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# Final Countdown to Solvency II – The Own Risk Solvency Assessment

As the implementation date of 1 January 2016 for Solvency II draws closer, reinsurance and insurance undertakings in Ireland are well under way with their Solvency II implementation programmes. One of the key elements of the new Solvency II regime is the Own Risk and Solvency Assessment ("ORSA"). The ORSA relates to the uncertainties associated with delivering an undertaking's commercial objectives and ensuring that those uncertainties are practically understood and managed with appropriate resources, so the risk profile of the undertaking concerned remains within the risk parameters set by the Board of Directors. At all times, ownership of the ORSA rests with the individual Boards of Directors of insurance and reinsurance undertakings.

## A New Prudential Supervisory Approach

The Irish Government is currently in the process of transposing into Irish law the Solvency II Directive (Directive 2009/138/EC) as amended by the Omnibus II Directive (Directive 2014/51/EC) which will become effective across all twenty eight EU Member States from 1 January 2016.

The Solvency II regime represents a significant reform of European insurance legislation affecting life, non-life and reinsurance undertakings and will establish harmonised requirements across the EU.

Solvency II will introduce economic risk-based solvency requirements meaning that risk is measured on consistent principles



and that capital requirements are aligned with the underlying risks of the insurance or reinsurance undertaking concerned.

In Ireland, the Solvency II regime will be given legal effect by secondary legislation in the form of Statutory Instrument. The Solvency II Directive will also be supplemented by more detailed technical Commission Level 2 measures and they in turn will be supplemented by Level 3 guidance for national supervisors developed and adopted by the European Insurance and Occupational Pensions Authority (EIOPA).

#### What does the ORSA involve?

All insurance and reinsurance undertakings are obliged as part of their risk management system to conduct their own ORSA. The Solvency II regime requires that the ORSA must include:

- (i) the insurance or reinsurance undertaking's overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and business strategy;
- (ii) compliance, on a continuous basis, with Solvency II requirements for capital and technical provisions; and
- (iii) the degree to which the insurance or reinsurance undertaking's risk profile deviates from the assumptions underlying the Solvency Capital Requirement, calculated with the standard formula or with its partial or full internal model.

Proportionality is a key principle underlying the Solvency II regime. The ORSA should be proportionate to the nature, scale and complexity of the risks inherent in the undertaking's business and the ORSA should enable the insurance or reinsurance undertaking to properly identify and assess the risks it faces in the short and long term and to which it is or could be exposed.

One particularly important feature of the ORSA is that it is not just an assessment of an undertaking's current risk profile but instead it is a consideration of how the risk and the insurance or reinsurance undertaking's ability to manage that risk might evolve and change over time.

Significantly, the Solvency II rules clearly state that that ORSA does not in itself create a further capital requirement.

## Ownership of the ORSA

The ORSA is more than a regulatory requirement. The Solvency II regime requires that the ORSA should be an integral part of the business strategy of insurance or reinsurance undertakings and shall be taken into account on an on-going basis in the strategic decisions of the undertaking concerned.

Importantly, insurance and reinsurance undertakings are obliged to perform the ORSA annually or without any delay following any significant changes to the risk profile of the undertaking. In simple terms, the ORSA is a living document and not a once off exercise. It is a key cornerstone of the risk management system under Solvency II for insurance and reinsurance undertakings.

The Central Bank of Ireland (the "Central Bank") has stated that its supervisory teams will be examining the extent to which the ORSA is embedded within insurance and reinsurance undertakings. Documenting the ORSA process and the undertaking's use of the ORSA will be crucial going forward for insurance and reinsurance undertakings to demonstrate full compliance with Solvency II to the Central Bank.

The ORSA also forms part of the supervisory process as insurance and reinsurance undertakings are obliged to inform the supervisory authorities of the results of the ORSA as part of the undertaking's reporting obligations.

### Groups and ORSA

The new Solvency II rules permit groups to apply for centralised risk management. However, each individual insurance or reinsurance undertaking within a group structure will still be obliged to prepare and have its own distinct ORSA. It may be possible, however, for the group to have a single documented process for all of the individual undertakings' ORSAs within the group structure.

## A Source of Competitive Advantage

The ORSA is an opportunity for insurance and reinsurance undertakings to gain a better understanding of their particular risk profiles and capital needs with a view to maximising their competitive edge in the marketplace. The ORSA also enhances the undertaking's decision making processes by linking its risk profiles with management and operational performance. The ORSA is a process rather than a report. Documenting the process and the undertaking's use of the ORSA will be essential going forward to ensure that the ORSA can be appropriately reviewed by the Central Bank as part of the supervisory review process.

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