Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Insurance Newsletter

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ORSA Review

Background

During 2021 the Bank conducted a thematic review of (re)insurance undertakings' Own Risk and Solvency Assessments ("ORSAs"). The review focused on high and medium high impact undertakings and was desk-based using the ORSA reports provided to us by undertakings. The purpose of our review was to make a holistic assessment of ORSAs across the industry in order to identify areas for improvement, to identify best practice, and to share our observations.

ORSA reports are the documented output of (re)insurers' ORSA processes and are a requirement under Solvency II. Since their introduction, ORSAs have evolved and we have seen them becoming increasingly embedded with a process that is well established in the majority of undertakings. While many undertakings cover the areas we would expect at an appropriate level of detail, there are some areas that we believe require further improvement. Where relevant, individual undertakings will have received feedback directly from supervisors. Below we set out a high-level summary of our observations that may be relevant to the wider industry.

1. Overall Solvency Needs and Stress Testing

Insurers are required to assess their Overall Solvency Needs as part of the ORSA. This should include a quantification of the insurer's future capital needs, including conducting a sufficiently wide range of stress tests or scenario analyses in respect of material risks.[1]

We expect insurance undertakings to design stresses and scenarios that could potentially threaten their capital needs. Stresses on key vulnerabilities should be appropriately severe and not optimistic. A common theme in our review is that group risk in particular should be stressed more severely and explicitly, as the majority of undertakings have significant interactions with, and reliance on, their group.

We found that many insurance undertakings focus on individual risks in their stress testing and scenario analysis, but appropriate consideration is not given to the interlinkage of stresses and the combined effects on different parts of the Balance Sheet. The Covid-19 pandemic has demonstrated the potential for such events to have varied consequences, including both an asset and liability shock, and potentially a shock to business volumes.

2. Reverse stresses

In our June 2021 newsletter article on recovery planning requirements we noted that "*the ORSA typically include reverse stress tests to demonstrate how severe a stress is required to be, in order to breach capital requirements from a starting point within the target operating range. The recovery plan on the other hand anticipates a severe stress and identifies the actions that could or would be taken in different scenarios.*"[2] In this context, undertakings should ensure that reverse stress tests are appropriately designed. Our review found some undertakings' reverse stress tests threatened neither the MCR, nor the SCR, of the undertaking.

3. Appropriate consideration and/or modelling of potential management actions

Many insurers in the Irish market are part of larger

1. EIOPA Guidelines on ORSA - Guideline 7 – Assessment of the overall solvency needs.
2. https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/insurance-reinsurance/solvency-ii/communications/insurance-quarterly-news/the-insurance-quarterly---june-2021.pdf?sfvrsn=4

international groups. Many undertakings place a blanket reliance on group in terms of recovery actions following material shock events. This can include capital and/or liquidity support or the continued availability of group IT and other operational supports. We expect undertakings to appropriately consider the feasibility of their stated management actions including group support. This could include modelling the feasibility of group support and stressing this reliance and the reliance to other supports such as reinsurance in undertaking's scenarios.

4. Climate Risk

EIOPA's Opinion on climate change risk scenarios in ORSA was published in April 2021.[3] This Opinion sets out the approach that they expect supervisors to take when assessing the use of climate risk scenarios. This covers a number of aspects including; time horizon, breadth of risks covered, materiality, the range of scenarios and reporting, which undertakings can then adopt as appropriate in their ORSA, risk management and governance practices. Arising from the publication of this paper the Bank expects that undertakings should do an assessment to identify material climate change risk exposures and subject the material exposures to a risk assessment in their ORSA.

Building on the opinion, EIOPA have recently launched a consultation on a practical guidance paper, which is aimed at assisting firms in assessing material climate risks and running scenarios. Further information can be found on Page 8 of this newsletter.

5. Reliability of modelling projections

Our review found that few undertakings reflect on the on the reliability of past projections with no evidence of or commentary on an analysis of the actual versus expected (AvE) projected levels of SCR coverage.

The Bank undertook a sample of back-testing of actual SCR and Own Funds versus the base case projected in previous ORSAs for some undertakings. It was found that undertakings had a tendency to overestimate future SCR and underestimate future Own Funds. This may be due to overestimating business volumes and underestimating profitability margins. This approach is more prudent (from a capital planning perspective), and results in a favourable AvE for SCR coverage. Undertakings should undertake an AvE type analysis themselves, to identify opportunities to improve the reliability of their projections.

6. ORSA Record and use in decision making

Finally, the ORSA document represents one element of the overall ORSA process. Some undertakings maintain an ORSA record and document this as an appendix to their ORSA report. This evidences Board oversight and challenge, discussions, use of ORSA in decision-making, actions taken, stress scenario tests, risk appetites and the HOAF opinion on the ORSA. We found this document to be a useful record that provides a greater sense of how the ORSA fits into the undertakings activities and proves how much the ORSA process is embedded in the risk management of the undertaking.

Stephen Marrey,
Senior Supervisor,
Major International
Insurance Firms,
Insurance Supervision Directorate

3. https://www.eiopa.europa.eu/sites/default/files/publications/opinions/opinion-on-climate-change-risk-scenarios-in-orsa.pdf

Insurance Updates

Update - EIOPA pan-Europe Internal Model Comparative Studies

The combined Solvency Capital Requirement (SCR) of Irish (re)insurance undertakings using an internal model was €10.9 billion at the end of 2020 and accounted for some 38% of the industry's total SCR. The significance of internal models both locally and across Europe means that they are an important area of supervisory focus for the Bank, other national supervisory authorities, and EIOPA.

In addition to rigorously assessing applications for new models and for major changes to approved models, a key objective of our ongoing supervision is to ensure that internal models continue to reflect companies' respective risk profiles and that any signs of "model drift" are identified and discussed with firms.

At an EU wide level, EIOPA's comparative studies aim to enhance the quality and convergence of internal model supervision across member states. They also provide a European perspective which is not otherwise available to national authorities. The Bank is an active participant in this work. Three major studies are currently under way and we appreciate the continuing support and efforts of the firms that are in scope.

1. Market and Credit Risk Comparative Study

In April 2021 EIOPA published its latest Market and Credit Risk Comparative Study report covering the 2019 year end. As in earlier studies, the results show that variations in model outputs can be partly attributed to modelling and business specificities. However, they also indicate areas for further scrutiny, particularly relating to the variation of modelled results for lower quality bonds, equity indices, and real estate investments.

This study also introduced several new analyses, covering the initial effects of the COVID-19 crisis versus modelled outputs for market and credit risk; analyses of dependency structures and foreign exchange modelling; and qualitative analyses of interest rate modelling and sustainability considerations.

Data submissions for the next study, covering the 2020 year end, closed in May 2021. A draft report is currently subject to private consultation with participants; EIOPA has arranged a closing event to discuss the results with all participants; and supervisory authorities will discuss each participants' results bilaterally by mid-January 2022. The final report is expected to be published in Q1 2022.

2. Study on Diversification

In October 2021 EIOPA launched the second phase of the Study on Diversification in Internal Models. The deadline for companies to provide data is 10 January 2022. The specific objective of this study is to gain a better understanding of dependencies and diversification benefits in internal models by comparing results and methodologies across firms.

The analysis of the information provided by firms in the first phase is in its final stages. Feedback to participants will be shared via EIOPA by February 2022. A more precise timeline will be communicated shortly.

3. Non-Life Underwriting Risk Comparative Study

The objective of the Non-Life Underwriting Risk Comparative Study is to analyse the relative positioning of non-life internal models and to provide a European perspective on their risk profile development over a five year period. Therefore, this exercise covers internal models results from the Solvency II implementation in 2016 to the first annual submission for this study in 2020. All of the Irish regulated internal model undertakings that were asked to participate have provided data for the study and this is currently being assessed.

Aurora Johannesson & Declan Costello,
Senior Actuaries,
Internal Models & Financial Resilience Team,
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Third Private Motor Insurance Report of the National Claims Information Database Published

On 16 November 2021, the Bank published the third annual Private Motor Insurance Report of the National Claims Information Database (NCID). The NCID compiles aggregate data received from insurers. This allows the Bank to publish an annual report containing analysis on the cost of premiums, the cost of claims, the aggregated financial performance of firms providing this insurance, and key settlement channel information.

The third annual Motor Insurance Report of the NCID captures data for the calendar year 2020. The impact of Covid-19 is therefore highlighted within the report.

Solvency II Review – Proposed amendments from European Commission

On 22 September 2021, the European Commission published its draft legislative proposal to amend the Solvency II Directive following on from EIOPA's 2020 review of Solvency II.

The proposal largely follows the technical advice provided by EIOPA in December 2020. However, there are some amendments, including a proposed reduction in the cost of capital rate used in the risk margin; and an adjustment to the changes that were recommended to be made to the interest rate risk component of the Standard Formula.

The European Council is currently debating the draft legislation, and it is likely that there will be some changes made before it is eventually implemented, which will not be until 2024 at the very earliest. The Commission's full proposals, and accompanying impact assessment, can be found here.

Sustainable Insurance

The section of the Insurance Newsletter highlights Sustainable Finance developments relevant to the insurance sector.

Supervisory Expectations on Climate & ESG Issues

Introduction

On the 3 November 2021, the Bank published its supervisory expectations[1] of regulated financial service providers (RFSP) regarding climate and other ESG[2] issues. These expectations were addressed to both the Chairs and CEOs of RFSPs illustrating the importance of this issue for the entire RFSP. This article provides a recap of the key areas of focus for RFSPs.

Background

The Bank's mission is to serve the public interest by maintaining monetary and financial stability while ensuring that the financial system operates in the best interests of consumers and the wider economy. We see addressing climate change as a strategic priority[3], and that the financial system has to be resilient to the risks it poses as well as having an important role to serve the needs of consumers and the wider economy in the transition to a carbon neutral future. We recognise that these issues are challenging, particularly as expertise and capabilities develop. Nevertheless, climate change does require action on the part of all participants in the financial sector. For those overseeing RFSPs, there is a need to lead and drive the climate and broader ESG agenda within their firms.

Our supervisory approach

Our supervisory approach to climate and ESG issues (which will continue to evolve) is informed by regulatory developments at EU level, the work of our peers and our broader supervisory objectives. Climate considerations are a key component of the ESG agenda that the EU is seeking to address as part of its sustainability package of regulatory reforms. The EU Sustainability Framework provides a range of statutory and regulatory requirements relating to climate and ESG risks that firms must adhere to.

The Bank's approach in this area is aligned to – and consistent with – the requirements under the EU's framework, as well as with developments and relevant rulebooks at EU level for banks, insurers and asset management firms. The NGFS' framework for supervisory engagement with firms on climate matters has also informed our thinking (along with the supervisory activities of peer regulators on climate and ESG issues).

Our supervisory expectations

The Bank's supervisory expectations apply to all RFSPs. They are articulated on the basis that they can be applied by RFSPs in a proportionate manner aligned to the nature, scale and complexity of the individual firm. Consequently, our expectations are not prescriptive in nature, and they are not set out at a granular level of detail. It is important to note that while our expectations are based upon international best practice, they are not binding upon firms. Our expectations do not replace or override any legal, regulatory or supervisory requirements applicable to firms, and it is a matter for firms to seek their own legal advice if they are unsure of their own obligations. Our expectations focus on five key areas:

- **Governance**: firms need to demonstrate clear ownership by their Boards of climate risks affecting the firm and to promote a culture that places emphasis on climate and ESG issues;
- **Risk management framework**: firms need to understand the impact of climate change on the risk profile of the firm and to enhance their existing risk management frameworks to ensure robust climate risk identification, measurement, monitoring and mitigation;

1. Central Bank climate supervisory expectations
2. Environmental, Social and Governance issues
3. Climate features in the Central Bank's climate strategy 2022 as part of our "future focus".

- **Scenario analysis**: scenario analysis and stress testing are critical to assess the impact of potential future climate outcomes, including impacts on capital adequacy, where applicable
- **Strategy and business model risk**: firms are expected to undertake business model analysis to determine the impacts of climate risks (and opportunities) on the firm's overall risk profile, business strategy and sustainability, and to inform strategic planning; and
- **Disclosures**: existing legal requirements on disclosure emphasise the importance of transparent disclosure to consumers and investors to protect their interests and wider market integrity. In particular firms need to ensure they do not engage in the practice of 'greenwashing'.

Next Steps

All RFSPs can now expect the Bank to become increasingly active and intrusive in its approach to the supervision of climate change risks. Specifically, we will be seeking evidence that:

- Boards are meaningfully considering climate change risk;
- climate change risks are being incorporated and embedded in organisational risk management frameworks and mitigation;
- climate risks are being considered as part of stress testing; and
- the EU taxonomy of sustainable activities[4] is being proactively applied.

Anne-Marie Butler,
Senior Lawyer,
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Insurance Supervision Directorate

SIF paper - Nature related risks in the insurance sector

The Sustainable Insurance Forum (SIF) has published a [groundbreaking study](#) on how losses in nature can translate into financial risks for the insurance sector. The study aims to support insurance supervisors and insurance companies in better understanding and responding to these risks.

What are nature related risks?
The risks related to climate change and natural hazards, together with risks from broader environmental issues such as pollution, desertification and water depletion

Nature loss can result in two main types of financial risks for the insurance sector's underwriting and investing business: physical and transition:

- Physical risks - result from the material destruction of natural capital, leading to disruption to natural services. This can result in financial losses for businesses, insurance companies and other financial institutions.
- Transition risks include risks that occur due to global policy, regulatory, economic and market shifts toward a "nature-positive" future.

In principle, as the loss of natural assets increases, associated financial and economic risks could increase in magnitude and frequency, and pose threats to the safety and soundness of insurance companies and broader financial stability. The study identifies that at a global level, the (re)insurance sector's capacity to understand nature-related risks, collect relevant data and design tools to assess these risks is at an early stage of development. The lack of data, information and methodologies was cited as the main reason insurers are not assessing nature-related risks. However some insurers have started taking steps to develop measurement tools and methods to understand, disclose and respond to these risks.

The report recommends that the insurance industry continue to identify and build data, analytical tools, forward-looking metrics, and indicators to assess and measure nature-related risks. Furthermore, industry should disaggregate asset-level nature-related risks by regions, sub-regions and countries as well as by types of risks.

4 Governance and risk in a time of uncertainty and change" - Deputy Governor Ed Sibley

Meanwhile increased supervisory attention is also turning to nature-related risks, with some supervisors starting to consider guidance, recommendations or standards on the topic.

The report recommends that insurance supervisors work to deepen the understanding and awareness of nature-related risks among regulated entities. Following this, supervisors could consider supporting the development of non-prescriptive guidelines and tools towards the better assessment and management of forward-looking nature-related financial risks, along with the disclosure of such risks in regulated entities.

Application Guidance on climate scenarios in the ORSA

On 10 December 2021, EIOPA launched a consultation on a draft application guidance paper relating to climate scenarios in the ORSA. This is a follow up to the opinion published in April 2021.

This is a relatively new style of document for EIOPA. It is aimed at helping industry, particularly small and medium sized firms, to start running climate risk scenarios. It covers how firms could carry out a materiality assessment, perform scenarios, along with practical examples on how this could be done, based on dummy life and non-life insurance companies.

The application guidance is optional, and is not a supervisory convergence tool. The examples provided give an indication of one approach that firms could take, but not the only approach. It should be used as a starting point for firms. Specific features of the business underwritten, and investments should be factored in when firms run their own scenarios.

The consultation runs until **10 February 2022**. Following the consultation, EIOPA will run a series of workshops with interested stakeholders.

Amendments to Solvency II Delegated Acts

Following on from the EIOPA opinion published in 2019 on integrating sustainability in Solvency II, the Commission have published amendments to the Solvency II Delegated Acts. These amendments require firms to incorporate sustainability in their:

- investment and underwriting practices.
- ORSA – both in identifying and assessing sustainability risks
- remuneration policy
- prudent person principle – considering the long term impact of investment decisions
- activities of the actuarial function

These changes will come into force on **2 August 2022**, and the CBI expects firms to be considering if any changes are required to their processes in advance of this deadline.

EU Renewed Strategy - financing the transition to a more sustainable economy

The renewed strategy was published in June, and aims to support the financing of the transition to a sustainable economy. This strategy is wide-reaching and will has impacts on all aspects of the financial sector. The following items are highlighted as they are of direct relevance to the insurance sector.

- EIOPA has been given a mandate to further develop their insurance protection gap dashboard.
- EIOPA has been given a mandate to assess the effectiveness of Solvency II in integrating sustainability risks – including work to see if a dedicated prudential treatment for assets or activities is needed.
- The European Supervisory authorities have been given a mandate to develop a regular stress testing methodology and to coordinate a one-off cross-sectoral stress test – date to be confirmed.

The Sustainable Insurance section of the Insurance Newsletter is contributed by the Insurance Risks Policy Team - Financial Risks, Governance & Policy Division. *insurancepolicy@centralbank.ie*

EIOPA Updates

EIOPA Report on the Independence of National Competent Authorities

On 18 October 2021, EIOPA published its Report on the independence of National Competent Authorities (NCA). The report assesses key aspects of NCA independence, such as, operational independence, financial independence, personal independence, as well as accountability and transparency. The report does not represent an assessment of NCAs independence. Rather it seeks to factually represent the legal and operational position of NCAs under the key elements of independence.

The report can also support NCAs in assessing whether any legislative or regulatory amendments are necessary to further improve the framework underpinning their independence. Moreover, the report also provides valuable information to EIOPA for future work in the field of supervisory convergence.

Publication of Risk Dashboard

On 3 November 2021, EIOPA published its latest Risk Dashboard. The Risk Dashboard is based on Solvency II data and it summarises the main risks and vulnerabilities in the EU insurance sector using a set of risk indicators. Environmental, social and governance (ESG) related risks, are included for the first time in the latest Risk Dashboard.

Assessment of value for money of unit-linked insurance products

On 30 November 2021, EIOPA published a supervisory statement which sets out the common principles needed so unit-linked products can offer value for money. EIOPA research highlights that while value for money is already embedded in product oversight and governance requirements, more convergence is needed in practical supervisory implementation. The statement does not introduce any additional regulatory requirements, but it clarifies the following five principles that EIOPA expects to see in the supervisory approach of EU/EEA National Competent Authorities (NCA):

- **Pricing**: Manufacturers should be able to present a structured pricing process.
- **Complexity**: Manufacturers should assess and determine the level of complexity of their products.
- **Testing**: Manufacturers should test their unit-linked products appropriately, also by using scenario analyses.
- **Regular review**: Manufacturers should continuously monitor and regularly review unit-linked products they have placed on the market, to identify events that could materially affect the main features, the risk coverage or the guarantees of those products.
- **Supervision**: NCA are expected to monitor their market to ascertain that insurance product manufacturers ensure that customers receive fair value unit-linked products.

Overall EIOPA expects a risk-based approach – where the products which pose the greatest risk of consumer detriment due to poor value for money receive supervisory priority. EIOPA's research highlights that poor value for money can undermine the development of the single market, reduce the impact of capital markets union, and lower household resilience to financial shocks over the longer term.

Forward Planner & Communications

Upcoming Dates

4 February 2022 – Submission date for Solo Q4 2021 quantitative reporting

10 February 2022 – Closing date for EIOPA Consultation on Application Guidance - Climate scenarios in the ORSA

15 March 2022 – Publication of Q1 Insurance Newsletter

Recent Speeches & Publications

Date	Topic	Link
8 December 2021	Opening Statement by Gerry Cross, Director, Financial Regulation - Policy and Risk at Joint Oireachtas Committee on Finance, Public Expenditure and Reform	https://www.centralbank.ie/news/article/speech-gerry-cross-director-policy-and-risk-joint-oireachtas-committee-8-december-2021
18 November 2021	Disruption in financial services: Navigating the winds of change – Deputy Governor, Ed Sibley to the Association of Compliance Officers of Ireland	https://www.centralbank.ie/news/article/Speech-Ed-Sibley-navigating-the-winds-of-change-18-nov-21
29 September 2021	Remarks by Director General, Financial Conduct Derville Rowland at the Deloitte Global Insurance Webinar	https://www.centralbank.ie/news/article/insurance-firms-require-strong-customer-focused-cultures-director-general-financial-conduct-derville-rowland-29-september-2021

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