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BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Executive Director
Insurance Supervision
Prudential Regulation Authority
Bank of England

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Solvency II: Own Risk and Solvency Assessment

In December 2013, the PRA published SS4/13: Solvency II: applying EIOPA's preparatory guidelines to PRA-authorised firms. This publication provided the PRA's expectation of firms in relation to the Own Risk and Solvency Assessment (ORSA) in 2014 and 2015, noting that the preparatory period was a time of development for firms in designing, compiling and trialling their assessments.

We have now reviewed a significant number of ORSAs, including a second or third iteration for some firms. We expect over time to undertake more detailed reviews on specific areas of firms' ORSAs, but to date our review has been at a high level for the majority of firms' reports. On the basis of these reviews, our overall assessment is that the ORSA's are generally of a reasonable quality. However, the process has also identified some common feedback points which are set out in this letter.

The ORSA is a firm's own framework so firms will need to consider which aspects of the feedback are relevant to them and look to take account of these as part of future development. The feedback is, in the main, relevant for all categories of Solvency II Directive firms but there is some information which is specific to group, internal model, and standard formula entities.

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Executive Director

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Appendix

Overall view

Whilst the reports we have reviewed have generally been of a reasonable quality there are two specific areas which have been noticeably weaker.

We consider that stress testing is a valuable mechanism for exploring the risks a business is exposed to and assisting in qualifying their potential impact. Stress testing therefore forms an important part of our current expectations of all insurance firms (as detailed in PS 09/20: stress and scenario testing) but this was an area of significant weakness across the majority of ORSAs reviewed.

Fundamental to the ORSA is that it is forward-looking. Whilst the majority of the ORSAs reviewed have been reasonable at reviewing the current and past risks and solvency position, they have been much weaker on the forward-looking assessment. The PRA appreciates that in some cases it can be difficult to project forward solvency figures. However, firms are expected to find ways to estimate future solvency. We also expect that the ORSA, as well as exploring those risks to which the firm is currently exposed, should also explore those risks to which it might become exposed in the future.

The structure of the ORSA report is important, not least as a means of ensuring that the analytical framework is clear. We have seen good ORSA reports which:

- include a clear summary;
- highlight the main messages and issues;
- are not too long; and
- clearly sign-post supporting documentation.

Further detailed feedback and observations resulting from our reviews is below.

The ORSA policy

Having an ORSA policy is a key requirement of Solvency II. As one of the key risk management tools required by the Solvency II Directive, the ORSA policy should be a standalone document and not, for example, part of the ORSA report. Some firms have not developed a separate ORSA policy and, where provided, it was often insufficiently detailed and far too generic. The ORSA policy should include the process and procedures required by the ORSA framework. The better policies have included:

- a clear scope which states whether the ORSA is for a group, solo entity or both;
- a clear list of all entities captured by the ORSA (as well as a list of entities which have been excluded);
- a description of how the ORSA incorporates the strategic and business planning processes;
- a description showing how the ORSA incorporates the risk profile, approved risk tolerance limits and overall solvency needs;
- the timing and frequency of the ORSA framework (including, for example, its detailed elements such as stress tests, sensitivity analyses and reverse stress tests) and the ORSA report including the triggers for an ad-hoc ORSA;
- information on data quality standards;
- the structure of the ORSA report, including details of the key ORSA records;
- a description of the roles and responsibilities of all those involved with the ORSA, including those of the Board;
- details of how the Board owns the ORSA framework and process; and

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- a requirement for the Board to approve the ORSA policy at least annually.

Board sign-off and embedding

The ORSA report should look to evidence how the Board has signed off the ORSA, and provide details of how it is embedded within the business.

Although the detail may not necessarily form part of the report, firms should have good supporting evidence which demonstrates any Board discussion. Such as a log of key decisions and a list of follow-up actions for named individuals. In addition, many firms have also introduced detailed management information as part of the ORSA framework, including an ORSA dashboard, which follows a similar structure to the ORSA report but with up-to-date information presented in a more visual way (tables, charts and key messages).

We have identified that some internal documents do not evidence sufficiently the extent of the Board's involvement, particularly Board challenge. Further, many of the reports provided insufficient evidence to demonstrate how the ORSA framework was embedded in the business; in particular, there was a lack of evidence to demonstrate how the ORSA findings and conclusions were used to inform decision-making.

Business strategy

Central to the concept of the ORSA is demonstrating strong linkages between business strategy, risk, capital and stress testing. We have seen some evidence that firms have made these links in their ORSA framework. However, very few ORSAs demonstrated credibly that firms had fully considered the impact risks may have on their forward-looking strategy. Stronger submissions considered a range of current and future internal and external risks to business planning, decision-making and capital management.

It is important that group ORSAs cover the business strategy, risk, capital and stress testing of the group as well a consideration of the strategies of the group businesses and any risks they may present. Several group submissions contained insufficient information in relation to the overall direction of the group from a strategic and risk perspective.

Risks

The ORSA requires firms to consider all material potential risks they may face on a qualitative and quantitative basis. A number of reports did not list the key risks to the business and show how these link to the stated risk appetite and individual risk tolerances. Where risks were identified, some ORSA reports did not detail the mitigating actions or, where actions were identified, they were not well explained, plausible, and/or lacked assigned owners. Many firms did not identify emerging risks, or, where they were identified, did not consider potential management actions to mitigate these. Where a firm had decided to accept a material risk, the report did not explain the rationale for the acceptance nor why it was considered appropriate and within the firm's risk appetite.

For groups, the better reports considered group-specific risks (i.e. those risks which the group centre might be exposed to such as leverage, dividend sustainability, access to funding and liquidity) as well as group-wide risks (those risks associated with the businesses owned by the group) including the risks from non-regulated, non-financial and non EEA entities.

Capital and solvency

As part of the ORSA framework, capital needs should be considered over the business planning period (often at least 3-5 years). In general, firms were able to articulate their current regulatory and own capital levels, and the buffers held in excess of these. However, there was less evidence considering the future capital position of firms. This can, in part, be explained by the Solvency II uncertainties which existed when the 2014 reports were prepared. As this uncertainty subsides, we expect future submissions to include much more detailed post-Solvency II numbers and analysis.

Group reports should consider the group solvency position, explaining how it is derived and any diversification benefit. The report should also consider the capital position of any key subsidiaries, as well as the management actions the entities and the group could take if needed, and an assessment of the availability and transferability (fungibility) of own funds.

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Stress testing

None of the reports reviewed contained sufficient evidence of appropriate stress and scenario testing. The ORSA report should document how the framework incorporates a wide range of plausible, reasonable, stresses and scenario analyses and provide details of the outputs from these tests. It should also demonstrate how these are applied to all material risks over the time horizon used in the forward-looking assessment in order to provide an adequate basis for the assessment of overall solvency needs. The output should be assessed on both a qualitative and quantitative basis over the business planning period.

Firms should apply reverse stress testing and the ORSA report should evidence how this is included in the framework and contain details of the results.

Consideration should also be given to the quality and volatility of own funds with consideration of the capital's loss absorbing capacity under different scenarios.

Groups

Groups are able to submit an ORSA which covers multiple legal entities within the group. However, groups are required to apply to receive approval to do this. Where a group is submitting a single ORSA report which covers a number of entities it is important that the process describes how the Boards of each of the individual entities are involved in approving the ORSA. The report must also cover each of the entities to a suitable level of detail.

Conversely, where a group chooses to provide individual ORSA reports for each entity in the group, alongside a group ORSA covering just the group functions, the process must describe how the individual ORSAs link to the overarching group ORSA.

Internal model

All internal model firms' ORSA reports should confirm and evidence the continued adequacy of the model to calculate the solvency capital requirement, and confirm that all risks identified by the firm are included in the internal model. Any risks which are not accounted for in the internal model must be included in the ORSA along with a justification for their exclusion.

Standard formula

The ORSA report of a standard formula firm should demonstrate that the standard formula is appropriate for the risks in the business and is representative of its risk profile. The report should consider any material deviations of the risk profile from the standard formula. The report should demonstrate how the ORSA framework will be used to monitor, on an ongoing basis, the appropriateness of the standard formula.