CEIOPS
Committee of European Insurance and Occupational Pensions Supervisors

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# Issues Paper

# Supervisory Review Process and Undertakings' Reporting Requirements

*CEIOPS publishes the following Issues Paper to invite stakeholders' comments on its views on the "Supervisory Review Process and Undertakings' Reporting Requirements" to inform CEIOPS' further work in these areas.*

*CEIOPS will not provide direct feedback to comments, but will take them into account in its future work.*
*Please send any comments to CEIOPS (**Secretariat@ceiops.eu**)*
*by email **not later than 12 November 2008**, indicating the*
***reference CEIOPS-IGSRR-18/08**.*

*CEIOPS will make all comments available on its website, except where respondents specifically request that their comments remain confidential.*

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## 1. Executive Summary

1.1. This Issues Paper is CEIOPS´ first attempt to undertake a discussion with stakeholders on a possible framework for supervisory review and reporting requirements. The paper contains three separate sections:

- Details of a framework that aims to converge the supervisory review process (SRP), through which supervisors can assess and monitor risk to policyholders such that the supervisor can prioritise supervisory actions and efforts;
- Details on the information analysis carried out by supervisors to evaluate the strategies, processes and reporting procedures established by the undertaking and its compliance with the laws, regulations and administrative provisions of the Directive; and
- Details on the quantitative and narrative reporting requirements that are envisaged to be reported by all undertakings under Solvency II.

1.2. While CEIOPS has chosen to detail each respective process independently, in reality these elements are inseparable. These processes should not therefore be viewed in isolation, as they are linked by a number of interdependencies.

1.3. The SRP is the overall process conducted by the supervisory authority in reviewing insurance and reinsurance undertakings ('undertakings'). It is used to evaluate, on an individual undertaking basis, compliance with the laws, regulations and administrative provisions adopted pursuant to the Directive (such as the quantitative requirements, reporting and disclosure requirements and system of governance requirements). It is through the SRP that supervisors monitor all undertakings, and identify those with financial and/or organisational weaknesses susceptible to producing higher risks to policyholders.

1.4. The SRP should be applied to all undertakings to ensure that all policyholders receive an adequate level of protection as required by the Framework Directive Proposal. All undertakings will therefore be subject to an appropriate level of supervision to ensure that the requirements of the Directive are met.

1.5. In accordance with the principle of proportionality, the SRP should be adapted to the nature, scale and complexity of the risks of each undertaking. At the same time, it is the aim of supervision to determine the nature, scale and complexity of the risks facing each undertaking, and to prioritise and focus supervisory actions and efforts according to a risk-based approach.

1.6. The frequency and intensity of supervisory actions should be based upon the risk profile of each undertaking. This paper sets out a framework through which supervisors should assess an undertaking's risk profile. Supervisory authorities should, where possible, use common criteria to assess and monitor risks, but they will not necessarily have a common way to quantify and categorise those risks. Although the categorisation may be different, the outcome is that supervisory actions and efforts are prioritised according to the risk assessment of undertakings. This process

should be carried out by all supervisory authorities. CEIOPS will undertake further work on the convergence of risk categorisation.

1.7. Linked to the SRP is the amount of information that undertakings are required to report to supervisors. The Framework Directive Proposal sets out annual public disclosure requirements through the Solvency and Financial Condition Report (SFCR)[1]. In addition, a private Report to Supervisors (RTS) would also be required to be produced. The SFCR and RTS would include quantitative and narrative information reporting requirements. The RTS would also cover the confidential or proprietary information that would not be required to be disclosed in the SFCR to be used for supervisory purposes only. At this stage, CEIOPS does not envisage further reporting requirements in addition to the SFCR and the RTS[2].

1.8. In terms of frequency of reporting, it is currently envisaged by CEIOPS that the quantitative information, collected through standardised reporting forms, would be required annually[3] for supervision alongside the information required in the annual SFCR. The full narrative information would only be required in conjunction with the intensity of the SRP (i.e. only when the supervisor intends to undertake a detailed periodic assessment as part of the SRP), however, on an annual basis, undertakings who are not required to report the full narrative information will be required to submit detail of only material changes[4] to the narrative information or report that no material changes have occurred[5]. CEIOPS may consider it appropriate that key information is reported on a more frequent basis but this will be developed at a later stage.

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[1] See Article 50 of the Framework Directive Proposal.

[2] For example, these requirements cover the reporting of the Own Risk and Solvency Assessment (ORSA).

[3] Undertakings should note that Article 127 of the Framework Directive Proposal requires the MCR to be calculated and reported to the supervisor quarterly.

[4] These material changes should also be reported to supervisors as they arise.

[5] Article 35 of the Framework Directive Proposal also provides for additional points in time when supervisory authorities can request information. A supervisory authority may wish to request a complete set of narrative information.

## 2. Introduction

2.1. As part of its preparation for future work under the Solvency II project, CEIOPS has been developing what it considers should form the basis of a convergent SRP and undertakings' reporting requirements.

2.2. Article 30 of the Framework Directive Proposal states that *"supervisory authorities shall conduct their tasks in a transparent and accountable manner"*. CEIOPS has published this Issues Paper to facilitate understanding of the reporting and disclosure requirements supervisors are currently envisaging (SFCR and RTS), how the supervisors intend to assess the information received and how supervisors intend to use this information in the SRP to prioritise supervisory actions and therefore ensure policyholder protection.

2.3. The material set out in this paper covers some of the main components of what is more commonly referred to as the "Pillar II" (regarding the way supervisors conduct their reviews) and "Pillar III" (supervisory reporting and public disclosure) elements of the Solvency II framework.

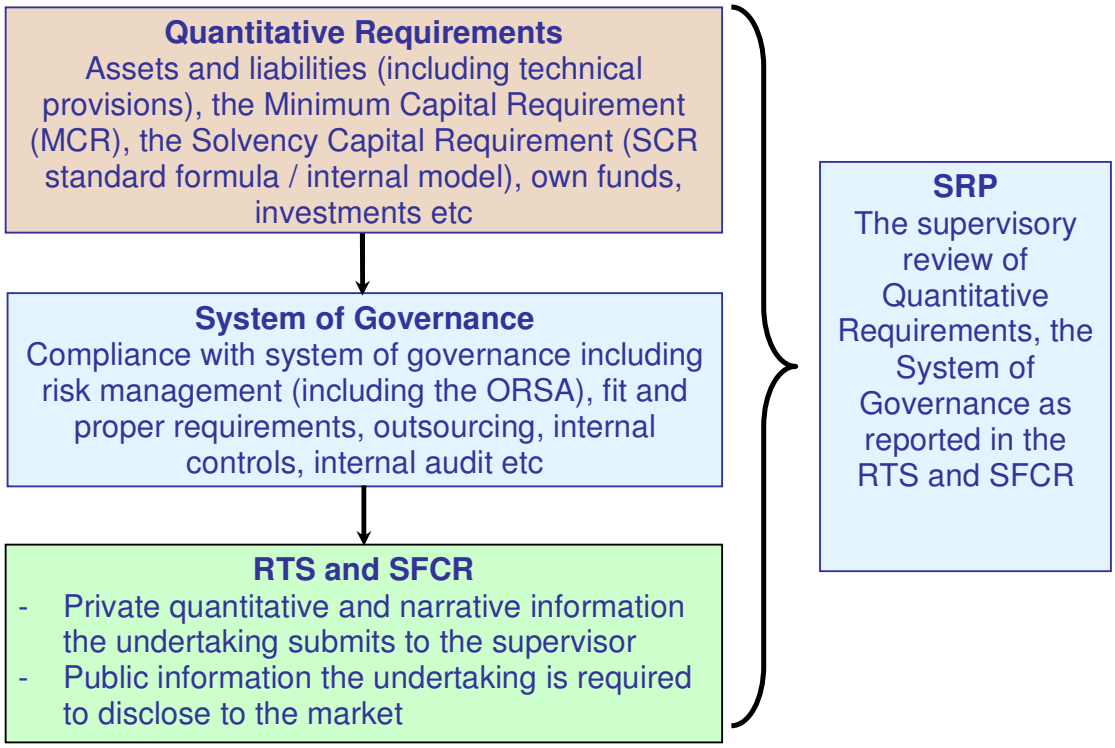
2.4. The material being developed by CEIOPS in this paper will be used to form its advice on the Level 2 implementing measures on reporting requirements and other Level 3 guidance material. In developing a consistent set of reporting and disclosure requirements and supervisory standards, this paper is designed to improve convergence of the reporting requirements and supervisory approaches across Member States. This paper does not outline implementing measures but considers the Framework Directive Proposal requirements and other relevant international developments (such as from the International Association of Insurance Supervisors).

2.5. This Issues Paper is not a CEIOPS Consultation Paper. It aims to present an update on CEIOPS' current thinking and provides the opportunity for the industry and other relevant stakeholders to comment and input into CEIOPS' work. We consider this input to be very important as comments received will be used to inform CEIOPS' future progress in defining the advice required to be submitted to the European Commission for their Level 2 implementing measures.

2.6. This paper does not seek to address the requirements around internal models, nor does it currently explicitly address the requirements for groups, which will be developed further by CEIOPS at a later stage.

## 3. Background

3.1. The Framework Directive Proposal sets out the high-level requirements for both undertakings and supervisors under Solvency II. The diagram below highlights the interaction between the requirements (namely the undertaking's quantitative requirements, the system of governance, the reporting and disclosure requirements (RTS and SFCR)) and the SRP.




3.2. Within its Issues Paper 'Policy on harmonisation of contents and formats for public disclosure and supervisory reporting'[6], CEIOPS stated that with regard to reporting, a framework of principles for a harmonised reporting and disclosure regime should include "… *a clear idea of what and why information is needed in order to perform the future supervisory review process and to foster market discipline."* CEIOPS also stated that *"The process shall also include an impact assessment*." As a result, this paper sets out the high-level rationale for requesting information and what the supervisor will be using it for.

3.3. The SRP is used to refer to the overall ongoing nature of supervision. Article 36(6) of the Framework Directive Proposal states that *'the supervisory authorities shall establish the minimum frequency and scope of the reviews, evaluations and assessments having regard to the nature, scale and complexity of the activities of the insurance or reinsurance undertaking concerned'*.

[6] CEIOPS-IGSRR-05/07, November 2007.

3.4. Supervisors may use a variety of methods to undertake such reviews, which is likely to include their own supervisory judgement(s) informed by using supervisory techniques such as, for example, on-site inspections and/or off-site analysis. These are referred to generally as supervisory actions. The SRP is not envisaged to require the same actions and/or resources for all undertakings, given their size, risks and solvency and financial situation. Instead, in line with a risk-based approach and the main objective of supervision, those undertakings that pose more of a perceived risk to policyholders should be subject to a more intensive supervisory review (and therefore actions) on a more frequent basis. However, at the individual level, policyholders should be afforded the same protection regardless of the undertaking with which they hold their policy. This stems from the Framework Directive Proposal requirements for all undertakings to, for example, hold the same level of own funds to a standard 99.5% VaR and to have an adequate system of governance.

3.5. The requirement for a risk-based supervisory approach[7] is designed to ensure that supervision takes the risk profile of all undertakings into account, provides a further incentive for undertakings to better measure and manage their individual risks, optimises supervisory resources and ensures an appropriate level of policyholder protection across their market.

3.6. The development of a convergent framework for the SRP is a key element in achieving a more harmonised risk-based supervisory regime across the European Community given it provides a common basis for supervisory intervention and for the exercise of supervisory powers.

3.7. Within its Issues Paper 'Policy on harmonisation of contents and formats for public disclosure and supervisory reporting', mentioned above, CEIOPS stated that "*… it is paramount for the implementation of the Solvency II framework directive that the basis for solvency supervision is more harmonised*". This paper aims to set out such a basis.

3.8. Underpinning the SRP are the reporting and disclosure requirements on undertakings[8]. These requirements represent an important source of information necessary for supervisors to conduct the SRP such that risk profiles can be evaluated. The reporting requirements are envisaged to consist of a public SFCR and a private RTS with both quantitative and narrative information. This information must be assessed and analysed by supervisors and, if necessary, completed so that the supervisor can form a judgement on the undertaking's solvency position and on its compliance with the Directive requirements.

3.9. With the aim of achieving the same level of policyholder protection for the policyholders of all undertakings, a framework is envisaged (from the areas covered within this Issues Paper) where, as part of the SRP, the undertaking is required to provide on an annual basis:

- the SFCR (as required by the Framework Directive Proposal);

[7] Article 28(1) of the Framework Directive Proposal states: "Supervision shall be based on a prospective and risk-orientated approach."

[8] Other ways of requesting information exist (i.e. ad-hoc information requests, on-site visits etc).

- quantitative reporting requirements (noting that, in the Framework Directive Proposal, the MCR is required to be reported on a quarterly basis); and
- information on any material changes[9] in the narrative information provided to the supervisor (or a declaration that no material changes have arisen during the year), or, in conjunction with a detailed assessment as part of the SRP, the full narrative information.

[9] Note that material changes to the solvency of the undertaking should be reported in a timely manner during the year.

## 4. Supervisory Review Process - Composition

4.1. Within its Issues Paper 'Policy on harmonisation of contents and formats for public disclosure and supervisory reporting', CEIOPS stated that it "*will focus its attention on the development of a new risk-oriented supervisory process that fosters convergence*". One objective of the SRP is to assist supervisors in setting priorities to achieve effective supervision, taking into account the principle of proportionality to the specific risks faced by each undertaking.

4.2. Regarding reporting requirements CEIOPS also stated that it "*…believes that there must be a clear understanding of why the information is needed and what it will be used for*". The details of the SRP set out below aim to meet this commitment and explain to stakeholders how the information reported by the undertaking is to be used.[10] This chapter aims to increase the convergence of supervisory practices and foster an open dialogue with undertakings.

4.3. To be consistent with the Solvency II objective of enhanced harmonisation, supervisors must possess a framework upon which to assess, quantify and monitor risk on an individual basis and therefore allow them to prioritise workstreams and focus regulatory efforts, subject to supervisory judgement. The SRP is the process used to identify any potential threats arising from inadequate risk identification and assessment practices by the undertaking, and highlight where there is a need for any supervisory action.

4.4. It is therefore essential that supervisory authorities have in place appropriate monitoring tools that enable them to identify risks to policyholders, for example, deteriorating financial conditions in an undertaking, and to monitor how that deterioration is remedied by the undertaking.

4.5. The SRP should bring together all the relevant information on an undertaking gathered in the course of supervisory activities. Information may be received by supervisors in several ways, for example:

- Periodic information reported by the undertakings;
- Applications, mergers and acquisitions activity, governance failures, fit and proper announcements, complaints, market events, etc;
- Results of any on-site inspections;
- National and international events, including financial and regulatory developments;
- Supervisory knowledge obtained through monitoring the market, cooperation with other supervisors and being aware of market circumstances arising that could affect certain types of undertakings;
- Reports from external parties, such as auditors or actuaries;
- Additional information requests and discussions with the undertaking; and

[10] Details on the SRP have been provided in this Issues Paper in the interests of transparency and will be worked on further by CEIOPS to form part of Level 3 measures.

- Past supervisory experience of the undertaking.

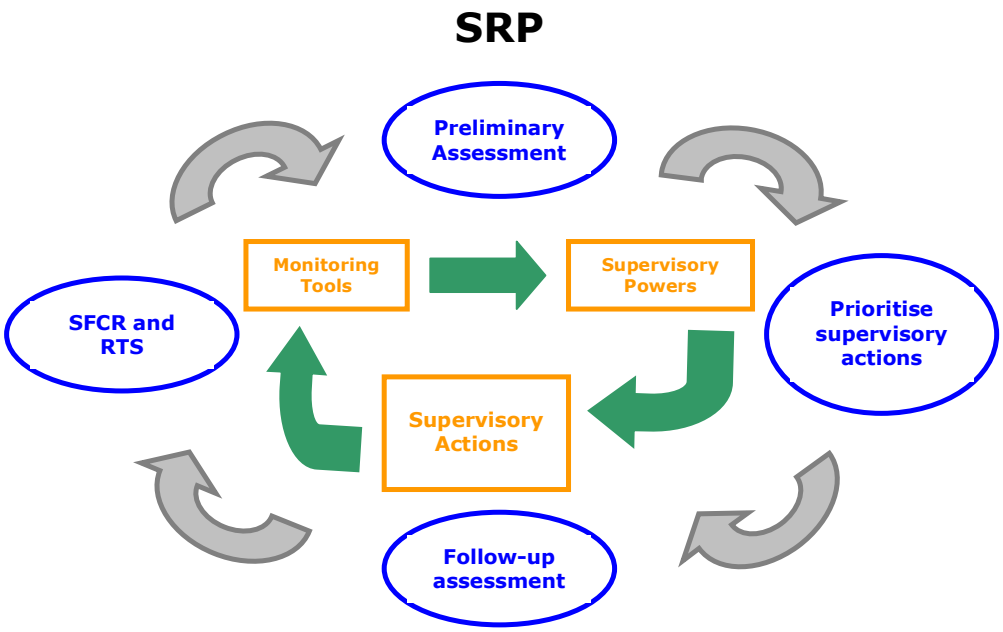
4.6. Additional information requests, discussions with the undertaking, thematic work and/or on-site inspections may be carried out as the supervisor considers necessary, to enhance its understanding of the undertaking and market developments (which will be achieved through discussions with a number of undertakings). The supervisor can always request and access all information needed for the purposes of supervision. The supervisor may also consider it appropriate for an undertaking to report key financial information on a more frequent basis than annually.

4.7. The SRP also comprises an assessment of the adequacy of the undertaking's methods and practices to identify future possible events or changes in economic conditions that could have unfavourable effects on its overall financial standing[11]. It also aims to foster ongoing dialogue between the supervisor and the undertaking.

4.8. In order to ensure the effectiveness of the SRP, it is important that supervisory authorities have the power to require the remedying of the weaknesses and deficiencies identified in the supervisory review including a follow-up process of their findings.

**Components of the SRP**

4.9. The SRP is essentially a continuous process. It can however be differentiated into components which allow supervisory authorities to effectively monitor undertakings and take appropriate supervisory actions. The components are: using the SFCR and RTS; a preliminary assessment; prioritising supervisory actions; and a follow-up assessment if required. The diagram below illustrates its ongoing nature.



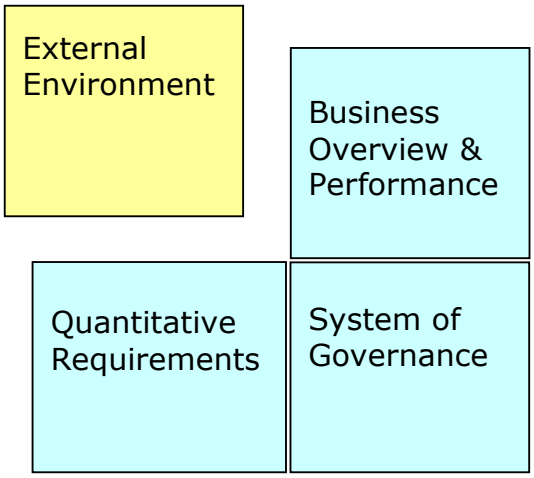

[11] This information could be derived from the undertaking's reporting of its ORSA.

4.10. This chapter will now elaborate on each component of the SRP process outlined in the above diagram, using the analysis of any relevant information at the supervisor's disposal (mainly the annual SFCR and RTS) as a starting point. With this information supervisory authorities should perform a preliminary assessment of the risk profile of all the undertakings that they supervise. The intensity with which this cycle occurs for each undertaking is likely to vary in a risk-based manner according to the discretion of the supervisor.

**Preliminary Assessment**

4.11. When performing a supervisory review, the supervisory authorities should conduct a preliminary assessment (using the information at their disposal) of the risk profile of every undertaking that they supervise. This preliminary assessment should then be used by the supervisory authority to prioritise supervisory actions and efforts, and to set an appropriate intensity for the ongoing supervision of that undertaking based upon the nature, scale and complexity of its risks. This assessment should be subject to review, for instance, if the undertaking's risk profile materially alters (for example, development of new activities, new management etc). The assessment should include a review of the information reported to the supervisor. It is at this time that the full narrative information is likely to be requested.

4.12. The preliminary assessment of the undertaking's risk profile could include a number of criteria. These criteria (as set out in the diagram below) consider factors from the external environment, as well as information obtained by the supervisor directly from the undertaking. It may be necessary for an on-site inspection and/or requests for further information for a supervisor as deemed appropriate to evaluate fully the risk profile of the undertaking.




4.13. These criteria should consider the possibility of an event occurring (at an individual level) which impacts adversely upon the solvency position of the undertaking. The likelihood of an event occurring is higher (all other things being equal) if the undertaking:

- is operating in a difficult environment;
- assumes more risks when carrying out its business (i.e. has a higher risk appetite);
- has material shortcomings within its internal controls and lacks an adequate governance structure; or
- is, in relative terms, thinly capitalised.

4.14. An important point to note is that while a lack of internal controls and an inadequate system of governance are 'negative' (in the sense that the supervisor would expect to see them remedied as part of a supervisory review), a lower risk appetite should not be seen as 'more desirable' than a higher risk appetite. The role of the supervisor is not to set an undertaking's risk appetite but to ensure that risks are effectively managed.

External Environment

4.15. Environmental factors encompass those risks which originate within the general business environment and/or macroeconomic climate and to which all undertakings in the jurisdiction of a supervisory authority would be exposed. These may include economic factors, legislative and political challenges, the degree of competition faced by the undertaking or the state of capital markets. The degree to which undertakings are affected will differ depending on entity-specific circumstances.

Business Overview and Performance

4.16. These risks will arise as a result of the nature of the undertaking's business, including the nature or type of its policyholders, the products it sells and the markets in which it operates.

4.17. Supervisors should consider the performance of the undertaking, including where appropriate, a comparison with undertakings that conduct similar activities. An analysis of trends in the undertaking's key financial figures may also highlight a deterioration in the undertaking's performance.

Quantitative Requirements

4.18. Supervisors should consider all sources of prudential risk which could cause the undertaking to suffer financial losses or insolvency and the adequacy of the undertaking's capital buffer to mitigate these shocks. The size of the losses should also be considered.

4.19. It is worth noting that additional capital does not affect the likelihood that an undertaking will suffer financial losses, but gives supervisors an indication of the extent to which the undertaking can absorb these losses. An indicator could be the level of solvency (technical provisions and own funds), both current and forward-looking.

System of Governance

4.20. Supervisors should assess the appropriateness of the undertaking's system of governance such as:

a) Governance Mechanisms – This is concerned with the quality of the undertaking's system of governance, supervisory reporting and public disclosure.

b) Governance Structure and Corporate Culture – The supervisor should assess the overall quality of the decision making process.

c) Board and Senior Management – The supervisor should assess the quality and appropriateness of the Board and senior management to run the undertaking (with regards to the fit and proper requirements).

d) Risk management – The supervisor should assess the different elements of the risk management system.

e) Internal controls – The supervisor should assess different elements of internal control such as control environment and control activities and monitoring.

4.21. As part of the assessment, the undertaking needs to demonstrate to the supervisors the effectiveness of its internal processes and systems designed to minimise the risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events. In addition to robust controls, low risk undertakings are likely to be able to demonstrate a comprehensive understanding of where weaknesses lie and the potential impact from an internal failing through the use of scenario analysis.

**Prioritising Supervisory Actions**

4.22. Supervisors should use the preliminary assessment just described to form a first opinion of an undertaking's risk profile. This should then be used to determine appropriate supervisory actions. The outcome is that supervisory actions and efforts are prioritised according to the risk assessment of undertakings, and this should be carried out by all supervisory authorities. Given this assessment using common criteria, supervisors may decide to categorise undertakings according to their risk profile. CEIOPS will undertake further work on the results of the SRP such as the convergence of categorisation of undertakings and the manner in which dialogue with undertakings occurs to report back on the SRP.

4.23. Relating the intensity of the SRP to the risk profile of the undertaking allows the supervisor to better determine supervisory actions according to a risk-based approach.

4.24. The discretionary decision-making ability must remain with supervisors and the subjective nature of the risk assessment process potentially limits the level of harmonisation. This framework is not designed to limit or constrain supervisory judgement or discretion; supervisors are encouraged to use the wealth of wider supervisory knowledge at their disposal.

4.25. Supervisors should consider the following high level principles for prioritising supervisory actions:

- every policyholder should be afforded the same level of protection;
- supervisory actions should be proportionate to the nature, scale and complexity of the risks of each undertaking;
- the SRP should be preventive and forward looking; and
- a supervisor must be able to react properly when it is necessary, especially in fast evolving, adverse situations.

4.26. It is important to note that, while supervisors prioritise their actions, this does not mean any undertakings subject to the Directive fall out of the scope of supervision. Furthermore, supervisors could also carry out random or routine inspections where these are justified.

**Follow-up Assessment**

4.27. As a result of the preliminary assessment and of the overall on-going monitoring of the undertakings, the assessment of the risk profiles should be up-dated on a continuous basis.

4.28. Supervisory judgement and experience play a fundamental role and, when necessary, the supervisory authority should review the prioritisation of supervisory actions and the intensity of the SRP for each undertaking.

**Supervisory Actions**

4.29. Once the risk profile has been established, the supervisory authority should decide upon the appropriate supervisory actions to ensure an undertaking remains compliant with the Directive.

4.30. A detailed periodic assessment is a specific review of the undertaking at a point in time using the supervisory actions deemed appropriate in a risk-based framework. This will mainly involve using the full information available at that date (based on, amongst other things, the last reported information set) and any on-site inspections. The existence of a periodic assessment does not mean that the supervisor cannot react instantly to a difficult situation.

4.31. In risk-based supervision (applying the proportionality principle), the SRP should take into account the nature, scale and complexity of the risks of each individual undertaking and be proportionate to these risks. It means that the intensity of such an assessment should also be proportionate to the risks of the undertaking.

4.32. Supervisors can tailor their actions such that they are both risk-based and proportionate in nature by varying the frequency and intensity with which they conduct the review and the volume of information requested for the purposes of supervision. Supervisors should not feel that they are constrained in the way in which they conduct their day-to-day supervisory practices. Clearly, supervisory judgement should prevail.

4.33. On-site inspections are an important supervisory action. They build on the off-site analysis to get a better understanding of the undertaking, including its risk profile. Supervision should comprise an appropriate combination of off-site activities and on-site inspections. On-site inspections are decided on using a series of criteria, including: level of solvency; quality of governance; quality of the supervisory reporting and disclosure, and significant changes to the previously reported items; or an unexpected event or situation that require fast exhaustive review. An on-site inspection may include verification of the reported data or any other elements reported to the supervisor. On-site inspections should involve meetings with members of the administrative or management body and other key persons within relevant functions.

4.34. Supervisors should be expected to act before an undertaking poses a material risk to policyholders. For undertakings posing a material risk, supervisors are likely to conduct a more intense review through the various supervisory actions available to them on a much more frequent basis in addition to requesting more detailed qualitative commentary and potentially additional data outside of the standardised reporting framework.

**Monitoring Tools**

4.35. Article 36(3) of the Framework Directive Proposal states that "*The supervisory authorities shall have in place appropriate monitoring tools that enable them to identify deteriorating financial conditions in an insurance or reinsurance undertaking and to monitor how that deterioration is remedied*".

4.36. To safeguard the interests of policyholders, supervisors must be aware when there is a growing threat to an undertaking's solvency. Effective supervision in this regard is enhanced by the establishment of solvency control levels. The current Framework Directive Proposal requires undertakings to calculate a MCR and a SCR. The undertakings are also required to derive their own solvency needs through the ORSA process along with an assessment of their own risk profile and changes from their risk assessment process. This information should be regularly reported by the undertaking, along with its level of own funds, and should be used as an important supervisory tool for monitoring undue risks to policyholders. All of this information should provide the supervisor with an indication if the undertaking has a deteriorating financial position or an increasing risk profile. Supervisors should maintain records over a period of time comparing the submissions from undertakings within its jurisdiction to identify such adverse trends.

4.37. Once deteriorating solvency or an increased risk profile is identified, discussions should be held with the undertaking to determine the cause of these trends. The supervisor should understand the potential threat posed to policyholder interests and, if this exists, how the undertaking intends to remedy the situation.

4.38. Discussions should commence well before any own funds requirement or own solvency needs are breached[12]. It would be beneficial to determine possible early warning indicators, taking into consideration the specifications of the new solvency regime, to act as an early warning system for intensified supervision within Solvency II. This process would prevent the situation where the first time a supervisor became aware of a deteriorating financial position was either after the undertaking had breached the SCR or had identified that it would do so within the next three months. These early warning indicators should not however function as a new solvency control level, and could be both quantitative and qualitative in nature, and do not necessarily indicate that the undertakings is in financial distress.

4.39. Quantitative early warning indicators could include:

a) deteriorating capital strength;

b) rapid growth;

c) declining profitability;

d) high expenses and low profitability;

e) sudden increase in technical provisions;

f) dramatic decrease in technical provisions;

g) significant divergence from budgets and business plans;

h) concentrated investments, particularly in related entities;

i) number of consumer or intermediary complaints (direct to supervisor, consumer protection authorities, appeal courts or addressed to the undertaking);

j) inappropriate bonus and remuneration structure that could provide inadequate incentives from a supervisory perspective; and

k) increasing distribution of surplus funds, dividends or any other loss absorbing buffers.

4.40. The main qualitative indicators could include:

a) change in strategy;

b) new classes of business/sources of business being written;

c) a crude underwriting strategy (pricing and risk selection), e.g. little or no segmentation compared to peer group;

d) changes to or delays in implementing an original business plan;

e) frequent changes to the administrative or management body, or key persons;

f) failure to implement supervisory requirements;

g) non-cooperation with the supervisor or delays in producing information;

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[12] The undertaking's own assessment of its solvency needs is not a regulatory capital requirement but should be used by the supervisor to better understand the undertaking's risks and capital position.

h) evidence of poor management (for example, poor quality internal information, not acting on supervisors' or auditors' recommendations or an unrealistic or incomplete business plan);

i) vulnerability to legal or fiscal changes;

j) pressure on management to achieve certain results or targets, for instance due to a stock market listing or imminent merger/acquisition;

k) identification of types of reinsurance arrangements which appear inconsistent with normal commercial practice or for which the commercial rationale for either party is unclear; and

l) changes in investment strategy or concentration in innovative/ unusual investment instruments or derivatives.

**Supervisory Powers**

4.41. Article 36(5) of the Framework Directive Proposal states that "*The supervisory authorities shall have the necessary powers to require insurance and reinsurance undertakings to remedy weaknesses or deficiencies identified in the supervisory review process*".

4.42. In those circumstances where the supervisor deems compliance with the Directive to be inadequate, the supervisory response should ensure that compliance with the Directive requirements is recovered and maintained. Therefore, the supervisor needs the appropriate powers to require the undertaking to take the appropriate action to remedy any areas of non-compliance with the Directive.

4.43. In relation to governance, if the undertaking is in breach of the Directive requirements, the supervisor should require the undertaking to remedy this situation in a timely manner. If the supervisor considers that there are improvements in governance that the undertaking could make in line with industry best practice (but the undertaking is not in breach of the Directive) then supervisors should discuss with the undertaking the steps that could be taken to improve their system of governance. Such improvements should consider the principle of proportionality.

4.44. If supervisors have specific concerns in relation to an undertaking they should be able to require that undertaking to carry out specific quantitative or qualitative assessments to act as an early warning indicator to potential issues[13]. The prescribed early warning indicators used should vary according to the external environment and nature of the business, while the types of assessments used should be harmonised as much as possible. In more extreme situations, supervisory powers could be a more intrusive measure such as skilled persons' reports by external experts and other investigative tools (such as visits by appointed specialists).

4.45. If a regulatory solvency level (the MCR or the SCR) is breached, the supervisory actions should vary according to which solvency level is

[13] See answers to CfA 3 in Answers to the European Commission on the 'first wave' of Calls for Advice in the framework of the Solvency II project – Supervisory Review Process (quantitative tools), CEIOPS-DOC-03/05, June 2005.

breached. It is important to note that the undertaking's internal capital needs, as derived from the ORSA, are not a regulatory solvency level. The supervisor should however be notified of such a breach in order to discuss the reasons for such differences with the undertaking concerned. Regarding regulatory solvency levels being breached, a "Supervisory Ladder" could look as follows:

| Level A<br>Own funds ≥ SCR (SCR including any capital add-on[14]) |
|---|
| Monitoring tools used to identify potential issues for discussion with the undertaking. These should be used in a flexible way by supervisory authorities; closer observations of downward trends to the SCR along with use of early warning indicators in order to identify possible 'near misses'. Where necessary, the supervisor may require undertakings to remedy weaknesses or deficiencies identified in the SRP. |
| Level B<br>MCR < Own funds < SCR, or if the undertaking observes a risk of non-compliance in the coming three months (Article 136 of the Framework Directive Proposal) |
| In this situation there is a risk to the financial viability of the undertaking. If an undertaking does not fulfil the SCR, it should re-establish the amount of own funds covering the SCR in due time or reduce its risk profile to reduce the SCR, based on a credible written detailed plan submitted to the supervisor for approval within two months.<br>The intensity of supervisory intervention should vary depending on whether there has only just been a breach of the SCR or whether the undertaking's own funds are just above the MCR.<br>When the undertaking breaches the SCR:<br>1. The undertaking is obliged (as stated in Article 136) to notify the supervisory authority as soon as its own funds have fallen below the SCR level or if the undertaking observes a risk of non-compliance in the coming three months. The undertaking should submit a realistic recovery plan within two months of observation and provide an explanation of how the situation has arisen.<br>2. Meetings would be organised with the administrative or management body and the senior management of the undertaking to outline concerns and discuss remedial actions. External auditors would be expected to be kept informed of the situation by the undertaking.<br>3. The supervisory authority should request the undertaking to take measures to rectify the situation by increasing own funds or adjusting the SCR. Measures that directly address the problem could include:<br>a) Requiring the undertaking to raise additional own funds within six months from the observation – the supervisor may extend that period by three months.<br>b) Limiting the redemption/repurchase of equity instruments; and |

[14] An Issues Paper on Capital add-on is currently being developed by CEIOPS.

setting limitations on dividend payments if it is clear that the undertaking faces a deteriorating financial position.

c) Requiring the undertaking to reduce its risk profile to comply with the SCR within six months (i.e. actions could be taken to adjust its investment portfolio or purchase risk mitigating instruments).

If the solvency of the undertaking deteriorates further towards the MCR, there should be an increase in the level of supervisory activity to enable the supervisor to better assess and control the situation. This could include:

i. Increased supervisory reporting which could require an undertaking to appoint an independent party acceptable to the supervisor to provide a report prescribed by the supervisor.

ii. Requiring the undertaking to extend the scope of internal or external auditors' or consultants' work (at the undertaking's expense), and for the professionals engaged to be required to report directly to the supervisory authority. Further activities could include requiring additional stress-testing and scenario analysis, commissioning independent actuarial reviews, and applying prudential limits and restrictions more rigorously.

iii. Measures to reduce risks including refusing, delaying or imposing conditions on request or applications submitted for regulatory approval, such as acquisitions and redemptions or repurchases of equity; setting restrictions on accepting new business; minimising the investment risks if the undertaking did not do so voluntarily.

Level C ('ultimate actions')

MCR > Own funds (including an absolute floor) or if the undertaking observes a risk of non-compliance in the coming three months

Undertaking's viability is in serious doubt and some restructuring/de-risking is needed. The following actions are presented in order of the degree of the deterioration of the situation.

1. In this case, within one month of observation, the supervisory authority would require the undertaking to present a credible written finance scheme, to restore own funds to at least the level of MCR within three months from that observation (or future observation), or otherwise restructure or prepare for an orderly run-off of existing business. Failing to safeguard the interest of policyholders should lead to the winding-up of the undertaking.

2. During that period, the undertaking should explore options for rehabilitation, restructuring, or compromises with creditors. Supervisors should consider partially or wholly stopping the undertaking from writing new business, and may appoint an independent person to review the accuracy and adequacy of cash outflows other than to policyholders, unless the undertaking or its owners present a credible written plan to the supervisory authority for restoring own funds within three months to the MCR. However, restoring own funds to the level of MCR does not prolong the maximum time for restoring own funds to the level of SCR in Levels A or B.

3. Supervisors should ensure that insolvency proceedings (for example for the withdrawal of the license and dissolution of the undertaking) are commenced. This will depend on the national company or insolvency legislation, but will typically take place where assets are still sufficient to pay policyholders.

## 5. Supervisory Review Process – Information analysis

5.1. This section addresses what supervisors should understand in the course of conducting the SRP. The details set out here are not additional requirements on undertakings but are purely for supervisory use only and will be tailored to each undertaking accordingly.[15]

5.2. Whilst reviewing and analysing the information reported by the undertaking, the supervisor should ensure that the undertaking has complied with the reporting requirements as set out in the Directive.

### A. Business overview and performance

### A.1 Business and external environment

5.3. The supervisor should understand the business the undertaking writes. With this information, the supervisor has the possibility to analyse trends on the main business lines to be aware of the undertaking's main profit areas and the potential risks to them. Adverse changes to the trend could be noted and if appropriate, discussed with the undertaking's senior management.

5.4. It is also important that the supervisor is aware of the jurisdictions in which the undertaking writes its business. This will enable the supervisor to have knowledge of obligations to other supervisory authorities and a greater understanding of the undertaking's customer base.

5.5. Supervisors should be aware of external environment developments that could impact the undertaking. This could be from regulatory or legal changes or market developments.

### A.2 Objectives and strategies

5.6. The supervisor should have an awareness of the strategy that the undertaking has set itself to understand the objectives of the undertaking. This should include the financial and non-financial objectives as well as the undertaking's business continuity plan. This would give the supervisor an idea of possible future developments.

### A.3 Investment Performance

5.7. Supervisors should have knowledge of the undertaking's financial performance from investments. The supervisor should be satisfied with how senior management make investment decisions as well as the key assumptions made with respect to interest rates, exchange rates and market indices. It is important that the supervisor has an idea of profitability and how well the undertaking is managed in this area.

[15] Details on the SRP have been provided in this Issues Paper in the interests of transparency and will be worked on further by CEIOPS to form part of Level 3 measures.

5.8. Supervisors could compare investment performance across undertakings with similar activities (nature, scale and complexity) and risk profiles to be aware of outliers.

### A.4 Performance from underwriting activities

5.9. The supervisor should have knowledge of the underwriting performance by business line and geographical area. The supervisor should be satisfied with how senior management make underwriting decisions and how the performance matches the undertaking's projections. This should help the supervisor's understanding of profitability and how well the undertaking is managed in this area. This will also help supervisors identify outliers and threats to profitability for the undertaking, as well as the market as a whole.

### A.5 Operating / other expenses

5.10. The supervisor should gain an awareness of the undertaking's material expenses and how these compare with previous years. The supervisor should identify fluctuations in expenses and monitor undertakings with a relatively high expense base.

## B. Quantitative requirements

### B.1 Assets, technical provisions and other liabilities

#### B.1.1 Assets

5.11. In relation to assets, the undertaking is required to demonstrate to the supervisor that:

a) Assets are invested in accordance with the 'prudent person' principle (as outlined in Article 130 of the Framework Directive Proposal) in particular that the complexity of the assets underlying the undertaking's portfolio should not exceed the sophistication of the internal processes to understand, monitor and manage these instruments.

b) Assets are appropriately diversified, both by counterparty, type of counterparty and by category, and are proportionate to the capability of the asset management (including any relevant outsourcing contracts).

c) The undertaking has carried out adequate ALM[16] analysis and the assets reflect to an appropriate degree the nature and duration of the liabilities (including effects of options and guarantees). Undertakings

[16] Asset-liability management (ALM) is the practice of managing a business so that decisions and actions taken with respect to assets and liabilities are coordinated. ALM can be defined as the ongoing process of formulating, implementing, monitoring and revising strategies related to assets and liabilities to achieve an organisation's financial objectives, given the organisation's risk tolerances and other constraints. ALM is relevant to, and critical for, the sound management of the finances of any organisation that invests to meet its future cash flow needs and capital requirements (taken from Society of Actuaries' Specialty Guide on ALM (2003)).

should also consider the liquidity of the assets as well as the amount that they expect to receive when assets are liquidated in stressed situations and the time needed to do so.

d) Assets have been valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

e) The documentation provides an adequate understanding of the differences between the valuation for solvency purposes and the accounting basis.

f) The undertaking has (as part of its overall investment strategy) an appropriate written investment and risk-policy, including rules and limits for derivative instruments and structured products of any kind.

### B.1.2 Technical Provisions

5.12. In relation to the calculation of technical provisions, the supervisor should be satisfied that the undertaking has established technical provisions with respect to all of their insurance and reinsurance obligations towards policyholders and beneficiaries of insurance or reinsurance contracts. The supervisor could place reliance on a qualified person, such as a person from the actuarial function, to certify the calculation of the technical provisions.

5.13. The undertaking should demonstrate that:

a) Technical provisions have been calculated in a prudent, reliable and objective manner (as stated in Article 75(4)) and that calculations have made use of and are consistent with information provided by the financial markets and generally available data on insurance and reinsurance technical risks (as stated in Article 75(3)); and the best estimate has been based on current and credible information, realistic assumptions and be performed using adequate actuarial methods and statistical techniques;

b) Adequate consideration has been given to key assumptions (e.g. longevity, mortality, claims development patterns, etc.) driving the level of technical provisions;

c) The documentation provided sets out adequate information and assumptions to allow the supervisor to understand the calculation of technical provisions along with a description of how technical provisions have been calculated;

d) The process of internal review regarding technical provisions has been proportionate to the complexity of the business written; and

e) The documentation provides an adequate understanding of the differences between the valuation for solvency purposes and the accounting basis.

5.14. Where the undertaking has reinsurance cover, it should demonstrate that:

a) gross liabilities are provided for in full;

b) the reinsurance recoverable properly takes into account the nature of the reinsurance;

c) it gives proper consideration to the level and amount of retentions; and

d) it properly understands the full reinsurance agreements, including any side letters.

5.15. The supervisor should maintain a list of key assumptions and methodologies that the undertakings within its jurisdiction have used in calculating their technical provisions (e.g. longevity, mortality, claims development patterns) to compare and contrast with those used by other undertakings with a similar risk profile or who write similar products and identify any outliers. Any outlying assumptions should be followed up with the undertaking to discuss the rationale for using these assumptions or methodologies.

5.16. The supervisor should also be satisfied that any simplifications or approximations used by undertakings in setting their technical provisions (including in the calculation of the risk margin) are appropriate for the scale, nature and complexity of the undertaking's business.

### B.1.3 Other Liabilities

5.17. In relation to other liabilities, supervisors should be satisfied that they understand the methodology used by undertakings to value these liabilities at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction and how these differ from their accounting basis.

5.18. Supervisors should also be satisfied that the appropriate classification between debt and equity has been made.

5.19. Supervisors should be satisfied that they have a clear understanding of any off-balance sheet items including exposures to SPVs and other commitments.

## B.2 Solvency requirements, own funds' structure and management

5.20. The undertaking is required to demonstrate to the supervisor that the MCR and SCR have been calculated in accordance with the Directive requirements. Equally, it should be evident that the undertaking has shown an appreciation of its specific risk profile in assessing its financial condition and overall solvency needs and that this is consistent with internally defined levels of risk appetite. Supervisors could compare own funds levels across undertakings with similar activities (nature, scale and complexity) and risk profiles to be aware of outliers.

5.21. In the calculation of the SCR underwriting risk module, undertakings are permitted (subject to supervisory approval) to replace the parameters in

the standard formula with their own undertaking specific parameters17. When an undertaking chooses to use its own data in the SCR underwriting risk module, as part of the SRP the supervisor should be satisfied that the internal data is complete, accurate, appropriate and relevant for the operations of the undertaking.

5.22. The supervisor should be satisfied that undertakings hold own funds, sufficient in both quantity and quality, to cover their solvency requirements. The undertaking must meet its capital requirements at all times. It should be evident that the capital and solvency[18] assessment processes are performed on a regular basis and form an integral part of the on-going management information reporting cycle.

5.23. The supervisory authority should review the monetary amount (quantity) and the classification in the tiers of own funds, for example, reflecting factors such as the loss-absorbency (quality) of each own fund item. Supervisors should understand the overall balance of the items making up own funds. The relative balance of quality and duration within tiers should be sensible given the nature of the risks. Capital planning should be a forward-looking exercise, for example, how undertakings would be looking to replace own funds approaching maturity or step-up/call dates.

5.24. When approving ancillary own funds, the supervisor can approve both the quantity and the method by which the undertaking can value these ancillary own funds. They can then be used for future periods in which they remain suitable, that is, notwithstanding a material change in the undertaking's business model. This review process should include the approval of any Tier 3 own funds items[19].

5.25. As stated in Article 102(1) of the Framework Directive Proposal, the undertaking is required to monitor the amount of eligible own funds and the SCR on an on-going basis as part of its normal operations. The supervisor should be informed on a timely basis of material changes in the level of eligible own funds, the SCR or the MCR. Material changes could be defined by setting certain solvency early warning indicators (such as, for example, a relative movement by more than *x*%[20] in the level of these metrics from their previously reported level or a movement in absolute terms as specified by the supervisor for a specific undertaking).

5.26. A breach of any of these specific solvency early warning indicators would require the undertaking to notify the fact to the supervisor, including an explanation of circumstances giving rise to the breach.

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[17] CEIOPS will give advice on the details of which parameters are allowed to be replaced within these underwriting risk modules.

[18] A comparison of the capital requirements to available or eligible own funds.

[19] See Article 89(4) of the Framework Directive Proposal.

[20] CEIOPS has deliberately not inserted a numerical value here.

## C. System of Governance[21]

### C.1 General Governance Requirements

5.27. In relation to general governance requirements, the supervisor may find it beneficial to compare the undertaking to other similar undertakings in order to properly contextualise undertakings' submissions.

5.28. The undertaking is required to demonstrate to the supervisor that it has:

a) An effective system of governance which is applied throughout the undertaking, providing for a sound and prudent management of the business and which is subject to regular internal review and challenge process;

b) An organisational structure that is transparent, suitable to the business model and provides a segregation of duties which is appropriate to the nature, scale and complexity of the business;

c) Written policies in relation to at least risk management, internal controls (including controls around IT systems), internal audit and outsourcing which are reviewed at least annually;

d) Governance committees[22] that act in the best interests of the long-run solvency of the undertaking; and

e) The ability to readily identify and resolve problems and issues as appropriate.

5.29. Particular attention should be paid in this review to the governance process around new products, new lines of business, new investment instruments or new functions, for example, as a result of either organisational changes or mergers and acquisitions.

### C.2 Fit and proper requirements

5.30. The supervisor should be satisfied that undertaking has sufficient processes and documented procedures in place to ensure that those persons that effectively run the undertaking, that are responsible for or that have other key functions are fit and proper. The supervisor should understand the system established by the undertaking and be satisfied that the key internal functions consist of persons with the relevant experience and expertise. For example, regarding the actuarial function, the supervisor should be confident in the experience and expertise of those setting the reserving methodologies and constructing underlying models.

5.31. Supervisors should also be satisfied that the undertaking has sufficient processes and documented procedures in place to employ personnel with

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21 An Issues Paper on Governance is currently being developed by CEIOPS and is expected to be published later in 2008.

22 CEIOPS does not intend to define what 'committees' would be needed as given the proportionality principle different undertakings will set up different governance structures according to the nature, scale and complexity of their risks. 'Committees' in this sense encompasses a range of governance oversight functions ranging from risk or audit committees to the undertaking's Board.

the skills knowledge and expertise necessary for the discharge of the responsibilities allocated to them.

## C.3 Outsourcing

5.32. When undertakings outsource critical or important operational functions, the supervisor should be satisfied that appropriate oversight and safeguards are in place as the undertaking remains fully responsible for the outsourced function and cannot discharge itself of its obligations under the Directive.

5.33. The supervisor should review outsourcing arrangements for critical or important operational functions that the undertaking has in place. It may include checking the details of the service provider (e.g. to determine their appropriateness through reputation of being a service provider, outsourcing experience, etc.) to assess the undertaking's review of the adequacy of controls around the outsourced activities. The supervisor should also have the ability to access the data and processes of the service provider(s).

5.34. The supervisor should review the assessment the undertaking has made to satisfy itself that, by outsourcing critical or important operational functions, the undertaking:

a) maintains an appropriate level of policyholder protection;

b) has not materially impaired the quality of its system of governance;

c) has not impaired the ability of the supervisor to monitor the compliance of the undertaking with its obligations; and

d) has fully assessed the impact on its operational risk (which feeds into its ORSA).

## C.4 Internal Audit Function

5.35. The undertaking should demonstrate to the supervisor that, to comply with the Directive, it has an effective and permanent internal audit function in place that is objective and independent from its operational functions.

5.36. The undertaking is required to demonstrate to the supervisor that the internal audit function:

a) has a permanent mandate and is adequately resourced and staffed by competent persons;

b) has full access to an undertaking's records;

c) has an adequate and complete audit universe (that is, addresses each activity and business line, eventually on a periodical basis, by the field of investigation of the internal audit department); and

d) has clear responsibilities and reporting lines to an administrative or management body (such as an audit committee or Board).

5.37. In addition, the undertaking is required to demonstrate to the supervisor that the internal audit function assists the undertaking by providing:

a) an understanding of the adequacy and effectiveness of internal control within the organisation;

b) evidence of action taken or recommendations made to improve the control framework and manage risk;

c) evidence of following up on relevant issues identified within the undertaking; and

d) relevant information to the undertaking's administrative or management body allowing suitable decisions and recommendations to be made given the findings from the internal audit functions' work.

## C.5 Actuarial Function

5.38. The supervisor should be satisfied that within the undertaking there is a permanent and effective actuarial function that is staffed with persons of appropriate experience and expertise for the role that the actuarial function is required to perform. In addition, the supervisor should check that the actuarial function has undertaken the following tasks and fulfilled the following requirements:

a) coordinated and overseen the calculation of technical provisions;

b) agreed, or disagreed, with the appropriateness of the methodologies, assumptions and underlying models used in the calculation of technical provisions;

c) reported to the administrative or management body that the calculation of technical provisions is reliable and adequate;

d) is sufficiently independent, for example to be able to form its own view of technical provisions;

e) is satisfied, or otherwise, with the overall underwriting policy and reinsurance arrangements; and

f) has appropriate involvement in the risk management system (e.g. in risk modeling and providing the link between risk and capital management).

## C.6 Internal Control System

5.39. The undertaking is required to demonstrate to the supervisor that it has an effective internal control system in place. The internal control system should be appropriate to the nature, scale and complexity of the undertaking's business.

5.40. The undertaking should ensure that the internal control system includes at least administrative and accounting procedures, data handling, an internal control framework, an appropriate remuneration policy that supports long-term strategies, appropriate reporting arrangements and a compliance function.

5.41. The compliance function should have the necessary authority, resources, expertise and access to all relevant information. To ensure its independence, the relevant persons involved in the compliance function should not be involved in the performance of services or activities they monitor. The compliance function should advise the administrative or

management body on any changes in the legal environment that the undertaking operates in.

## C.7 Risk management system

5.42. The undertaking is required to demonstrate to the supervisor that it has a robust risk management[23] system which is:

a) Capable of identifying, monitoring, and mitigating both current and future risks (like possible changes in economic conditions) in line with its set risk tolerance/risk appetite. Stress testing and scenario analysis could be used to determine the effect of these risks materialising under extreme but still plausible conditions. Supervisors should assess whether this process is adequate and delivers a prudent picture of the risk profile of the undertaking.

b) An integral part of the business strategy and the undertaking's management information.

c) Subject to regular internal review and challenge of the risk analysis. The review by the administrative or management body should generate a continuous feedback loop within the undertaking (both at group and solo level).

d) Proportionate to the nature, scale and complexity of its business and therefore fit for purpose.

5.43. The supervisor should compare the results of this review to its expectations for a risk management system and also to the results of reviews from other similar undertakings.

5.44. Given the ORSA is included within the risk management system, the supervisor should review the processes that the undertaking employs to manage its own funds and should assess whether these processes are appropriate. Comparisons to other undertakings should be useful taking into account the nature, scale and complexity of the risks inherent in the business.

5.45. Regarding risk exposure, concentration, mitigation and sensitivity, the undertaking is required to inform the supervisor of:

a) material risks (current or those that may be faced in the long term) and their potential effects in order to provide the supervisor with a view across the industry of the major threats to the undertakings in its jurisdiction; and

b) any perceived emerging threats to the undertaking's solvency position, including details of a deteriorating solvency position (which should be analysed and notified to the administrative or management body with, where possible, future management actions to safeguard the solvency position of the undertaking).

5.46. The supervisor could be proactive in monitoring these threats across the industry and having discussions with the undertakings potentially

[23] This may be more widely understood by supervisors and the industry as 'Enterprise Risk Management (ERM)' referring to the process of integrating risk and capital management through the ORSA. Please refer to the IAIS' "Guidance Paper on enterprise risk management for capital adequacy and solvency purposes" published in October 2007.

affected. This could be undertaken by carrying out industry surveys. Undertakings that have not identified material risks noted by their peers should be engaged in discussions to determine what considerations they have given to these areas. This process could lead to a closer supervisory approach if it was deemed that the undertaking has not identified a material risk to its solvency. This information should, subject to any issues over confidentiality/information sharing, be usefully shared across jurisdictions and used within the SRP.

**Own Risk and Solvency Assessment**[24]

5.47. As part of the SRP the undertaking is required to demonstrate to the supervisor, through the documentation of its ORSA process and the outcome thereof, that:

a) the undertaking has considered its overall solvency needs (i.e., the assets necessary to cover the liabilities including the technical provisions, the regulatory capital requirements – SCR and MCR – as well as the internal capital needs) over a suitable business planning time horizon;

b) the material risks the undertaking is currently exposed to, or may face in the long term, have been considered and quantified, and included in the analysis of its overall solvency needs;

c) comparisons have been made between the quantitative (SCR) analyses undertaken and the undertaking's overall risk profile and solvency needs;

d) risk management is closely integrated with capital management and that the risk and capital management policies are clear in how this interaction should take place; and

e) the supervisor should be satisfied that the undertaking anticipates meeting its regulatory own funds requirements (SCR/MCR) over an appropriate time horizon (i.e. consistent with its business plan and solvency requirements) and the supervisor would expect the undertaking to demonstrate an appreciation of any anticipated issues which have the potential to affect its solvency position.

5.48. Capital and risk management should be compared between undertakings of a similar nature or size by the supervisor to identify undertakings whose capital and risk management processes could be considered appropriate.

[24] CEIOPS published an Issues Paper for consultation on the Own Risk and Solvency Assessment in May 2008.

## 6. Undertakings' Reporting Requirements

### General principles on reporting

6.1. The Framework Directive Proposal states that the EC shall adopt implementing measures specifying the information to be provided for supervisory purposes with a view to ensuring convergence of supervisory reporting to an appropriate extent. The goal should be an adequately high level of harmonisation of contents and formats for supervisory reporting and public disclosure. There will be both narrative information and quantitative standardised reporting forms. As stated in CEIOPS' Issues Paper 'Policy on harmonisation of contents and formats for public disclosure and supervisory reporting'[25], "*As far as possible, the means of submission, frequency of reporting and submission times should be harmonised, nevertheless providing a flexible structure to allow for local specificities and future changes.*"

6.2. As stated in CEIOPS' Advice on the Principle of Proportionality'[26], the proportionality principle shall be applied to the utmost extent possible. The information to be reported and disclosed should reflect the nature, scale and complexity of the risks inherent to the business of the undertaking. This principle shall also be applied to the SRP framework.

6.3. This section does not at this stage attempt to define what would be publicly reported in the SFCR and what would be privately reported in the RTS (noting that the Framework Directive Proposal has already specified at a high-level some information that is required to be publicly disclosed (see Article 50)). CEIOPS intends to address this issue when the full reporting requirements have been established. It then will take into account the parameters for public disclosure as defined in the policy paper on Supervisory Reporting and Public Disclosure.

6.4. In order to ensure a coherent and structured approach to the design of the contents and formats, a framework of principles should be adopted, establishing a logical and purposeful discipline on that design, so that all information is 'fit for purpose'. This will include a clear idea of what information is needed:

a) to perform the future SRP; and

b) to foster transparency through market discipline.

6.5. The reporting framework should be based on best-practice considerations, rather than by aggregation of differing national requirements.

6.6. The development of the reporting system should be harmonised as far as possible to promote the facilitation of the supervisory review process – it should foster the dialogue and understanding between supervisors, facilitating the cooperation and exchange of information between supervisors of entities within a cross-border group.

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[25] Policy Paper published by CEIOPS in November 2007 (CEIOPS-IGSRR-05/07).
[26] Consultation Paper published by CEIOPS in February 2008 (CEIOPS-CP-01/08).

6.7. The requirements should avoid duplications and make optimal use of the information developed by undertakings for internal management purposes[27].

This should lead to:

a) more accurate and reliable information; and

b) a reduction of the cost for the undertakings in meeting the reporting requirements.

6.8. Local specificities may require details that are available only on a national basis (e.g. formats for the reconciliation of local GAAP with Solvency II valuation rules, consumer protection information, etc). Local specificities should be justified by the characteristics of local business or risks and not by substantial differences in the supervisory review process.

6.9. Reporting requirements should be suitable and necessary to achieve their objective as well as being appropriate. Each reporting requirement is necessary only if there is no less onerous method available that is equally or even better suited to serve the Directive's disclosure objectives. Appropriateness requires that the drawbacks of a measure are not totally disproportionate to the benefits gained. It is the intention of this paper that all requirements be both necessary and appropriate.

6.10. With regard to narrative information supervisors should expect considerable differences between undertakings depending on the business insurers write and the methods and approaches they apply. Undertakings that use different or more sophisticated methods and approaches, as well as undertakings that are innovative or face sizable risks, can expect to have a correspondingly increased need for documentation for submission to the supervisor on demand, or increased reporting requirements. More complexity, deviation from the 'norm' and bigger risk-taking generally require more explanations for supervisors and may therefore influence the volume of documentation or reporting. The challenge will be in setting the documentation and reporting requirements at an appropriate level, but where possible, in the interests of standardising reporting requirements, narrative information reported on predefined periods is likely to be limited.

6.11. Frequency and extent of the supervisory reporting of different aspects of the business is also an area where the principle of proportionality may be applied.

6.12. Standardised quantitative information should be submitted annually, while narrative information should be submitted as required by the intensity of the SRP. On an annual basis (alongside the SFCR and quantitative information), undertakings will also be required to submit material changes to the narrative information or, if it is the case, report that no material changes have occurred. If no material changes have been reported for a number of years, supervisors may consider it appropriate to request the complete set of narrative information.[28]

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[27] This does not mean that all management information should be reported to supervisors.

[28] Narrative information can also be required upon occurrence of predefined events or during supervisory enquiries.

6.13. Supervisors shall take account of relevant historic, current and forward-looking information. The reporting framework must allow the supervisor to take timely action when action is needed, e.g. to request additional information, perform on-site inspection, exchange information or take action.

6.14. Information should:

a) be relevant, reliable and comprehensible;

b) reflect the nature, scale and complexity of the business of the undertaking concerned; and

c) be accessible, complete in all material respects, comparable and consistent over time.

6.15. The reporting framework leaves the onus on the undertaking to identify, manage and communicate on-going solvency, financial and operational positions to the supervisor. The reporting requirements are envisaged to consist of a public SFCR and a private RTS with both quantitative and narrative reporting requirements.

6.16. Undertakings would be required to inform the supervisors in a timely manner (i.e. as soon as possible but no longer than a period of two weeks since the event causing the change) of developments that have had a material affect on the undertaking's solvency or financial condition. Fuller detail should be required either in the periodically reported information or as requested by the supervisor.

6.17. Material changes are those that the undertaking considers are significant to the business and would therefore assist the supervisor in understanding the way that the business is run and managed. Such material changes could include:

a) new business lines to be written;

b) changes in persons who run key functions;

c) internal organisational restructure;

d) lawsuits being bought against the undertaking;

e) changes in business strategy;

f) changes in own funds levels;

g) new emerging risks;

h) emergence of new future claims (previously not included in the last reported technical provisions);

i) governance failures; and

j) with-profit bonus distribution.

6.18. Article 35(2)a) of the Framework Directive Proposal also contemplates that there might be rules in this area at some point stating that undertakings need to submit relevant information to the supervisor following predefined events, at predefined periods or during enquiries.[29]

[29] CEIOPS will look at developing these areas at a later date but would welcome suggestions from stakeholders.

6.19. Early warning indicators allow supervisors to react before any capital requirement or own solvency needs are breached. Therefore, where possible a link should be made between the early warning indicators and the reporting requirements. An early warning system can also be the foundation for a risk-based and flexible reporting system. Based on an analysis of the undertaking's risk profile and other supervisory judgement, the supervisor can decide that an undertaking only has to report a main set of information items, including important indicators. When these indicators give cause for concern, more detailed information can be required.

6.20. The reporting framework should be sensitive to who needs what information, when, and why. While the reporting framework may envisage a pre-defined set of information and pre-defined early warning indicators for requiring additional information in the interests of a streamlined reporting and review process, supervisors should be able to request additional information when circumstances require this.

6.21. Certified information is deemed more reliable than uncertified information, although careful thought needs to be given to which information needs to be certified and which type of assurance needs to be given.

6.22. Illustrative details of envisaged reporting requirements are contained within Annex 1, while specimen data for standardised reporting forms is contained within Annex 2. Annex 2 should not be viewed as being exhaustive.

CEIOPS is considering the requirements that should be placed on undertakings before information can be reported. Feedback from stakeholders is therefore welcome to help determine the proportionate safeguards that should be in place to ensure that information is accurate and that the correct persons are accountable for it within an undertaking.

Examples of safeguards might be a requirement for:

- sign-off by external audit on some/all of the information (including systems of governance);
- sign-off by the actuarial function;
- sign-off by internal audit; or
- sign-off by the Board.

Consideration should be given to the scope of such sign-offs.

## Annex 1

### Reporting Template

I. It is envisaged that the reported information will include both quantitative and narrative requirements[30]. Standardised reporting forms will be developed for each of the quantitative requirements outlined below to facilitate review and comparability by supervisors.

II. This template sets out a preliminary list of items that could be reported. The undertakings should first report the forward looking information on its business overview and performance; then the quantitative requirements such as the MCR, the SCR and technical provisions; and finally details on its system of governance requirements.

III. The list is not exhaustive and if undertakings consider that additional information would be important to assist in the understanding their business then this could be provided.

[30] It is recognised that some quantitative information may be required to support the narrative elements of supervisory reporting and public disclosure. The quantitative information listed below should be developed into standardised reporting templates.

**Reporting Template**

**A. Business overview and performance**

A.1 Business and external environment
A.2 Objectives and strategies
A.3 Investment performance
A.4 Performance from underwriting activities
A.5 Operating/other expenses

**B. Quantitative requirements**

B.1 Assets, technical provisions and other liabilities – nature of an undertaking's valuation techniques for asset, other liabilities and how it has set it technical provisions.
- B.1.1 Assets (including investments)
- B.1.2 Technical provisions
- B.1.3 Other liabilities

B.2 Solvency capital management – nature of an undertakings' capital management processes along with its capital requirements and capital resources.
- B.2.1 Managing capital
- B.2.2 Own funds
- B.2.3 Regulatory capital requirements
- B.2.4 Standard formula vs. internal model

**C. System of Governance**

C.1 General governance requirements
C.2 Fit and proper
C.3 Outsourcing
C.4 Internal audit
C.5 Actuarial function
C.6 Internal controls (including compliance function)
C.7 Risk management (including capital management)
- C.7.1 Material risk exposures
- C.7.2 Material risk concentrations
- C.7.3 Risk mitigation
- C.7.4 Individual risk information
- C.7.5 Risk sensitivities
- C.7.6 Details on the ORSA
  - C.7.6.1 Quantitative requirements
  - C.7.6.2 Narrative analysis

## A. Business overview and performance

The undertaking should provide a description of its business and the performance from its income statement including the following:

### A.1 Business and external environment

A description should be provided setting out the nature of the undertakings' business and external environment which could include:

*Narrative information*

a) The undertaking's main business lines and which jurisdictions it writes those business lines in (specifically highlighting any changes over the year).

b) The main trends and factors that have contributed positively or negatively to the development, performance and position of the undertaking over the last five years and/or are expected to contribute to it in the future (over its business planning time horizon).

c) The undertaking's perceived competitive position and its business model (examples are the undertaking's approach for acquiring new business, dealing and settling claims, outsourcing etc).

d) Significant features of any potential regulatory and legal issues affecting the business.

e) Recent important market developments that have or are expected to affect its business.

### A.2 Objectives and strategies

A description should be provided detailing the objectives and strategies of the undertaking which could include:

*Narrative information*

a) Information on the financial and non-financial objectives of the undertaking and a summary of the strategies in place to achieve them (including the expected timeframes involved).

b) An explanation of the significant changes in the undertaking's strategy compared to prior years.

### A.3 Investment performance

A description should be provided detailing the undertaking's financial performance from investments which could include:

*Narrative information*

a) Management’s discussion and analysis of investment performance by segment.

b) Information on returns on investments and, where relevant, components of such returns on appropriate subsets of an undertaking’s investments (e.g. investments belonging to the undertaking’s life insurance business, investments by statutory or notionally segregated portfolios, investments in assets backing a group of investment-linked contracts, investments grouped in the same asset class).

c) Information showing gains and losses recognized directly in equity (i.e. "other comprehensive income" according to the terminology in IAS1 amended September 2007, not yet adopted by the EU).

d) Information about transactions with shareholders, distribution to shareholders and profit-sharing with policyholders.

e) The impact of amortisation and impairment of intangible/tangible assets on investment performance.

f) Details on investment expenses occurred over the year compared to prior and future years.

g) Key assumptions the undertaking is making with respect to interest rates, exchange rates, and market indices.

*Quantitative information – standardised reporting form*

a) Quantitative information from the income statement of the undertaking from investment activities detailing material sources, and amounts, of income and expenses on different categories of investments (to include a reconciliation of any differences to its accounting bases).

b) Changes in values, both over the accounting period and since an asset was acquired, and total interest income and total interest expense income, both received and accrued.

c) Levels of with-profits (i.e. discretionary) bonus payouts

### A.4 Performance from underwriting activities

A description should be provided detailing the undertaking's underwriting performance reported by material business line[31] and geographical area which could include:

*Narrative information*

a) Management's discussion and analysis of the undertaking's overall underwriting performance along with an analysis by line of business.

b) Details of the undertaking's underwriting performance against plan and significant factors affecting deviations from plan (e.g. large unexpected claims, premium volumes).

c) Projections of the undertaking's underwriting performance over their business planning period with details of significant factors affecting their performance.

d) Details on underwriting expenses occurred over the year compared to prior and future years including assessment of claims leakage and policyholder fraud.

*Quantitative information – standardised reporting form*

Specifically, for non-life undertakings:

a) The amount of premiums, claims and underwriting expenses by line of business for the year both gross and net.

[31] There are a number of different ways in which a business line could be classed as 'material'; the definition used should be appropriate to the nature, scale and complexity of the business and its size relative to the market. This should be decided on by the undertaking in the first instance but supervisors can override such a decision.

b) Details of any reinsurance programmes purchased including those currently not being claimed on.

c) For undertakings that write multi-year contracts, information on that part of the premium provisions that relates to policies more than one year old.

d) Claims incurred in the year should be analysed between claims incurred on existing contracts and claims incurred on contracts written in the year.

e) Claims incurred should be analysed between claims incurred in the year and movements on prior year claims.

f) The unwinding of the discount and changes in provisions arising from changes in risk-free rates should be included.

Specifically, for life undertakings:

a) Annual Premium Equivalent (APE) – split between single and regular premium.

b) Analysis of the surplus on a standardised basis that compares experience with prior expectations and identifies the effect of changes in valuation assumptions.

### A.5 Operating/other expenses

A description should be provided detailing the undertaking's material expenses incurred including:

*Narrative information*

a) Expenses split by material expense type and/or function (e.g. salaries, tax, dividends); and

b) Comparison of expense levels compared to prior and future years with explanation of material changes.

*Quantitative* information – *standardised reporting form*

a) The amount of expenses incurred by material type/line of business.

## B. Quantitative requirements

### B.1 Assets, technical provisions and other liabilities

The undertaking should provide information on its solvency balance sheet within this section.

#### B.1.1 Assets (including investments)

The undertaking should provide information on assets held and that assets have been invested in accordance with the 'prudent person' principle (as outlined in the Framework Directive Proposal) namely that the complexity of the assets underlying the undertaking's portfolio should not exceed the sophistication of the internal processes used to understand, monitor and manage these instruments. In addition the undertaking could provide information including:

*Narrative information*

a) The basis, methods and assumptions used for valuing assets including any differences with the accounting valuation basis used by the undertaking.

b) Where asset types along with investment objectives, policies and management differ significantly between parts of the undertaking, separate disclosures should be provided for each of these parts.

c) A description of any consideration through ALM that the assets held match, to an appropriate degree, the insurance products written, including for example the nature of the expected claims, any discretionary element of the undertaking's liabilities, the contingent nature of embedded policyholder options and guarantees and the sensitivity of the liabilities to any changes in the external environment. The undertaking should also detail how its assets are invested in the best interests of the policyholder.

d) How the undertaking ensures the security, quality, liquidity and profitability of the assets it invests in.

e) An overview of any derivative instruments used in the reduction of risk or facilitating efficient portfolio management.

f) An overview of any assets, such as structured products, that are not regularly traded on a financial market.

g) An overview of investment concentrations by asset type, counterparty, geography etc.

*Quantitative information – standardised reporting form*

Solvency balance sheet information on assets which could include:

a) the amount of different categories of assets held by the undertaking (e.g. segmentation of the investment portfolio according to well-defined investment categories), and exposures to counterparties and types of counterparties; and

b) mark-to-market changes in asset values

c) a reconciliation of differences in the solvency valuation basis of assets to their accounting basis.

B.1.2 Technical provisions

The undertaking should provide information on technical provisions held which could include:

*Narrative information*

a) Relevant information on the determination of the technical provisions with key assumptions and methodologies used in measuring insurance liabilities and in the development of financial information (e.g. relevant information on discount rates, expenses, future margins, mortality and disability rates, taxation assumptions, participation features, guarantees and options, management actions, policyholder behaviour, the rates of inflation, mismatching provisions, claims development patterns etc) to enable the user to understand how the amount of technical provisions was established.

b) If undertakings have used any simplifications, compared to the recommended full CEIOPS specification, in calculating their technical provisions (including deriving their risk margin), these should be detailed along with the justification of why they consider that these simplifications are appropriate.

c) An indication of the level of uncertainty associated with the level of technical provisions to allow the users to judge whether estimates are likely to fall within a wider or a narrower range including details of any sensitivity testing undertaken on key assumptions, the potential variability of any material future outstanding claims.

d) An overview of any material changes in the level of technical provisions since the last reporting period including, for example, an explanation of any changes in the key assumptions used to set technical provisions (on a gross and net basis) with details of the impact of these changes along with a justification which could be supported by recent experience. In addition the undertaking would be expected to highlight changes in the development patterns of existing claims, new material claims that have emerged over the year, those settled during the year, material changes in lapse rates or expected investment performance, increase in new business etc.

e) The impact of reinsurance in the assessment of technical provisions, together with any additional provisions to reflect the credit exposure to reinsurance undertakings.

f) Any material differences between the accounting valuation basis used by the undertaking and their solvency valuation.

*Quantitative information – standardised reporting form*

a) Solvency balance sheet information setting out the amount of technical provisions (separated between the best estimate and the risk margin).

b) Solvency balance sheet information on the segmentation of technical provisions according to homogeneous risk group / line of business and by category (e.g. provisions for premiums, provisions for claims, expenses that will be incurred in servicing (re)insurance obligations, guaranteed and discretionary benefits) by the best estimate and the risk margin.

c) Solvency balance sheet information on the amount of technical provisions both gross and net of reinsurance (including the calculation of an allowance for reinsurance defaults) according to homogeneous risk group / line of business).

d) Solvency balance sheet information statement of quantitative changes in the technical provisions (on a gross and net basis) since the last reporting date.

e) Reconciliation of material differences in the solvency valuation basis of the undertaking's technical provisions to its accounting basis.

f) Specifically for non-life undertakings, historical patterns of claims development ('triangulations') on either an accident year or underwriting year basis for material lines of business. The disclosure about claims development shall go back as appropriate to the nature of the tail, or a minimum of 10 years, which ever is greater and include details on reserve releases.

g) Details of run off triangles for annuity reserving.

h) Specifically for life undertakings, the effect of management actions and policyholder behaviour should be disclosed according to homogeneous risk group / line of business.

i) Key valuation principles used in setting technical provisions (e.g. mortality, discount and lapse rates).

B.1.3 Other liabilities

The undertaking should provide information on material other liabilities held which could include:

*Narrative information*

a) An undertaking should provide narrative information on the basis and assumptions upon which other liabilities are valued (measured) including material differences to their accounting basis.

b) An undertaking should explain it has dealt with any debt versus equity issues.

*Quantitative information – standardised reporting form*

a) An undertaking should provide balance sheet information detailing the nature and value of other liabilities (non-insurance).

b) An undertaking should provide a reconciliation of material differences in the solvency valuation basis of their liabilities to their accounting basis.

c) An undertaking should also provide details of off-balance sheet items such as exposures to SPVs, and other commitments.

## B.2 Solvency capital management

The undertaking should provide a description of methods it employs to manage capital, the level of capital that it holds, and its solvency requirements including:

B.2.1 Own funds

Undertakings should provide information on the structure and amount of own funds, their quality and information on its objectives, policies and processes for managing its own funds which could include:

*Narrative information*

a) Details on the methods employed by the undertaking to manage its own funds;

b) Details on its own funds structure including terms and conditions of the main features of own fund items held by the undertaking including summary information on the loss-absorption capacity of that item.

c) An analysis of significant movements in own funds over the period being reported on. This commentary would be expected to be more extensive if the movements in capital requirements or own funds signalled a deterioration in the undertaking's solvency position. This should not be a particular issue for undertakings as they are required[32] to have

[32] See Article 134 of the Framework Directive Proposal

procedures in place to identify deteriorating financial conditions and alert supervisors when these occur.

d) Details of any other financing/support facilities (such as agreed borrowing drawdown facilities) or additional committed lines of credit that can be called upon to meet claims.

e) Details on the forecast level of the undertaking's own funds over a suitable business planning period including plans to replace any own funds approaching maturity or plans to raise own funds.

f) Any material differences between the accounting valuation basis used by the undertaking and its solvency valuation.

g) The amount of own funds, by tier, covering the MCR and the SCR (for the MCR this should be reported quarterly).

h) Details on own funds transferability within the undertaking (and group) highlighting restrictions on own funds where appropriate (e.g. pledged as collateral or held in a participating fund).

*Quantitative information – standardised reporting form*

a) The level of own funds within the undertaking split by component (e.g. tier and type) – reported quarterly for own funds backing the MCR.

b) The level of deductions made from own funds and the tier from which the deduction is made.

c) A reconciliation (if relevant) of the material difference between an undertaking's regulatory (eligible) own funds and own funds reported in financial statements.

d) Own funds projections forecast over the planning time horizon.

B.2.2 Regulatory capital requirements

Undertakings should provide information on the amount of the MCR and the SCR which could include[33]:

*Narrative information*

a) Narrative on the results of the calculation of its MCR and SCR using the standard formula or an internal model[34] (if approved) by risk module and, for public disclosure, whether this is still subject to supervisory assessment.

b) Information on any non-compliance with the MCR and the SCR during the reporting period with explanations of its origins, consequences and remedial actions taken.

c) If undertakings have used entity specific parameters in the SCR underwriting risk module, then these should be explicitly provided (compared to the standard parameters) along with justification of why the undertaking considers that these are complete, accurate, appropriate as well as directly relevant for the operations of the undertaking.

[33] The supervisor should immediately be informed of any breach of the SCR and the MCR.

[34] Per Article 110(7) the SCR standard formula is only required to be provided for a period of two years following internal model approval.

d) Details of any capital add-ons applied to the SCR together with information on its justification from the supervisory authority concerned.

e) The reasons for any material changes in the level of MCR and SCR.

*Quantitative information – standardised reporting form*

a) The result of the calculation of its MCR (quarterly) and SCR using the standard formula or an internal model (if approved) by risk module.

b) Overall comparison of technical provisions, the MCR and the SCR compared to own funds over a suitable business planning period.

c) Details of any capital add-on applied to the SCR[35].

B.2.3 Standard formula vs. internal model

Undertakings should provide information to allow a proper understanding of the main differences between the standard formula and an internal model used to derive the SCR (for a period of two years following internal model approval to supervisors[36]) which could include:

*Narrative information*

a) reconciliation by risk module between the two different bases explaining qualitative material differences in assumptions (for two years following internal model approval); and

b) justification of differing key assumptions from the standard formula (for two years following internal model approval).

*Quantitative information – standardised reporting form*

a) Comparison by risk module between the results of the standard formula and internal model.

## C. System of Governance

### C.1 General governance requirements

Details on the undertaking's governance structure to facilitate understanding of its business which could include:

*Narrative information*

a) Any material changes in the governance structure that have taken place during the year;

b) An assessment of the adequacy of its system of governance for the undertaking's risk profile;

c) The structure of the administrative or management body, providing a description of their main roles and responsibilities;

d) If the undertaking is integrated in a group or conglomerate, a high-level description regarding the corporate structure of that group; and

[35] Noting that according to Article 50(2) the capital add-on need not be separately publicly disclosed during a transitional period not exceeding 5 years after Solvency 2 comes into force.

[36] See Article 110 (7) of the Framework Directive Proposal.

e) Where relevant committees exist (e.g. compensation committee, audit committee, risk management committee), a brief description of their responsibilities.

## C.2 Fit and proper

*Narrative information*

An undertaking should provide details of process and procedures it has established to ensure that it is satisfied that those persons that effectively run the undertaking or that have other key functions are fit and proper.
For those persons that effectively run the undertaking this should include all information needed to assess the fitness and propriety of these persons.

An undertaking should notify the supervisory authority of any changes to the identity of the persons who effectively run the undertaking or are responsible for other key functions, along with all information needed to assess whether any new persons appointed to manage the undertaking are fit and proper.

An undertaking should provide details of the processes and procedures in place to employ personnel with the skills knowledge and expertise necessary for the discharge of the responsibilities allocated to them.

## C.3 Outsourcing

*Narrative information*

An undertaking should provide details of the outsourcing of any critical or important operational functions and activities (along with the service provider) and safeguards around the outsourcing arrangement that the undertaking has put in place. These details should include:

a) Evidence that appropriate oversight and safeguards are in place (as the undertaking remains fully responsible for the outsourced function and discharging all of its obligations under the Directive).

b) How the undertaking has considered the outsourcing arrangement as part of its business continuity plans.

c) Details of the service provider and how the supervisor has satisfied itself that the service provider is competent to provide the undertaking with the services to be outsourced.

d) How outsourcing the function has not materially impaired the quality of the undertakings system of governance.

e) How the undertaking has fully assessed the impact on its operational risk (through its ORSA).

f) How an appropriate level of policyholder protection is maintained.

If an undertaking is planning to enter into an outsourcing arrangement it should provide evidence of these considerations in advance to the supervisor.

## C.4 Internal audit

*Narrative information*

An undertaking should provide details of:

a) how the internal audit function operates including how the internal audit function provides assurance on the adequacy and effectiveness of and the internal controls within the undertaking;

b) how the undertaking is satisfied that the internal audit function maintains its independence from the activities it reviews

c) how the internal audit examines compliance of the activities of the undertaking with its internal strategies as dictated by the administrative or management body, undertaking-wide processes that have been established and internal and external reporting procedures;

d) evidence of any action taken to improve the control framework and mitigate risk from internal audit work;

e) summary of audits performed during the period and its plan for future periods (with rationale for those future audits);

f) evidence of key risk exposures and any management response;

g) an overview of the findings reported to the administrative or management body and their use of internal audit and audit reports (i.e. actions taken or recommendations made).

## C.5 Actuarial function

*Narrative information*

An undertaking should provide details of the actuarial function including the personnel in the actuarial function and their experience and expertise. The undertaking should also outline the areas of responsibility that the actuarial function has and the areas of work it is involved in, including:

a) the coordination and oversight of the calculation of technical provisions and any internal opinions provided to the administrative or management body on the reliability and adequacy of the calculation;

b) how the actuarial function is independent from the finance function for example to be able to form its own view of technical provisions;

c) the overall underwriting policy and reinsurance arrangements; and

d) the risk management system (especially in risk modeling and providing the link between risk and capital management).

## C.6 Internal controls

*Narrative information*

An undertaking should provide details on its internal controls system and describe why it considers this system appropriate to the nature, scale and complexity of its business. These disclosures should include details on:

a) The administrative and accounting procedures in place within the undertaking that enable it to deliver in a timely manner to the supervisor

financial reports which reflect a true and fair view of its financial position and which comply with all applicable accounting standards.

b) The internal controls framework in place, clear delegation of responsibilities, reporting lines and segregation of duties, and how it fulfils its obligations with respect to the adequacy, access, period of retention and security of records.

c) The appropriate reporting arrangements in place to provide its administrative or management body with the information it needs to play its part in identifying, measuring, managing and controlling risks of regulatory concern (i.e. policyholder protection) in a relevant, reliable and timely manner.

It is the responsibility of the undertaking to decide what information is required, when, and for whom, so that it can organise and control its activities and can comply with its regulatory obligations. The detail and extent of information required will depend on the nature, scale and complexity of the business.

The disclosures should also include details on the permanent compliance function and how it:

a) has the necessary authority, resources, expertise and access to all relevant information;

b) has the relevant persons involved in the compliance functions, who should not be involved in the performance of services or activities they monitor; and

c) advises the administrative or management body on compliance with the laws, regulations and administrative provisions adopted pursuant to the Directive along with any changes in the legal environment that the undertaking operates in.

## C.7 Risk management

*Narrative information*

An undertaking should provide details on its system of governance including the risk and capital management objectives and policies of the undertaking for each separate module of risk. In addition to the below qualitative information, the undertaking will also have to report quantitative information. This should be captured in the standardised reporting forms.

The qualitative disclosures could include:

a) The scope and nature of risk and capital measurement systems, including a description of measurement tools (e.g. risk maps and capital plans) used to measure and assess the risks within the undertaking.

b) High-level details on the scope, frequency and requirements of the management information presented to the undertaking's administrative or management body and evidence of key decisions made based on this information.

c) The structure and organisation of the relevant risk and capital management systems or other appropriate arrangements and other functions in the undertaking, such as internal audit, actuarial department etc.

d) Details of the staffing and organisational structure of those responsible for the risk management system.

e) How the undertaking has integrated its internal model into its overall risk management strategy.

f) For risks which are not so readily quantifiable, such as liquidity risk and operational risk, qualitative measures in the context of internal systems and controls and governance.

g) For liquidity risks, details of the undertaking's analysis in this area including the potential effects of liquidating assets in stressed situations or calling on sources of liquidity if required.

h) A description on the following separately for each module of risk (including any limitations in its analysis).

C.7.1 Material risk exposures

*Narrative information*

An undertaking should provide details on its material risk exposures which could include:

a) Details on the nature of the material risk exposures on the undertaking, how these have developed over the past few years and how management expects them to change over the next few years (including the process for identifying emerging risks).

b) A description of the products and investments that the undertaking manages that give rise to the most material risks, paying particular regard to derivative instruments and structured products.

c) Details of the risk appetite/limits imposed by the undertaking in relation to its overall business objectives (e.g. chosen lines of business/products) setting out the level of risk to which the undertaking is willing and is financially able to be exposed to for each risk module and how these tolerance are enforced throughout the business. This analysis should take into account its financial strength and the nature, scale and complexity of its risks, the liquidity and transferability of own funds, and the resources it needs to adequately manage its risks.

d) Where an undertaking-wide risk management system is being used, an undertaking should provide narrative information about such a system[37].

e) Information about, and changes to, its management of asset-liability matching including details on the appropriateness of its investments in matching its liabilities, its ability to realise its investments quickly if necessary without substantial loss in value, and the sensitivities of these investments to fluctuations in key types of market variables such as interest rate, exchange rate, equity price indices and credit risks.

[37] This may be more widely understood by supervisors and the industry as 'enterprise risk management' referring to the process of integrating risk and capital management process through the ORSA. Please refer to the IAIS' Guidance Paper published in October 2007.

C.7.2 Material risk concentrations

*Narrative information*

An undertaking should provide details on its material risk concentrations which could include:

a) Description of the kinds of risk concentrations to which the undertaking is exposed and how significant these are both by type of risk and concentrations (e.g. by type of insured event with a reinsurance undertaking, number of undertakings it engages with for reinsurance, geographical area, currency, top asset concentration ratios, top premium concentration ratios, largest reinsurance undertakings in aggregate).[38]

b) A description of the methods used and assumptions made in arriving at the quantitative data on concentrations and a description of how management determines concentrations.

c) Information on concentration of insurance risk including details of concentration exposures (e.g. group life risks – sum assured for largest schemes, probable maximum losses/expected maximum loss information for non-life undertakings).

C.7.3 Risk mitigation

*Narrative information*

An undertaking should provide details on its risk mitigation practices, not only in terms of the business that they write but also any risk mitigating tools purchased or used (e.g. reinsurance, financial instruments) which could include:

a) Undertakings should detail their strategies and methodologies for mitigating risk, and the processes for monitoring the continuing effectiveness of these risk mitigation strategies (e.g. that risk mitigation instruments are annually reviewed and not just rolled-over year-on-year especially if the internal or external environments have changed).

b) The undertaking should detail whether and how it uses reinsurance or some other forms of risk transfer (such as derivatives, securitisation and alternative risk transfer or mitigation mechanisms) to help to control its exposure.

c) Undertakings should provide information on the adequacy of the undertaking's reinsurance cover, how reinsurance is obtained (through brokers or directly) along with a description of the undertaking's reinsurance policy (scopes, priorities and adequacy with respect to the undertaking's risk strategy).

[38] De-minims limitations would need to be established.

### C.7.4 Individual risk information

Specifically for the individual risk categories below, the following could be provided:

#### C.7.4.1 Underwriting risk

*Narrative information*

a) Information on its objectives and policies for managing underwriting risk with evidence that clear documented underwriting risk standards are monitored and enforced (e.g. pricing disciplines, underwriting guidelines, cycle management policies, investment returns, claims processing).

b) Information on the nature of the measures used to assess underwriting risks within the organisation.

c) Information on material underwriting risks classified by type of risk (e.g. reserve risk, catastrophe risk, longevity risk).

#### C.7.4.2 Market risk

*Narrative information*

a) Information on its objectives and policies for managing market risk with evidence that clear documented market risk standards are monitored and enforced.

b) Information on the nature of the measures used to assess market risks within the organisation (e.g. for interest rate risk - duration, convexity, or multiple measures).

c) Information on material market risks classified by type of risk (e.g. equity, property, interest rate, currency) considering both assets and liabilities.

#### C.7.4.3 Credit risk

*Narrative information*

a) Information on its objectives and policies for managing credit risk with evidence that clear documented credit risk standards are monitored and enforced.

b) Information on the nature of the measures used to assess credit risks within the organisation.

c) Information on material credit risks classified by type of risk for different classes of financial assets and other credit exposures and the monitoring of significant risk concentrations for each class (e.g. from reinsurance, monies due from brokers, monies due from policyholders).

#### C.7.4.4 Liquidity risk

*Narrative information*

a) Information on its objectives and policies for managing liquidity risk with evidence that clear documented liquidity risk standards are monitored and enforced.

b) Information on any restrictions on the ability of undertakings to liquidate certain classes of assets.

c) Information on the nature of the measures used to assess liquidity risks within the organisation.

d) Details of any management actions that can be deployed (e.g. deferral of large claims) to mitigate liquidity risk.

#### C.7.4.5 Operational risk

*Narrative information*

a) Information on its objectives and policies for managing operational risk with evidence that clear documented operational risk standards are monitored and enforced.

b) Information on the nature of the measures used to assess operational risks within the organisation.

c) Information on material operational risks classified by type of risk.

d) Narrative on the processes within the undertaking to capture, assess and monitor operational risks (for example details on operational risk data bases maintained and reporting mechanisms).

e) Information on the gross operational loss amount suffered by undertakings, the number of operational loss events and some detail of operational losses suffered compared to own funds.

### C.7.5 Risk sensitivities

The undertaking should provide information on the sensitivities of its material risk exposures. This should cover information about the sensitivity of risks on solvency positions to changes in variables that may have a material effect on their business to include:

*Narrative information*

a) Underwriting risk (e.g. investment conditions, premium volatility).

b) Market risks (e.g. market falls, investment returns).

c) Credit risks (e.g. increase in counterparty defaults, spreads widening).

d) A description of the work performed and an explanation of the results of the sensitivity analysis and any other aspects that may enhance the understanding of the results such as the use of 'over-arching' scenarios.

### C.7.6 Details on the ORSA

An undertaking should provide details on the process that it has undertaken to fulfil its obligation to conduct an ORSA including the following[39]:

#### C.7.6.1 Quantitative requirements

An analysis of the undertaking's quantitative requirements calculations including:

a) Details on the extent to which the undertaking considers its own risk profile differs from the assumptions underlying the SCR.

[39] CEIOPS is considering producing a reporting template for undertakings to use to report the ORSA.

b) Information to allow a comparison between the regulatory capital requirements generated from the SCR (standard formula and internal models) and the internal capital needs resulting from the ORSA process[40].

c) Details on the forecast level of the MCR and SCR (at a 99.5% confidence level over a one year time horizon) over a suitable business planning period.

d) An estimate of the undertaking's future internal capital needs that would result from the ORSA process compared to own funds.

C.7.6.2 Narrative analysis

a) Details of the undertaking's internal capital needs given its risk profile and how it has made that assessment (i.e. using a different risk tolerance/confidence level, its business strategy, time horizon etc).

b) Details of the future risk exposures that the undertaking considers it may be exposed to and how these have been captured in its overall solvency needs.

c) Details of any material risks that the undertaking has identified that are not included within its SCR and how it has quantified these risks.

d) A description of how the ORSA process is integrated into the business strategy of the undertaking.

[40] Noting that the ORSA is a process that results in the undertaking determining its overall solvency needs and is not therefore a regulatory capital requirement.

## Annex 2

### Specimen data for undertakings' standardised reporting forms

| Type of data | Example of data expected | Use of data/ justification |
|---|---|---|
| *Key quantitative information* | | |
| Own funds | Breakdown of own funds into tiers, by instrument. | Enable analysis of sources and availability of own funds to support the business, and how it compares with the SCR and MCR. |
| SCR (adjusted) | Similar to QIS 4 spreadsheet. | Understand an undertaking's SCR calculation by risk module. |
| MCR | Similar to QIS 4 spreadsheet. | Understand an undertaking's MCR calculation by risk module. |
| Balance sheet | Details of asset and liabilities (especially other liabilities than technical provisions) split between life, non-life and pure reinsurance, and statutory account equivalent data. | Understand the make-up of the undertaking's solvency balance sheet (and comparison to financial statements). |
| Income statement | Summary of income and expenses and movements on reserves. Further split for certain items into gross and reinsurers share. | Allow analysis of individual undertaking trends and comparison with peers of sources if income and expenditure. |
| Off balance sheet items | Exposures to SPVs, and other commitments | Understand commitments potentially facing the firm that are not apparent from other financial data. |
| Key forecast numbers | Key SCR, MCR, own funds, balance sheet and income data | Understand undertaking's assumptions/expectations going forward to provide information on trends. |
| *Breakdown of key quantitative information* | | |
| Breakdown of life insurance technical provisions | Should include:<br>▪ movements in year;<br>▪ key assumptions;<br>▪ comparison to accounting value;<br>▪ split by material line of business;<br>▪ net and gross figures;<br>▪ geographical split by Member State;<br>▪ discounting effect; and<br>best estimate plus risk margin etc. | To aid understanding the nature, scale and complexity of the business, the split between best estimate and the risk margin, and discount effect. |
| Breakdown of non-life insurance technical provisions | Should include:<br>▪ movements in year;<br>▪ key assumptions;<br>▪ comparison to accounting value;<br>▪ split by material line of business;<br>▪ net and gross figures;<br>▪ geographical split by Member State;<br>▪ discounting effect; and<br>best estimate plus risk margin etc. | To aid understanding the nature, scale and complexity of the business, the split between best estimate and the risk margin, and discount effect. |

| | | |
|---|---|---|
| Valuation assumptions | Information including for example economic, mortality, lapse and expense assumptions | Understand undertaking's assumptions/expectations |
| Life insurance premiums | Split between direct business, reinsurance accepted and reinsurance ceded; single and regular premium business. May be split by different business locations. | To understand revenues and products in detail and allow cross-undertaking comparisons. |
| Life insurance expenses | May be split by business location, or material type such as administrative, operational or line of business. | Understand the expenses of that business and allow cross-undertaking comparison. |
| Life insurance claims | Analysis of the claims and reinsurance recoveries. | Provide information on the claims being made, and allow comparison with peers. |
| Non-life insurance premiums | Triangles of premiums over the previous 10 years split between gross and reinsurance, with premiums in each of these years and undiscounted gross future premiums split similarly. | To understand revenues in detail and allow cross-undertaking comparison. |
| Non-life insurance expenses | Triangles of commissions and other acquisition expenses over the previous 10 years together with details of reinsurance commissions and profit participations etc. May be split by business location, or material type such as administrative, operational or line of business. | To provide supervisors with an insight into the expenses of the business and allow cross-undertaking comparisons. |
| Non-life insurance claims | Claims triangles (split between claims paid, claims outstanding and undiscounted incurred but not reported (IBNR)), and reinsurance recoveries. | Provide details of the nature of the claims made and allow comparison with peers. |
| Breakdown of counterparty data | Identify significant exposures via reinsurance and large asset exposures, including share of liabilities and type of assets held. | Life and non-life and pure reinsurance - concentration/counterparty risk monitoring; comparison with SCR changes |
| *Specific data* | | |
| Non-linked assets | Analysis of assets with expected income, yield and mean term provided where relevant. Different data for life and pure reinsurers, from non-life undertakings. | To identify non-linked assets within an undertaking. |
| Analysis of derivatives | Showing nominal exposures at reporting date, sensitivities and maximum in the exposure year, split by long and short positions as well as by type and risk category. | Understanding an undertaking's involvement with these instruments and the scale of the transactions being undertaken. |
| Exposure to structured products | Exposure to ABS, CDO, etc. | Understanding an undertaking's involvement with these instruments and the scale of the transactions being undertaken. |

| | | |
|---|---|---|
| Breakdown of property linked assets | Directly held assets and also via Collective Investment Schemes. | Understanding of how less liquid assets support the business. Increasingly important to understand these assets. |
| Index linked assets | Further details of these by type, credit rating and instrument type, by solvency value. | To aid understanding of the assets held and enable any identification in trends e.g. vulnerability to a decline in rating scores |
| With profits asset performance | Return on assets in financial year that back with-profits reserves. | To understand performance of with-profits assets and allow cross-undertaking comparisons. |
| With-profits payouts | Performance of specimen policies (at maturity, and for early surrenders) | Monitoring payout levels, benchmarking |
| Unit linked fund performance | Price information for individual funds at year end and change on year | Monitor performance of undertaking, benchmarking |