 and 1.4.1 to point to the local standard(s) that are substantially consistent with ESAP1, rather than referring to ESAP1 directly, if appropriate;*
3. *Choose the appropriate date for insertion in paragraph 1.6.1;*
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 reference in the Table of Contents) and the footnote associated with paragraph 1.6.1.]*

Commented [JKvS(7): References to paragraphs in Section 1 have been updated as Section 1 has changed.

Section 1. General

1.1 Purpose

1.1.1 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:

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- 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.

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1.2 Scope

1.2.1 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, and to the extent relevant to the actuary's involvement and responsibilities. Wider adoption of this ESAP is encouraged, particularly amongst those actuaries who provide actuarial services in support of those actuaries to whom this standard applies.

1.2.2 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 or amended 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.

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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.

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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/her work.

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1.2.3 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 with undertakings.

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1.3 Relationship to ESAP1

1.3.1 Insofar as possible, this ESAP does not repeat guidance already provided in ESAP1. Any actuary who asserts compliance with this ESAP (as a model standard) must also comply with ESAP1. References in ESAP1 to “this ESAP” should be interpreted as applying equally to this ESAP3, where appropriate.

Commented [JKvS(8): Former Section 1.3 “Compliance” has been removed as ESAP1 has been updated in 2019, incorporating the former 1.3 text to apply in general to all ESAPs.

1.3.2 A failure to follow the principles in this standard need not be considered a departure if it does not have a material effect. The contents of this standard should be read in that context, even where the term material is not explicitly used or where the word “must” is used.

Commented [JKvS(9): Added, similar to ESAP2.

1.4 Language

1.4.1 Some of the language used in all ESAPs is intended to be interpreted in a very specific way in the context of a decision of the actuary. In particular, the following words are to be understood to have the meanings indicated:

a. “must” means that the indicated action is mandatory and failure to follow the indicated action will constitute a failure to comply with this ESAP, unless the departure is due to a conflict with law (ESAP1 1.3.1) or code of professional conduct (ESAP1 1.3.2).

Commented [JKvS(10): This section is copied from ESAP2, meaning:

1) Meaning of “may” and “any” added

2) Referring to AAE Glossary added

Text involving the verb “must” no longer marked in bold font [no reason to have a double way of pointing out must standards]. Also, must and should requirements are now in separate sub-numbers.

b. “should” (or “shall”) means that, under normal circumstances, the actuary is expected to follow the indicated action, unless the departure is due to a conflict with law (ESAP1 1.3.1) or code of professional conduct (ESAP1 1.3.2). However, in all other cases, if following the indicated action would produce a result that would be inappropriate or would potentially mislead the intended users of the actuarial services, the actuary should depart from that guidance and disclose that fact and provide the reason for not following the indicated action as described in ESAP1 1.3.3.

Commented [JKvS(11): Note that “law” is not marked as defined term in ESAP2, section 1.5.1a and 1.5.1b.

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c. “may” means that the indicated action is not required, nor even necessarily expected, but in certain circumstances is an appropriate activity, possibly among other alternatives. Note that “might” is not used as a synonym for “may”, but rather with its normal meaning.

d. “any” (as in e.g. “any report”) means all such items if they exist, while acknowledging they may not exist. Such a reference does not give rise to a requirement to create such an item.

1.4.2 This ESAP uses various terms whose specific meanings are defined in the AAE Glossary. These terms are highlighted in the text with a dashed underscore and in blue (e.g. actuary).

1.5 Cross-references

- 1.5.1 This ESAP refers to the content of the [Solvency II Directive](#) and the Commission Delegated Regulation (EU) 2015/35 supplementing the [Solvency II Directive](#), both as amended as per the approval date of this ESAP. If the [Solvency II Directive](#) or the Commission Delegated Regulation (EU) 2015/35 is subsequently amended, restated, revoked, or replaced after this date, the [actuary](#) should apply the principles in this ESAP to the extent they remain relevant.

Commented [JKvS(12)]: Old section 1.6 Defined terms removed (integrated in section 1.4).

Commented [JKvS(13)]: First part of the text updated.

1.6 Effective Date

- 1.6.1 This standard applies to [actuarial services](#) relating to the design or performance of the [QRSA process](#) performed after [Date¹].

Commented [JKvS(14)]: Text made more specific to ESAP3.

¹ Date to be inserted by standard-setter adopting or endorsing this ESAP

Section 2. Appropriate Practices

2.1 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 2.1.

Where the [actuary](#) has [material](#) involvement in, or responsibility for, the design of parts of the [ORSA process](#), but not all of it, the [actuary](#) should confirm with his or her [principal](#) (ideally as early in the process as possible or practical) the extent to which the scope of his or her [work](#) includes the topics addressed within the sub-sections within 2.1 and, in the case of sub-section 2.1.1, which of the areas mentioned in the bullet points fall within the scope of the [work](#).

2.1.1 Establishing a structured approach to uncertainty

2.1.1.1 The [actuary](#) must take reasonable steps, to the extent relevant to his or her involvement and responsibilities, to ensure that the [ORSA process](#) follows an appropriately structured approach to [uncertainty](#).

2.1.1.2 In considering whether the [ORSA process](#) follows an appropriately structured approach to [uncertainty](#), the [actuary](#) should take into account 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 business developments planned by management;

Commented [JKvS(15)]: Section on definitions has been removed. Note that there was no definition of "ORSA". This has been added in the AAE Glossary, and "[ORSA](#)" is now formatted as defined term in ESAP3.

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- ensures appropriate ~~scenario and stress testing~~ scenario testing and stress testing is carried out, including reverse stress testing, considering also relevant management actions;
- ensures appropriate ~~back testing~~ 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 performance 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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2.1.1.3 The actuary must be in a position to explain and justify the approach he or she has taken to his or her considerations, if reasonably requested to do so.

2.1.2 Deviation from Solvency II balance sheet approach and methodology

2.1.2.1 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.

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2.1.2.2 In considering the significance of any such deviation, the actuary should take into account:

- 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.

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2.1.2.3 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.

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2.1.3 The ORSA consideration period

2.1.3.1 The actuary must take reasonable steps to ensure that the period considered under the ORSA process is appropriate for its intended use.

Commented [JKvS(16): “intended purpose” is a mix of “intended use” and “purpose”. For consistency within this document, replaced by “intended use”. [at three places]

2.1.3.2 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:

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- the possible future run-off of existing business;
- the nature and possible run-off of any new business acquired in the future;
- expected changes to business practices, such as changes in underwriting and claims processes;
- changes in the economic environment which are considered likely to happen; and
- changes in the economic environment which are considered possible and plausible, but currently not considered likely.

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2.1.3.3 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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2.1.4 Inconsistency with the undertaking’s risk management approach

2.1.4.1 Where the actuary has reasonable grounds for believing that there is material inconsistency between the ORSA process and the undertaking’s approach to other parts of risk management, the actuary must ensure that such inconsistency is appropriately communicated.

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2.2 Performance of the ORSA process

2.2.1 Quantitative risk assessment and financial projections

2.2.1.1 The actuary must take reasonable steps to ensure that the risk quantifications and financial projections used in the ORSA process are appropriate for its intended usepurpose.

2.2.1.2 In considering whether the quantifications and projections are appropriate, the actuary should take into account 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 or risk;
- assumptions used are appropriate, with sufficient clarity over their derivation; and
- scenario testing, stress testing and sensitivity testing~~scenario, stress- and sensitivity testing~~ included are sufficient to indicate the significance of material risk drivers and risks.

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2.2.1.3 The actuary must be in a position to explain and justify the approach he or she has taken to his or her consideration of appropriateness, if reasonably requested to do so.

2.2.1.4 Where the actuary has reasonable grounds for believing that there is a material shortcoming in the quantifications or projections that renders the ORSA unsuitable for its purpose, then the actuary must ensure that such shortcoming is appropriately communicated.

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2.2.2 Qualitative risk assessment

2.2.2.1 The actuary must take reasonable steps, to the extent relevant to his or her involvement and responsibilities, to ensure that the qualitative risk assessments used in the ORSA process are appropriate for its intended usepurpose.

2.2.2.2 In considering whether the qualitative risk assessments are appropriate, the actuary should take into account the extent to which the assessments:

- make use of relevant past data both from within the undertaking and from other appropriate sources;

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- take into account an appropriately-wide range of relevant scenarios;
and
- have been subject to a sufficiently rigorous internal review process.

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2.2.2.3 The actuary must be in a position to explain and justify the approach he or she has taken to his or her consideration of appropriateness, if reasonably requested to do so.

2.2.2.4 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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