
ORSA (Solvency II) vs ORA (IORP II)

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- ORSA (Solvency II) and ORA (IORP II)
- EIOPA expectations for ORSAs and ORAs
- AAE assistance

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- Financial regulators typically require regulated institutions (banks, insurers, asset managers, IORPs ...) to hold regulator-specified minimum levels of capital or equivalent (Pillar 1)
 - They also expect firms to work out how much capital they ‘intrinsically’ need to face the risks to which they are exposed (‘economic’ capital) (part of Pillar 2)
- Institutions are expected to carry out own assessment of risks:
 - Insurers (Solvency II): **own risk and solvency assessment** (ORSA)
 - Banks and investment firms (Capital Requirements Directive): **internal capital adequacy assessment process** (ICAAP)
 - Soon, pension funds (IORP II): **own-risk assessment** (ORA)

■ Solvency II

- **Maximum harmonisation** Directive
- Extensive role for EU Commission and EIOPA in formulating and setting guidelines
- Has led to Delegated Regulation (Level 2), implementing technical standards (Level 3), ...
- Harmonises solvency requirements across EU (for single market)

■ IORP II

- **Minimum harmonisation** Directive, see IORP II Recital (3)
- Much less scope for EIOPA to create binding guidance
- Social and labour law reserved to member states



■ Recital (3)

- This Directive is aimed at minimum harmonisation and therefore should not preclude Member States from maintaining or introducing further provisions in order to protect members and beneficiaries of occupational pension schemes, provided that such provisions are consistent with Member States' obligations under Union law. This Directive does not concern issues of national social, labour, tax or contract law, or the adequacy of pension provision in Member States.

■ Recital (77)

- “The further development at Union level of solvency models, such as the holistic balance sheet (HBS), is not realistic in practical terms and not effective in terms of costs and benefits, particularly given the diversity of IORPs within and across Member States. No quantitative capital requirements, such as Solvency II or HBS models derived therefrom, should therefore be developed at the Union level with regard to IORPs, as they could potentially decrease the willingness of employers to provide occupational pension schemes”

■ Recital (76)

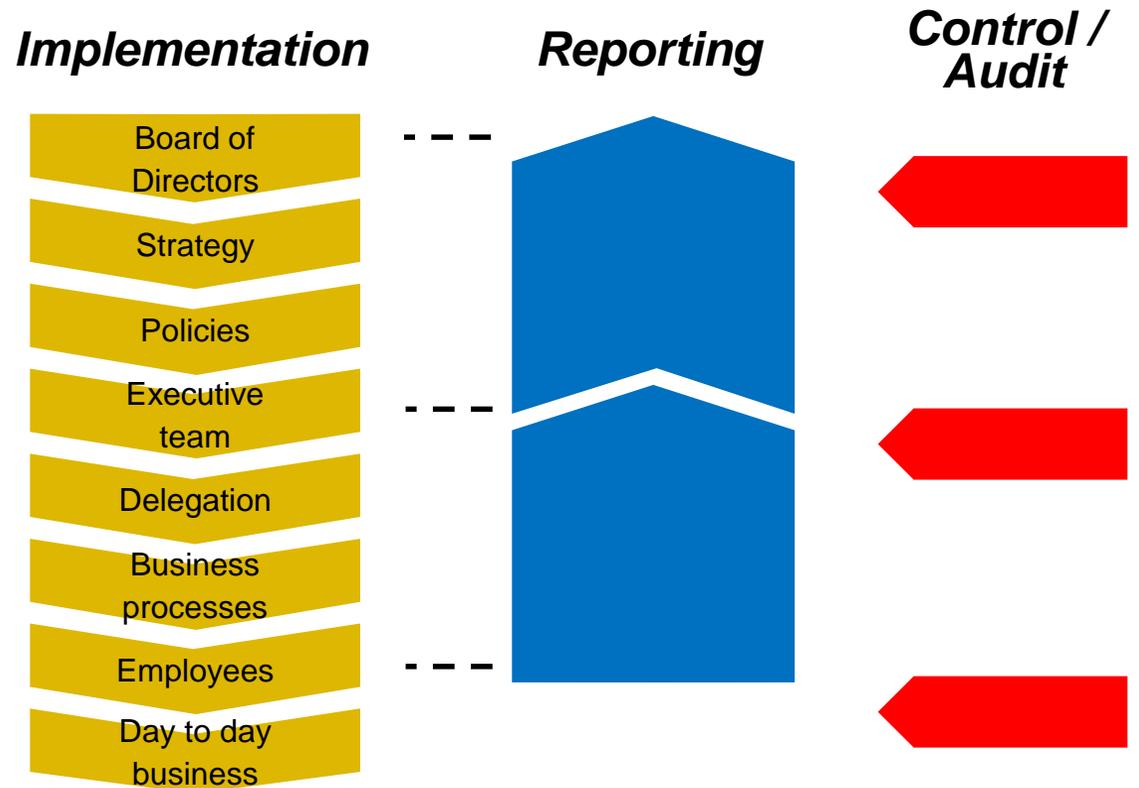
- “In order to ensure fair competition between institutions, the transitional period allowing insurance undertakings falling within the scope of Directive 2009/138/EC [Solvency II] to operate their occupational retirement provision business under the rules referred to in Article 4 of this Directive should be extended until 31 December 2022. Directive 2009/138/EC should therefore be amended accordingly.” [Also optional application of some articles mandated in IORP II Article 4]

■ Recital (75)

- “In order to ensure the smooth functioning of the internal market for occupational retirement provision organised on a Union scale, the Commission should, after consulting EIOPA, review and report on the application of this Directive and should submit that report to the European Parliament and to the Council by 13 January 2023.”

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- Undertaking needs:
 - Adequate capital
 - Employees 'fit' to carry out its business activities
 - A process for achieving a complete and holistic risk understanding of the business
- An ideal ORSA connects full risk picture with governance and internal control system



Source: [Bernardino, G. \(2011\)](#) (adapted)

- **Aims** to ensure that insurers identify and assess all risks that they are (or could be) exposed to, maintain sufficient capital to face these risks, and develop and better use risk management techniques in monitoring and managing these risks
- **Is a process** for an overall and holistic risk understanding, viewed from the management and/or supervisory body
- **Provides** a comprehensive picture of the firm's risks
- **Gives** the supervisor insight into the level of quality of the management's and Board's risk understanding
- **Links** the risk picture with the firm's risk management system and internal control system
- **Captures** risks before they are quantifiable
- **Is** a process that should include unquantifiable knowledge about risks (so should not focus just on risks that are quantifiable)

■ Is not

- A new rules-based solvency calculation
 - A pre-defined process. The firm needs to develop its own (efficient) self-assessment process
 - A process (key function) which as a starting point can be outsourced
 - A process with one concrete number as its output
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- ORSA has many similarities with ICAAP and equivalents applicable to other parts of the financial services industry

- EIOPA-BoS-14/259 (“Guidelines on own risk and solvency assessment”) sets out 20 guidelines including ones on:
 - General approach, role of Board, documentation (including policy, record, internal report, supervisory report), frequency
 - Need for a forward-looking perspective of overall solvency needs
 - Valuation and recognition bases
 - Continuous compliance with regulatory capital requirements and technical provisions
 - Deviations from assumptions underlying SCR calculation
 - Linking ORSA to strategic management and decision-making
 - Additional guidelines for groups

- Under IORP II, a “Holistic Balance Sheet” (HBS) or “Common Framework” (CF) type of analysis is excluded from (Pillar 1) solvency capital requirements, see Recital (77)
- But for (Pillar 2) risk management purposes, pension funds still need to understand their capital needs, bearing in mind applicable benefit support mechanisms, e.g. sponsor support, conditional indexation, pension protection schemes, ...
- EIOPA is expecting (hoping?) HBS or something similar (maybe enhanced by suitable cashflow-based modelling?) will be used by IORPs as a standardized risk assessment approach in ORAs
 - Enabling consumers, members, beneficiaries etc. to compare different IORPs

- E.g. IORP II Article (28) (“own-risk assessment”) requires the risk assessment to include:

...

(e) an assessment of the risks to members and beneficiaries relating to the paying out of their retirement benefits and the effectiveness of any remedial action taking into account, where applicable:

(i) indexation mechanisms;

(ii) benefit reduction mechanisms, including the extent to which accrued pension benefits can be reduced, under which conditions and by whom;

(f) a qualitative assessment of the mechanisms protecting retirement benefits, including, as applicable, guarantees, covenants or any other type of financial support by the sponsoring undertaking, insurance or reinsurance by an undertaking covered by Directive 2009/138/EC or coverage by a pension protection scheme, in favour of the IORP or the members and beneficiaries;

...



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- **AAE assistance**

- For insurers, actuaries may work in:
 - Actuarial function: contributing to undertaking's risk management process
 - Risk management function: coordinating ORSA process
- AAE has developed ESAP 3 (“Actuarial practice in relation to the ORSA process under Solvency II”), covering e.g.:
 - Design and performance of ORSA process
 - Establishing a structured approach to uncertainty
 - Deviation from Solvency II balance sheet approach and methodology
 - ORSA consideration period
 - Consistency with the undertaking's risk management approach
 - Qualitative and quantitative risk assessment (including projections)
- Also some relevant IAA Standards and Notes, e.g. ISAP 6

- Proposed EAN 1 will provide non-binding guidance to actuaries for Actuarial Function Report in relation to IORP II Article 27(1)
 - EANs are AAE educational documents on actuarial subjects for actuaries or those who use or rely on actuaries

- Proposes topics AFs may wish to consider. For contribution to the IORP's risk management suggests includes AF's:
 - Contribution to risk modelling underlying calculation of technical provisions and recommendations for IORP's risk management process
 - Contribution to the ORA, including views on stress-testing and scenario-testing and overall funding needs
 - Assessment of risks to members and beneficiaries including the qualitative assessment of mechanisms protecting retirement benefits (guarantees, covenants, other financial support mechanisms, ...)

- **ORSA and ORA: some similarities but also some differences**
 - No harmonised 'solvency' framework for IORPs envisaged under IORP II. Different approach to harmonisation in Solvency II vs IORP II. Different roles envisaged for EIOPA (and EU Commission)
- **EIOPA expectations for ORSAs and ORAs**
 - EIOPA has published detailed guidance and support material for ORSAs and has some ideas in relation to ORAs
- **AAE assistance**
 - For insurers: ESAP 3 (for risk management actuaries)
 - For IORPs: draft EAN 1 (but more akin to ESAP 2, "Actuarial Function Report under Directive 2009/138/EC" than to ESAP 3)



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