IVASS
ISTITUTO PER LA VIGILANZA SULLE ASSICURAZIONI

Prot. 0008712/18 of 12/01/2018

Supervisory Regulations and Policies Department

To the insurance and reinsurance undertakings whose head offices are located in Italy
TO THEIR PREMISES

To the Ultimate Italian parent companies
TO THEIR PREMISES

copy to: the branches in Italy of insurance and reinsurance undertakings with head offices in a non-European Economic Area country
TO THEIR PREMISES

RE: Results of the comparative analysis of the Reports on the own risk and solvency assessment (ORSA).

The principles of the new Solvency II regulatory regime require that insurance undertakings have an internal risk management system in place which includes the so-called ORSA, Own Risk and Solvency Assessment.

The representation of the ORSA process submitted to the supervisors through the "Report on own risk and solvency assessment" (the so-called ORSA Report) is of paramount importance in the supervisory process. The Report is in fact one of the key documents on which supervisors base their investigation and assessment about the undertaking's capacity to identify and manage potential risk factors.

Given the importance of the ORSA Report, IVASS has conducted a comparative analysis of the Reports submitted, taking also account of the additional information requested in our letter to the market of 21 April 2017 concerning the impact, in terms of capital and solvency, of the occurrence of low-for-long interest rate environment and of a pronounced surge of credit spreads on financial assets.

The main results of this analysis are indicated in the enclosed document, together with the areas requiring improvement and IVASS' expectations.

Best regards.

by delegation of the Joint Directorate

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Annex

ORSA Reports for 2016

Consistency of the ORSA reports with the scheme envisaged by the new regulatory provisions

The ORSA Reports submitted by the undertakings are, on the whole, consistent with the provisions in the new ORSA regulation on the forward looking time horizon considered, the deadlines for transmitting the reports to IVASS, the reference date for the analysis and the use of the scheme of the report for the supervisor[1].

The derogations envisaged by the regulatory provisions on the deadlines for transmitting reports and time horizon have been used in a very limited number of cases.

In relation to the scheme of the report for the Supervisor and taking account of the principle of proportionality envisaged by the relevant regulatory framework, we have observed that the largest deviations have concerned small-sized companies and companies belonging to groups with a foreign parent undertaking. .

The ORSA process is being increasingly integrated into business

The reports examined show how the ORSA process is being assimilated within the framework of ordinary management procedures. In general, ORSA has proved to be a useful tool to support the decision-making process (for ex. dividend distribution) and for the review/confirmation of the strategic plan.

The RAF becomes stronger especially for large undertakings and groups

The *Risk Appetite Framework* (RAF) has refined and reinforced especially for undertakings belonging to groups which calibrate - at the individual level - the risk tolerance thresholds established by the parent undertaking. The process for the definition of the risk tolerance thresholds is not yet adequately robust, as a result the risk tolerance thresholds can vary markedly from one year to another.

Role of the board committees, the risk management and the actuarial function in the ORSA process

The current and forward looking assessments have highlighted an increased awareness and a better definition of the roles played by the various corporate functions in the ORSA processes. In general, board committees (in particular the risk committee) are playing a more and more active role supporting the activity of the administrative body. When there are no committees for risk control and analysis within the board, it is the risk management function which plays a prominent role in the ORSA process, by coordinating the process and assuming a leading role in the drawing up of the report.

The actuarial function still plays a limited role in the assessments of a more technical nature, in particular in the identification of significant risks - both in the baseline scenarios and in the adverse scenarios. Sometimes technical assessments regarding scenarios and stress tests are left only to the risk management function.

The ORSA report is intended for the Supervisor

The ORSA report is an integral part of the regular supervisory reporting: its primary goal is to highlight to the supervisor, in a clear and comprehensive way, the process and the results of the assessments conducted by the undertaking on the current and forward-looking capital

[1] Art. 3 of IVASS Regulation No. 32/2016.

adequacy to face the risks that it proposes to accept, also in the adverse scenarios that might occur. The approval of the report by the Board before sending it to the supervisor - as required by the current regulations - is aimed to further support this goal: the report is a central tool in the dialogue between the undertaking and the supervisor. For this purpose, the report must provide evidence that the Board is fully aware of the central role of the ORSA process and of its results, with specific regard to the risks to which the undertaking is exposed.

The main risks faced by undertakings are financial risks

The main risks in this sector are financial risks, linked to the structure of the undertakings' portfolios. In this context undertakings have assessed that they are more vulnerable to a potential increase in the credit spreads of bonds than to a low-for-long interest rate scenario. For the life sector, a high level of vulnerability has also been observed for the surrender risk, and undertakings are revising their portfolio of products in order to better manage this risk.

The assessments of second pillar risks differ according to the method for calculating capital requirements

Among the risks included in the second pillar, there are marked differences between undertakings which have used an internal model to calculate their own capital requirement and those which have used the standard formula. Compared to the past, the former have devoted greater attention to the liquidity risk, the reputational risk and the strategic risk while the latter have rarely provided a detailed analysis of the risks not included in the standard formula or specific in-depth studies on the operational risk. IVASS expects all undertakings to pay the necessary attention to any material risks that are not included in the calculation of the Solvency Capital Requirement, with special regard to the liquidity risk.
The representation of the tools used and assessments made for the monitoring, management and control of the risk on government bonds should be improved, also through more detailed information on the possible strategies examined and on the checks made to assess the vulnerability of the undertaking to these exposures.

Consistency between stress scenarios and strategic plan must be strengthened

The quality of the design and development of the stress test and sensitivity analysis scenarios has been enhanced, although there is still room for improvement: more severe stress scenarios should be considered for those risks to which the companies are exposed. Moreover there should be greater consistency between the assumptions made on the evolution of the risk scenarios and the undertaking's strategic plan. Only a few entities have adopted reverse stress testing techniques, which are extremely useful since they allow to identify risk scenarios which can reduce the levels of capitalisation, raising them to predefined thresholds (up to the complete absorption of capital surplus compared to regulatory requirements). To confirm the fact that undertakings perceive exposure to financial risks as being significant, stress scenarios almost always envisage: the decrease in stock prices, increased credit spreads, a fall in the interest rate curve, a rise in surrenders for life policies. These scenarios have however been adopted at the level of each risk; no combined risk scenarios have been designed.

Gaps in the assessment of the deviation between the risk profile and the assumptions underlying the SCR calculated using the standard formula

The 2016 reports witness the start of the on-going assessment of compliance with capital requirements and requirements relating to technical provisions (the so-called ORSA second assessment). The main groups have carried out the forward looking assessments both assuming a baseline scenario and an adverse scenario, although there is still a clear need for integration and development. Large-sized undertakings have focused their attention on the deviation between the assumptions underlying the SCR (*Solvency Capital Requirement*) and the entities' risk profile (so-called ORSA *third assessment*). In this regard, some groups have made comparisons between single risks and between the forecast values estimated in the previous ORSA report and the actual values (so-called back testing).

The approach followed by the companies which have adopted an internal model is significantly different from the one adopted by those using the standard formula. In fact, in this latter case, a study on the adequacy of the standard formula - and of its calibration - for the assessment of the undertaking's risk profile has rarely been made and/or supported by sensitivity analysis.

Safeguards against the risk of concentration for groups need strengthening

The number of the groups providing a quantification of the impact of portfolio concentration risk in terms of capital has increased, although in some cases this risk is still assessed only from a qualitative point of view. The representation of this risk should be improved, together with the arrangements for its management both in qualitative and quantitative terms.

A more detailed description must be provided of remedial actions, the conditions and timing for their implementation, the assessment of their effectiveness

The granularity of risk-mitigation measures has been enhanced, although in most of the cases the benefits attributable to such measures continue to be represented in generic terms. In some cases safeguards have been strengthened and contingency plans have been designed and developed which, apart from including aspects of business continuity, provide for actions to be taken in case events occur which might undermine the solvency of undertakings. There remains considerable room to improve the clarity of the initiatives that can be implemented for each type of risk, in particular when defining the measures taken, those available and those actually effective if activated in time. The analysis of the ORSA reports from nearly all the small and medium-sized undertakings has shown that they do not contain any information on the drafting of contingency plans.

Despite the progress made…

…there is still considerable room for improvement

Although we recognise that there has been a gradual improvement in quality compared to the previous years, the greater methodological accuracy and increased awareness of the pivotal role of the ORSA process in the management of undertakings, the comparative analysis on the 2016 reports indicate the need for an overall strengthening of the ORSA analysis which, in the logic of *Solvency II*, represent an essential instrument of corporate governance.