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Embracing Solvency II - The Own Risk and Solvency Assessment

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.

The ORSA is a key cornerstone of the risk management system under Solvency II.

Since the introduction of Solvency II in January 2016, Irish (re)insurance undertakings have used the ORSA as an opportunity to gain a better understanding of their particular risk profiles and capital needs with a view to maximising their competitive edge in the marketplace. From a regulatory perspective, the Central Bank of Ireland (the "CBI") has also pointed to the ORSA as being an invaluable source of information to help (re)insurance firms to make sound strategic decisions.

Solvency II – an Irish perspective

The EU's Solvency II Directive was transposed in Ireland by the European Union (Insurance and Reinsurance) Regulations, 2015 (the "2015 Regulations") which became effective across all EU Member States on 1 January 2016.

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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.

What does the ORSA involve?

All (re)insurance 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 (re)insurance 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 (re)insurance 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.

The ORSA Process

The ORSA is a process rather than a report. The process by which (re)insurance undertakings produce the ORSA is as important as the finalised document itself. The ORSA process represents an opportunity for (re)insurance undertakings to integrate existing infrastructure and processes in relation to risk management, capital management and strategic commercial planning. The ORSA process enhances the undertaking's decision making ability by linking its risk profiles with management and operational performance.

Proportionality

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 (re)insurance 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 (re)insurance undertakings and shall be taken into account on an on-going basis in the strategic decisions of the undertaking concerned.

Importantly, (re)insurance undertakings are obliged to perform the ORSA annually or without any delay following any significant changes to the risk profile of the undertaking.

The CBI 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 CBI.

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 (re)insurance undertakings to gain a better understanding of their particular risk profiles and capital needs. 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 CBI as part of the supervisory review process.

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