

<b>Comments Template on CEIOPS-CP xx Draft proposal for Level 3 Guidance on the ORSA</b>		<b>Deadline 18.03.2011 12:00 CET</b>
Name of Company:		
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<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> <li>⇒ <b>Do not</b> change the numbering in the column "reference".</li> <li>⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph, keep the row <u>empty</u>.</li> <li>⇒ Our IT tool does not allow processing of comments which do not refer to the specific paragraph numbers below. <ul style="list-style-type: none"> <li>○ If your comment refers to multiple paragraphs, please insert your comment at the first relevant paragraph and mention in your comment to which other paragraphs this also applies.</li> <li>○ If your comment refers to sub bullets/subparagraphs, please indicate this in the comment itself.</li> </ul> </li> </ul> <p><b>Please send the completed template, <u>in Word Format</u>, to <a href="mailto:secretariat@ceiops.eu">secretariat@ceiops.eu</a>. Our IT tool does not allow processing of any other formats.</b></p> <p>The numbering of the paragraphs refers to Consultation Paper No. 83 (CEIOPS-CP-83/10).</p>		
Reference	Comment	
General Comment	Groupe Consultatif generally welcomes this guidance and particularly the focus on what is to be achieved by the ORSA rather than on how it is to be performed.  We do however consider that the forward looking dimension may be slightly under-developed and a stronger emphasis on the performance of ORSA as an integral part of business planning may have been appropriate.	

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	<p>While we support the overall style, more use of examples would likely be effective in making the guidance meaningful both for firms and for their supervisors.</p> <p>We can see that it is desirable for undertakings to think through what ORSA is appropriate to their circumstances rather than rely on external guidance on proportionality. Nevertheless it would be reasonable to suggest as factors which might be taken into account:</p> <p>Scale and complexity of business;</p> <p>Stability of business model;</p> <p>Stability and strength of financial performance.</p>	
1.1.	To our understanding no level 2 implementing measures will be coming on ORSA	
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1.6.	We very strongly support this.	
1.7.		
1.8.	Some guidance to firms and/or supervisors may be needed on the assumptions implicitly underlying the SCR standard formula calculation as – to the best of our knowledge – these are not explicitly stated.	
1.9.	Does this mean that ORSA should be identical with the internal model for the first year?	
1.10.		
2.1.	<p>We welcome the view that economic capital models do not need to meet the internal model requirement when used for ORSA – presumably for non-internal model firms - but it is not clear what the minimum requirements will be – can we confirm these are set out in this note?}</p> <p>We agree that proportionality should work both ways for most firms but have some concerns if very</p>	

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	small firms have complex products but are well capitalised would a sophisticated ORSA model be required, particularly if such firms could easily be absorbed by a larger insurer to secure policyholder security.	
2.2.	We agree that the administrative body should be able to challenge assumptions underlying the internal model. We would highlight that assumptions should include the model choice and data choice which can have key influence on the results.	
2.3.		
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2.5.	We agree that the differences between the risk profile and the internal model should be documented. However we note that the definition of risk profile is not clear and provide more input below.  It is in background notes that the independent review does not need to be external which could be mentioned also here (see 3.15)	
2.6.	Also we note that the difference between quantifiable and non-quantifiable is rather arbitrary. One could consider operational risks (or even some long term risks such as longevity trend) as essentially non-quantifiable despite their inclusion in the SCR standard formula.  Some guidelines on the boundary between quantifiable and non-quantifiable would be helpful. For example does an unquantifiable risk mean that there is insufficient data to calibrate a distribution or that there is inherent uncertainty in what the underlying distribution is?  We welcome that EIOPA agree that an alternative risk measure is allowable. We would like to have clarification if this also requires pegging back to the 1 in 200 1 Year VAR as in the Calibration Standard or is a more relaxed approach taken allowing firms to use a risk measure they feel is appropriate and a calibration point they feel in appropriate?	
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2.11.		
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2.13.	<p>There is some ambiguity over what is meant by a risk profile. A typical risk profile would show the quantum amount of capital contribution for each risk – perhaps on a diversified or undiversified basis.</p> <p>However an internal model is typically used to generate this risk profile and the standard formula only describes the stresses to risks and doesn't have a risk profile itself.</p> <p>There are two ways we can conceive to interpret the risk profile as cited in the text.</p> <p>One might be the universe of quantifiable risks that the undertaking is exposed to. This could be compared to the universe of risks in the internal model and standard formula. This would be a natural thing to undertake in an ORSA in order to justify the universe of risks included in the internal model. This would be a somewhat narrow definition of risk profile.</p> <p>A second interpretation would be a ranking of the importance of the different risks. This could be undertaken in broad terms using a sensitivity analysis – and might be undertaken in order to determine where the main focus of the internal model should be or which elements of the standard formula should be retained in a partial internal model.</p> <p>However one of the requirements of an internal model is to be able to rank risk and producing such a risk ranking is a key output. Such risk ranking output would typically form part of the validation process and be used to confirm the extra attention spent on modelling some risks and dependencies over others.</p> <p>Our interpretation is therefore that this risk ranking element of the validation process feeds into the ORSA on a regular (say annual) basis to verify that the most material risks are being given the most attention in the model. Later Guidelines suggest this interpretation is aligned with EIOPA.</p> <p>Finally the risk profile could be interpreted as the distribution / model / dependency structures assumed in the internal model / or standard formula reflect the assumed distribution / model / dependency on the internal model or standard formula.</p> <p>However in building an internal model the statistical quality test would have had to check this process. Therefore we see this element of the ORSA being a review of the application statistical quality test to</p>	

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	<p>verify that the assumed distributions / models / dependency structures are still appropriate for the business. Again later Guidelines suggest this is aligned with EIOPA's view.</p>	
<p>2.14.</p>	<p>See Comment in 1.8 also the allowance for a qualitative assessment of the risks profile is welcomed but suggests that the risk profile will only be the universe of risks or at least a ranking of risks into broad categories such as high, medium and low.</p> <p>Such a ranking while adequate for a standard formula form doesn't seem appropriate for a internal model firm who could be expected to have undertaken a quantitative risk ranking exercise.</p> <p>We note the standard formula doesn't provide a risk ranking for comparison so it is hard to assess if the risk profile of the business compared to the risk profile of the Standard Formula – except by comparing the universe of risk covered.</p> <p>The model choice and calibration data of the ORSA and the Standard Formula or Internal Model could be compared where sufficient disclosure is in the calibration document.</p> <p>The text talks exclusively about the decision to adopt an internal model as being a result of looking at the risk profile of a business.</p> <p>However we expect the reason for choosing an internal model would be driven by factors such as a perceived competitive advantage, ambition to be an internal model firm, perceived capital advantage or pressure from a regulator. Without a concept of what the risk profile of the Standard Formula firms are left to make the decision on whether to use the Internal Model on the basis above.</p> <p>It would be therefore helpful for EIOPA to clarify where the Standard Formula is considered to be strong / medium and weak to allow firms to identify if weak areas of the Standard Formula are major elements of the firms risk profile and would therefore necessitate an internal model.</p> <p>We agree that the Internal Model and ORSA influence each other. We interpret the text as meaning that the ORSA is the framework in which ongoing internal model adequacy is undertaken – this appears to mean that the on-going IMAF process should form part of the ORSA. If this is the intention it would be helpful to clarify that this is the case.</p> <p>We welcome the comment that blind reliance on models should be avoided and that model may require compensating adjustments. These would seem to be expert judgements which should be explained. A weak point of modelling is described as follows. Assumptions are made in the parameterisation of</p>	

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	<p>statistical distributions that are used in the models. The choice of these parameters is subject to a good deal of uncertainty and measurement error. Furthermore changing these parameter assumptions can have a significant effect on the outcome.</p> <p>We believe that stress and scenario testing is an important instrument to be used in the discovery of the risk profile of an undertaking.</p> <p>Stress and scenario testing can be used to supplement the stochastic scenarios with plausible scenarios that may not be adequately captured using the stochastic models that form the calculation kernels of internal models.</p> <p>A deeper investigation of particular scenario testing can be used to probe whether the internal models adequately pick up on dependency, for example whether inter-temporal dependency is adequately captured in the model.</p> <p>An example might be a market risk event leading to an operational risk event reputational and then onto a reputational risk event. If a model inadequately captured these inter-temporal links the risk profile of the business could have a different shape than a simple application of the internal model might suggest.</p> <p>We agree that the adoption of a PIM should require re-consideration of the linkages to other components although re-consideration of the less material components seems overly cautious especially for small firms.</p>	
2.15.	<p>We note the reference to new standards. We would expect ongoing compliance with the existing tests and standards but question if there will be additional tests and standards introduced for the internal model?</p> <p>We agree that the risk profile should be monitored to ensure the continuing appropriateness of the internal model.</p> <p>We agree that model errors need to be considered. It is not so much the errors as the lack of right answer over which model could be chosen.</p> <p>We agree that the circumstances where the model does not perform well should be disclosed.</p>	

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	We question if a minor model change be material or if such a change that automatically be considered a major change.	
2.16.		
2.17.	<p>It is difficult, for an insurer, to determine “the volatility of its overall solvency needs relative to its capital position.” As a consequence, we don’t believe that insurers will be able to meet the requirement as expressed in §2.17 to achieve the justification of the frequency of the assessment.</p> <p>We believe that the determination of the frequency of the assessment should be based on a reasonable set of stressed scenarios.</p> <p>We propose the following wording :</p> <p style="padding-left: 40px;"><i>“The undertaking should perform the ORSA at least annually. Notwithstanding this, the undertaking has to establish the frequency of the assessment itself particularly taking into account its risk profile and the sensitivity of its overall solvency needs to a set of stressed scenarios consistent with its risk profile, and relative to its capital position. It should justify the adequacy of the frequency of the assessment.”</i></p>	
2.18.		
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2.20.	<p>The Guideline 20 could be modified according the following proposal :</p> <hr/> <p><b>Guideline 20 (Article 45)</b></p> <p><b>The group should adequately capture all specificities of the group, including group specific risks and the interdependencies within the group. The impacts of these specificities should take into account in</b></p>	

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	<b><u>the group risk profile.</u></b>	
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3.15.	'persons different from those involved in performing the ORSA' may be more consistent with the view of the ORSA as a business process choreographed by the risk function but involving input and challenge from a range of sources.	
3.16.		
3.17.	In relation to (f) see comment on 1.8	
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3.22.	Does this make sense as there is no obligation for undertakings to perform more frequently than annually, would this actually give an incentive to perform more seldom?	
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3.25.	<p>Two categories of significant changes in the risk profile exist:</p> <ul style="list-style-type: none"> <li>o the significant change that results in a management decision (external growth, changes in reinsurance policy, in asset allocation or in products,...)</li> <li>o the significant change that results from an external event</li> </ul> <p>We believe that requirement of §3.25 should be applicable for the first category as non-regular ORSA should have been performed before the management decision, so that its reporting to supervisor could</p>	

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	<p>be done with no delay when event occurs. However, we don't believe that reporting with no delay could be possible for the second category of external events. As a consequence, we propose to define three steps for the reporting in case of significant change resulting from an external event</p> <ul style="list-style-type: none"> <li>o reporting with no delay of the detailed exposure to the specific risk deriving from the event: for example, the gross exposure to a specific class of assets impacted by the event (impact on value, liquidity,...), the gross exposure to CAT event with details on reinsurance mechanism,...</li> <li>o reporting with very limited delay (the same delay as the one presented in article 54 1 . b) of an assessment on the results of ORSA based on a simplified approach, with disclosure of the range of uncertainty embedded in the approach</li> <li>o based on discussion with supervisor and depending on the range obtained with a simplified approach as described previously, reporting on complete ORSA</li> </ul>	
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3.32.	<p>We believe that the guidelines should precise what kind of assessment could be done by the undertaking regarding external action that could limit the risk in some very specific cases.</p> <p>For example, some legislation allow for surrender suspension in savings business, tailored to avoid extreme crisis.</p> <p>As guidelines focuses on external factors that have adverse impact and on management action, it is not clear how supervisor action that could reduce the risk profile should be considered when designing the stressed scenarios.</p>	
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3.56.		
3.57.	See comment on §2.17.	
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3.62.	The last sentence is redundant.	
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3.67.	See comment on 1.8	
3.68.	See comment on 1.8 – we agree that this is a gap which needs to be filled.	
3.69.		
3.70.	<p>We think that the requirement c) is not enough self-explanatory and could lead to differences in practice. We propose the following wording:</p> <p align="center"><i>“An assessment of the sensitivities of the SCR to the main parameters, including undertaking-specific parameters;”</i></p>	
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3.83.	We are not persuaded that ORSA should require an undertaking to demonstrate that its internal model continues to be acceptable, although undertakings might reasonably be required to consider the point. We agree that the forward-looking character of ORSA may usefully point to changes likely to be required in the internal model in order that the model continues to be acceptable.	
3.84.		
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3.87.	We prefer 'considering performing an updated ORSA' – it is entirely possible that model change will have been anticipated in the ORSA so that no updating is required.	
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3.93.		
3.94.	<p>The term “magnified” has to be defined and explained.</p> <p>The proposition lacks a structure linked with the Guidance 18. It could be structured as the following :</p> <p>“The Group ORSA adequately considers all specificities of the group regarding its structure. It includes the differences between undertakings of the group such as business strategy and planning horizon.</p> <p>The Group ORSA adequately captures also all specificities of the group regarding its Risk Profile:</p> <ul style="list-style-type: none"> <li>a) Risks specific to the group</li> <li>b) Risks that might not be observable at solo level but are magnified at group level (contagion risks – see definition on 3.112)</li> <li>c) Interdependencies within the group and their impact on the group risk profile“</li> </ul>	
3.95.	<p>The last phrase of this paragraph should be removed.</p> <p>The proof of the availability of information regarding the SCR calculation has to be provided trough checks on pillar 1 calculations.</p> <p>The ORSA has to be consistent with the scope defined for pillar one calculations instead of being a demonstration.</p> <p>Any difference between the ORSA scope and the pillar one scope has to be disclosed.</p>	
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3.112.	<p>The following remark is produced when we understand that “into the full or partial model.” means “into the full or partial <b>internal</b> model.”</p> <p>We propose to remove the last phrase of this paragraph since the obligation to integrate material group specific risks into the full or partial model. The choice of integrating significant risks into the internal model scope depends of the undertaking group choice.</p> <p>Instead of this phrase we propose to add at the end of the paragraph, the following phrase :</p>	

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	<p>"Although the SCR only takes quantifiable risks into account, the group is expected to identify and assess the extent to which non-quantifiable risks are part of its risk profile and to ensure that they are properly managed."</p>	
3.113.	<p>The term "complexity risk" has to be defined and explained.</p> <p>Additionally, we don't see the reason why each of these risks is a specific group risk. Indeed these are risks, but they are risks for (large) solo companies. One can say that larges companies are groups or the other way around, but that will not always be the case. See also or comment to 3.114. About g): This should be part of the model used to calculate group diversification like always when putting risks together and should not be seen as an extra risk because of being a group.</p>	
3.114.	<p>GC thinks this gives an overly simplified and misleading view on the currency risks that the firm or group needs to manage.</p> <p>The standard formula is not correct when a firm has significant asset and/or liability exposures in a currency other than its reporting currency. ( e.g. reports in EUR but has large exposures to USD business. Taking the extreme case of 100% of business in USD with all assets in USD there will be an SCR contribution of 25% ( assets -liabilities) yet there is no risk. SCR is minimised by holding assets =liabilities in USD and the excess in EUR. That is a perverse incentive. A similar situation arises in groups with an EUR parent with significant business in various non EUR subsidiaries each of which hold capital in excess of liabilities in the currency matching the exposures.)</p> <p>Even if no better solution emerges for the standard formulas (leaving PIM) we think EIOPA should expand its guidance under ORSA.</p> <p>EIOPA might write</p> <p>&lt; The standard formula requires a calculation based on a % of (total assets - total liabilities ) in each currency except the entity's reporting currency. Firms should be aware that sound risk management needs to look more closely at exposures in particular to recognise that excess capital should be held in a variety of currencies reflecting the currency mix of the risk. For example a EUR reporting entity with large exposure to USD denominated liabilities might consider it appropriate to hold USD denominated assets to cover the liabilities but also to cover some of the SCR. as this would be a lower risk position than holding all excess assets in EUR.</p> <p>The same issues arise for groups where each non EUR entity would naturally hold all assets in its local</p>	

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	<p>currency (assuming all liabilities are in the local currency). This would be a minimum risk position but would create a currency charge in the group SCR under the standard formula.</p> <p>In both cases as the SCR is a diversified calculation firms or groups will need to make a judgement about how to distribute excess assets between currencies. A supervisor may form a view that a strategy that minimises SCR in this aspect is not sound risk management.&gt;</p>	
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3.116.	The term "magnified" should be explained.	
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