

**EU–U.S. Insurance Project  
Report to the Steering Committee**

**Key Elements of Regulations and Supervisory  
Practices in Respect of Group ORSA**

**November 2015**

## Introduction

The EU-U.S. Insurance Project started in early 2012, when the European Commission, the European Insurance and Occupational Pensions Authority (EIOPA), the U.S. National Association of Insurance Commissioners (NAIC) and the Federal Insurance Office (FIO) of the U.S. Department of the Treasury (Treasury) agreed to participate in a deeper dialogue to contribute to an increased mutual understanding and enhanced cooperation between the EU and the U.S. to promote business opportunity, consumer protection and effective supervision. In December 2012, the Project published the *EU-U.S. Dialogue Project Technical Committee Reports Comparing Certain Aspects of the Insurance Supervisory and Regulatory Regimes in the European Union and the United States*. The Report was accompanied by an initial “Way Forward” document which outlined a set of objectives and initiatives to be pursued through 2017.<sup>1</sup> In light of further developments in the EU and the United States, and of progress at the time on the Project, the Steering Committee in July 2014 revisited and updated the Way Forward and reaffirmed its commitment to the Project.

With respect to the topic of group supervision, the July 2014 Way Forward document contained several initiatives, including the following:

Promote harmonization of Own Risk and Solvency Assessment (ORSA) reports and establish common ORSA reporting elements which could be used by EU and U.S. groups.

To that end, a group of technical experts was convened in 2015 to exchange information about the requirements and use of ORSAs in both the EU and the U.S. in order to identify high-level principles underpinning supervisory practices in respect of group ORSA. These efforts leveraged best practices for both jurisdictions to identify key elements and state of the art processes for ORSA to fulfil supervisory objectives. The analysis compared existing ORSA content and processes within the EU and the U.S. to highlight areas for greater harmonization where appropriate, recognizing the need for jurisdiction-specific nuances given differences in markets and legal/supervisory regimes.

The business of insurance continues to be regulated primarily at the state level in the United States. Each state’s legislature enacts insurance laws and empowers agencies within that state with the implementation and enforcement of those laws. NAIC is the standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. As explained further, below, the NAIC in 2012 adopted a Risk Management and Own Risk and Solvency Assessment Model Act (Model Act) which has now been adopted in 34 states.

At the federal level, the Board of Governors of the Federal Reserve System (FRB or Federal Reserve), FIO within the Treasury, and the Financial Stability Oversight Council (FSOC) are active in the U.S. insurance sector. The Federal Reserve is the primary, consolidated federal regulator of bank holding companies (BHCs), savings and loan holding companies (SLHCs), certain foreign banking organizations with U.S. operations

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<sup>1</sup> The Report and the Way Forward are available at: <http://www.treasury.gov/initiatives/fio/EU-US%20Insurance%20Project/Pages/default.aspx>

(FBOs), and nonbank financial companies the FSOC has determined should be subject to supervision by the FRB and enhanced prudential standards (nonbank financial companies). In some instances, those supervised entities are holding companies of insurers. The FRB regulates their operations, activities, and capital to varying degrees, among other things<sup>2</sup>.

At present, an ORSA per se is not required by the FRB of insurance groups under its supervision, however this does not remove the requirement for these insurance groups to file an ORSA Summary Report with their lead state. The analysis that follows therefore compares the ORSAs under the Solvency II regime in the EU with standards of the NAIC's Model Act.

In the European Union, insurance supervision is performed in each Member States by a relevant national supervisory authority. The pursuit of insurance and reinsurance business is harmonised at the EU level by the Solvency II regime, which will apply from 1 January 2016. As regards the EU legislative process, one of the main institutions is the European Commission, which is the executive branch of the EU and is responsible for proposing new European laws to the Parliament and the Council. The core responsibilities of European Insurance and Occupational Pensions Authority (EIOPA) are to support the stability of the financial system, transparency of markets and financial products as well as the protection of policyholders, pension scheme members and beneficiaries. EIOPA is inter alia empowered to issue guidelines in order to ensure consistent application of the EU law.

### Regulatory Framework

The NAIC in 2012 adopted a Risk Management and Own Risk and Solvency Assessment Model Act (Model Act). The Model Act has been implemented by 34 states to date, although some of these states will not require the Summary Report to be filed until 2016 or 2017. Section 5 of the Model Act constitutes a legal basis to perform ORSA at the group level. For purposes of this analysis, comparisons with EU provisions are made only to the standards set forth in the Model Act, not to actual requirements pursuant to individual states' laws or regulations. In addition, the ORSA Guidance Manual published by NAIC and specifically referenced in the Model Act provides regulators' expectations towards insurance groups to complete their ORSA.

In the EU, all groups that fall under the Solvency II group supervision regime are required to conduct an ORSA, according to Articles 45 and 246 of the Solvency II Directive<sup>3</sup>. The Directive will apply from 1 January 2016, which should be preceded by adoption by the EU Member States of measures necessary for its implementation. EIOPA

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<sup>2</sup> For more information on the respective authorities of FIO, FRB, FSOC and the U.S. states, see the *United States Financial Sector Assessment Program Self-Assessment* at <http://www.treasury.gov/resource-center/international/Documents/FSAP%20-%20Joint%20Insurance%20Sector%20Self-Evaluation.pdf>.

<sup>3</sup> Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (OJ L 335, 17.12.2009, p.1). The requirements applicable at the level of individual undertaking apply mutatis mutandis at the group level, which means they should be applied with necessary alterations while not affecting the main point of the requirements. In addition, certain group-specific requirements apply.

has also published Guidelines on ORSA<sup>4</sup>, which focus on what is to be achieved by an ORSA rather on how it should be performed.

As a general rule, the group ORSA in both regimes should be reported on a regular basis, meaning once a year. However, an additional assessment can be triggered during the year in case of significant interim changes in the risk profile of the group.

### Scope of Regulation

In the U.S., the ORSA is required annually of larger insurers and insurance groups<sup>5</sup> (collectively, the subject entities/groups make up over 90% of the U.S. premium volume). The ORSA can be performed at either the solo level, or by the insurance group, provided that all insurance legal entities within the group are covered by the collective group-wide filing made available to the lead state insurance regulator. Despite this option, which is intended to allow the group the ability to produce a report consistent with the manner in which the groups perform their risk management, the assessment of risk capital and prospective solvency assessment is required to be reported to the lead state for the entire insurance group. The NAIC's ORSA Guidance Manual provides a framework, and allows discretion for insurers/groups to develop an ORSA process that is considered by the management to be suitable and appropriate.

Property and casualty insurers within a group could be included in one sector-specific ORSA Summary Report or combination of reports, and the life insurers within the same group could be included in another sector-specific ORSA Summary Report or combination of reports, if those sectoral operations within a group are under different enterprise risk management (ERM) frameworks.

In the EU, all insurance companies in the scope of Solvency II<sup>6</sup> have to perform the ORSA at least on an annual basis. Therefore the supervisory review process of the whole group includes a group ORSA report for the group level as well as ORSA reports prepared on an entity level. All insurance groups are obliged to carry out an ORSA at the group level.

It is possible, subject to supervisory approval, to provide one single supervisory report of the ORSA, which covers assessments carried out at the level of the group and all or selected undertakings belonging to that group. The assessment as such has to be carried out separately for the group level and each entity level. The final product, which is the ORSA supervisory report, is one document relevant for the group and individual entity level.

In summary, both European and U.S. groups have certain flexibility to adapt the process of ORSA and the supervisory report(s) to the specificities of a particular group.

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<sup>4</sup> EIOPA Guidelines on own risk and solvency assessment (EIOPA-BoS-14/259 EN).

<sup>5</sup> Insurers with annual direct written and unaffiliated assumed premium above \$ 500 million and groups with annual direct written and unaffiliated assumed premium above \$ 1 billion. For the detailed description of thresholds please refer to Section 6 of the NAIC's Risk Management and Own Risk and Solvency Assessment Model Act.

<sup>6</sup> Solvency II does not apply to insurance undertakings which fulfill all conditions stipulated in Article 4 of the Solvency II Directive.

## Nature of ORSA

In both regimes ORSA means the process of assessing the risk profile and capital needs necessary to address those risks in a forward-looking perspective. It is expected in both the U.S and the EU that ORSA is the group's own assessment, therefore certain flexibility is provided as to the process to perform the exercise.

The ORSA process should be unique to each group, reflecting its specific business, strategy, organisational structure and approach to risk management systems. It should also be appropriate to the group's nature, scale and complexity of its risk profile.

As the result of the ORSA exercise, the group should produce a document(s) describing the outcome of its risk and capital assessments, which should be provided to the relevant supervisory authority ('the supervisory report of the ORSA' to be submitted to the group supervisor in the EU and 'the ORSA Summary Report' to be provided to the relevant lead state insurance regulator in the U.S.).

## Content of the ORSA

In the U.S., the ORSA Summary Report should address three major areas:

- description of the Risk Management framework,
- assessment of the risk exposure under normal and stressed conditions,
- group assessment of risk capital and prospective solvency assessment.

Under Solvency II, the ORSA needs to cover at least:

- the overall solvency needs taking into account the group's capital needs with regard to its specific risk profile, approved risk tolerance limits and the forward looking business strategy of the group;
- the compliance, on a continuous and forward-looking basis, with regulatory capital requirements;
- the significance with which the risk profile of the group deviates from the assumptions underlying the solvency capital requirement (SCR),
- the group's business actions taking into account the results from the above mentioned assessments.

In the EU, general information on the group's risk management framework is not part of the ORSA supervisory report, but is included in the regular supervisory report on its system of governance. The ORSA supervisory report focuses on the outcome of specific risk assessments which are required in the general frame of the group's risk management.

The report provided to a group/lead supervisor in both the EU and the U.S. should include the overall economic solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the group (EU) or high-level summary of the qualitative and/or quantitative assessment of risk exposure in both normal and stressed environments for each material risk category, which includes comparison of available capital against risks to which the group is exposed (U.S.). In

addition, the reports in the EU and the U.S. should include an assessment of compliance with regulatory capital requirements.

In both the EU and the U.S., an ORSA carried out at the group level should address group-specific issues, such as: the effect of diversification, group-specific risks (concentration risk, risk concentrations, contagion risk, complexity risk and operational risk), intra-group transactions as well as the availability (transferability and fungibility) of capital within the group.

### ORSA as Part of Risk Management

The U.S. regulation requires an insurance group to maintain a risk management framework to assist the insurer with identification, assessment, monitoring, management and reporting on its material and relevant risks. ERM framework principles are included as the first part of the ORSA Summary Report:

- how the insurers in the group identify and categorize relevant and material risks and manage those risks as it executes its business strategy,
- risk-monitoring processes and methods,
- risk appetite,
- an explanation of the relationship between risk tolerances and risk limits.

Both in the E.U. and under the standards of the Model Act in the U.S. it is required that ORSA should be conducted as part of the risk management framework. The European framework includes written policies with regard to, inter alia, risk management and ORSA. The Model Act framework in the U.S. does not specifically require an ORSA policy, however U.S. companies are expected to have a number of written policies to support the rigor of their risk management framework. In these policies the group needs to describe its general approach towards risks including risk appetite and tolerance limits as well its methods and processes applied. The ORSA report includes assessment of this general concept as provided in the policies for analysis of specific risks.

ORSA is thus an integral part of the ERM for both European and U.S. insurers and groups. It should also be an essential element of the business strategy and the process of taking strategic decisions at the level of the group and of an individual undertaking. These commonalities should help both European and the U.S. groups meet expectations of supervisory authorities as they operate on a transatlantic basis.

### Involvement of the Board

The boards of European groups should take an active part throughout the whole ORSA process in a 'top-down' approach. This involvement includes approval of the policy for the ORSA and steering on performance of the assessment. The board should also challenge the results of the ORSA and approve the supervisory report. Supervisors will expect that future management actions will result from the ORSA results.

The ORSA Summary Report of U.S. groups should include a signature of the group's chief risk officer attesting to the best of his/her belief and knowledge that the insurer

applies the enterprise risk management process described in the ORSA Summary Report and that a copy of the report has been provided to the insurer's board or the appropriate committee thereof.

The requirements regarding involvement of the board in the ORSA allow effective communication between the board and the supervisory authorities, as well as within the colleges of transatlantic groups. In both systems the board bears the ultimate oversight for the ORSA assuring that its results are used for management actions, but in the U.S. there is no specifically identified board responsibility over ORSA, rather corporate law requires board members to utilize the duty of care and loyalty.

### Supervisory Approaches to ORSA

Since the December 2012 report, supervisors have started to gain increasing insight and experience in reviewing and using group ORSAs. Throughout 2015, the supervisory authorities participating in the Project – Technical Committee on Group supervision have discussed and compared their ORSA-related practices.

The analysis of supervisory practices with regard to ORSAs poses certain difficulties due to the fact that ORSA requirements have only been applicable in the U.S. since the beginning of 2015 and in the EU the preparatory requirement for the ORSA has been introduced by EIOPA for the years 2014 and 2015. The final ORSA is only applicable once Solvency II is in place, i.e. from 2016.

However, on the basis of sharing and reviewing the preparatory ORSA experiences in colleges as well as from rules on supervisory cooperation and information exchange, certain conclusions may already be drawn for from both the U.S. and the EU.

In terms of supervisory expectations, both EU and U.S. supervisors are responsible for reviewing the ORSA report and the ORSA process. If an ORSA report is done well, it should provide supervisors with information on the key risks facing the firm, risk tolerances, the capital the firm holds against risks and management actions they can take on a forward-looking basis. In judging the quality of an ORSA report, the supervisors are expected to take into account the ORSA report itself but also their own knowledge of the group's business.

Supervisors are expected to make a judgement as to whether the ORSA report is an adequate assessment of the own risks and solvency both at solo and at group level and whether the outputs from the ORSA are utilised in relevant decision-making processes by the Board.

In order for an ORSA report to be considered appropriate, both EU and U.S. supervisors will expect to bring the inputs and outputs from the ORSA together and provide the links and analysis between them (e.g. interconnectedness between the group business strategy and the group risk profile).

In the EU, the supervisory discussion on ORSA has already taken place in some colleges. Relevant information has been exchanged in the colleges in different formats, in some

cases the whole ORSA report, in others only a report of the supervisory review. In the U.S., ORSA summary reports have been shared only on a limited basis within colleges thus far.

In both the U.S. and the EU, the outcome of the ORSA exercise will be a subject of interest of colleges, however specific solutions in this regard, e.g. the exact scope of information exchanged on ORSA, may differ. In the U.S., typically the lead state supervisor receives an ORSA Summary Report, prepares an assessment on the basis of this report and shares this assessment with college members. However, solo supervisors can request the full ORSA Summary Report from the lead state. In the EU, exchange of ORSA reports is not envisaged as an obligation, but particular colleges may decide to do so as part of their coordination arrangements. In addition, according to EIOPA Action Plan 2016 for Colleges, supervisors should share within colleges their views regarding the structure, quality and consistency of the ORSA approach across the group. The conclusions from analysing ORSA will also be reflected in conclusions from the supervisory review process, which should be exchanged within colleges.

In both the U.S. and EU the size of the ORSA reports can be a barrier to sharing them with all members of the college. Practical solutions in this regard are still to be elaborated, including what information and materials will be exchanged with regard to ORSA. This information exchange should be adequate to enable supervisors within the college to focus their supervisory review and actions on the major issues regarding the risk profile of the group and/or of specific entities.

To sum up, ORSA is expected to be an important input in discussions and analyses carried out within colleges in both the EU and the U.S. The above-mentioned similarities in approaches applied by EU and U.S. supervisors should facilitate the assessment of risk profiles of transatlantic groups within their colleges.

## Conclusions

The nature and purpose of ORSA are comparable in the U.S. and the EU. The relation of ORSA with the risk management framework of the group is also similar. In addition, for both the ORSA is required at solo and at group level, as well as an assessment of the interconnectedness between the risks at the group level. The frequency of ORSA in both the EU and the U.S. is set at least annually.

These similarities should facilitate discussions regarding ORSAs in colleges of supervisors of both EU and U.S. groups. This should allow for common understanding among supervisory authorities from EU Member States and state supervisory authorities in the United States, secure the efficiency of discussions held in the colleges as well as reaching common conclusions.

The analyses regarding ORSA requirements and relevant supervisory practices should be continued in order to benefit from relevant practical supervisory experiences, which will evolve as more experience is gained with ORSAs in the future.

## Appendix I – Contributing Parties

The Steering Committee acknowledges the contributions of all who participated in preparing this report. Those individuals are listed below along with their state/Member State/ or organization affiliation.

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