ISLE OF MAN
FINANCIAL SERVICES AUTHORITY

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CORPORATE GOVERNANCE CODE OF PRACTICE FOR INSURERS

Consultation Paper

CP17-10/T11

This consultation paper is issued by the Isle of Man Financial Services Authority ("the Authority"), the regulatory authority responsible for the supervision of the financial services, insurance and pensions sectors in the Isle of Man.

What is it for?

In June 2013 the Insurance and Pensions Authority[1] published its Roadmap[2] for updating the Isle of Man's regulatory framework for insurance business ("the Roadmap"). That document set out the objective to establish a project to enhance the Island's regulatory framework to ensure that it remains up to date, proportionate and, where appropriate, consistent with the ongoing development of the Insurance Core Principles ("ICPs") issued by the International Association of Insurance Supervisors ("IAIS"). Since its issue the Roadmap has been updated at least annually, and more recently six monthly, to reflect progress made across the various work streams established under the project.

The developments explained within the Roadmap include amendments likely to be proposed in respect of the corporate governance of insurers. These highlight some potentially significant changes, including in respect of actuarial requirements, enterprise risk management and own risk solvency assessment.

This document contains the Authority's detailed proposals in respect of the corporate governance of insurers and the proposals include the changes highlighted in the Roadmap.

Who is affected by it?

This document will be of interest to the boards and senior management of existing and prospective insurance companies.

Other parties with an interest in the Isle of Man insurance sector, including general insurance intermediaries and the legal and auditing professions may also find this discussion paper and the issues raised of interest.

http://www.iomfsa.im/regulatorydevelopments/insuranceframework.xml

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[1] With effect from 1st November 2015 the functions of the Insurance and Pensions Authority were transferred into the Isle of Man Financial Services Authority
http://www.iomfsa.im/ViewNews.gov?page=lib/news/iomfsa/transferoffuncti.xml&menuid=11570

[2] The Roadmap may be downloaded from the Authority's website at:
http://www.iomfsa.im/regulatorydevelopments/insuranceframework.xml

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Glossary of Terms

Term	Meaning in this document
Act	Insurance Act 2008
ALM	Asset-Liability Management
Amended CGC	Corporate Governance Code of Practice for Insurers
AML	Anti-Money Laundering
Authority	The Isle of Man Financial Services Authority
Bill	Insurance (Amendment) Bill 2017
CFT	Combating the Financing of Terrorism
CGC	Corporate Governance Code of Practice for Regulated Insurance Entities
ERM	Enterprise Risk Management
IAIS	International Association of Insurance Supervisors
ICPs	Insurance Core Principles (of the IAIS)
ORSA	Own Risk Solvency Assessment
Roadmap	Roadmap for updating the Isle of Man's regulatory framework for insurance business

Executive Summary

This document sets out the Authority's proposals and rationale for amending the Corporate Governance Code of Practice for Regulated Insurance Entities ("the CGC") as it relates to insurers that are authorised under section 8, or permitted under section 22, of the Insurance Act 2008 ("the Act").

The amended CGC will not apply requirements to registered insurance managers, who are currently within scope, nor introduce requirements to general insurance intermediaries to whom the CGC does not currently apply. Corporate Governance requirements for those regulated sectors will be the subject of a further consultation exercise to be carried out in April 2018. However, it should be noted that, in relation to registered insurance managers, much of their activities (e.g. when acting as an outsourced provider of a significant function of an insurer), will be covered by proposals in this document in respect of insurers.

In relation to groups, the amended CGC will continue to require insurers to consider the implication of risks from its wider group. However, the Authority is developing specific corporate governance requirements for insurance groups to be applied <u>where the Authority will be group supervisor</u> under group supervision provisions to be introduced in the Act. These will also be the subject of a separate consultation exercise, to be carried out in October 2017.

Key changes proposed in the amended CGC are:

- New provisions requiring an enterprise risk management ("ERM") framework, including a risk appetite framework which is an integral part of the insurer's business strategies and plans;
- As part of the ERM framework, the requirement for an own risk solvency assessment ("ORSA");
- The introduction of requirements in respect of the actuarial function for insurers; and
- More explicit reporting requirements to the Authority, particularly of events that impact an insurer's risk profile, financial condition and the fair treatment of its policyholders.

The ERM, ORSA and actuarial changes support the implementation of the CGC's existing risk-based capital requirement, which requires capital to be held by an insurer that is adequate for its particular risk profile whilst having regard for potential future adversity.

Further important changes include:

- Specific requirements in respect of corporate culture and ethical values;
- Greater emphasis on the need to be forward looking especially within the ERM framework;
- More detailed requirements in respect of board meetings;
- More detailed requirements in consideration of policies around remuneration to clarify to whom the policies shall apply and desired outcomes; and
- Additional requirements in respect of the fair treatment of policyholders which reflect the proposals in the Conduct of Business (Long term insurance) Code and Conduct of Business (Non long term insurance) Code.

The amended CGC will remain subject to the principle of proportionality, such that insurers are expected to implement the requirements in a manner appropriate to the nature, scale and complexity of the insurer, its activities and the risks to which it is or may be exposed.

Feedback on any aspect of the proposals from interested parties is welcome.

1 Introduction

1.1 ICP Project

The proposals in this consultation have been developed in line with the Authority's ICP Project as explained in its Roadmap.

Accordingly, in developing the CGC, the main source used for information on relevant international insurance standards has been the IAIS ICPs.

1.2 Development of existing requirements and other changes to the CGC

The existing CGC came into operation on 1 October 2010 and represented a significant formal addition to the Isle of Man insurance regulatory framework at that time. This included setting initial requirements as a foundation for more detailed later developments in key areas such as risk-based capital and conduct of business[3].

Whilst this document proposes a range of updates to the CGC, as set out in the executive summary, the main focus of changes being put forward herein is to develop measures supporting the introduction of risk-based capital requirements. These changes include the areas highlighted in the Roadmap, namely:

- Actuarial requirements (including in respect of non-life insurers).
- Enterprise risk management, including own risk solvency assessment.
- Reporting of material risk or financial issues to the Authority.

Other changes, some of which may be significant for different insurers, are identified and explained in the remainder of this document.

2 Summary of appendices

In this document:

Appendix 1 contains an overview of the ORSA proposals and their rationale to help explain the changes proposed.

Appendix 2 contains an example ORSA summary format for illustrative purposes

[3] Some changes in relation to conduct of business have been put forward in the CGC. However, the main detailed proposals relating to the selling of insurance contracts to customers is the subject of a separate consultation.

Appendix 3 contains a draft 'clean' version of the Corporate Governance Code of Practice for Insurers.

Appendix 4 contains a 'marked up' version highlighting the proposed amendments.

3 General amendments

In the amended CGC the following general changes were made:

1. A standard format for secondary legislation has been applied which has changed the document's overall look and numbering. The marked up version of the CGC attached does not show the old numbering; however, the table below provides a cross reference between the old and new numbering.

2. Pursuant to the transfer of functions of the Insurance and Pensions Authority into the Isle of Man Financial Services Authority, references to the Insurance and Pensions Authority and Supervisor have been changed to Financial Services Authority and Authority.

3. In line with current drafting style for secondary legislation the term "must" has been use instead of "shall" in relation to requirements throughout.

4. Certain sentences incorporating the words "not limited to" have been shortened in cases where the meaning will not be changed. For example, "includes, but is not limited to" has been shortened to "includes; and "such as, but not limited to" has been shortened to "such as".

4 Table of proposed amendments to CGC

In the following table, the first column refers to the numbered paragraphs in the current ("old") CGC, the second refers to the paragraphs as numbered in the "new" amended CGC and the third contains the Authority's comments on corresponding changes.

This document needs to be read in conjunction with the updated CGC.

Readers will note that a number of comments in the right hand column are simply statements of what the change is rather than an explanation. Where this is the case, the Authority considers that the change is self-explanatory as a desirable component of an insurer's corporate governance framework (where relevant and proportionately applied).

Old CGC	New CGC	Comments in relation to corresponding change
1.1	3	This introductory paragraph includes some minor amendments to its wording which are reflective of other proposed changes to the CGC.
3.1(c)	-	Old sub-paragraph 3.1(c) is deleted. For the avoidance of any doubt, the CGC will still apply to an insurance manager insofar as the manager acts in the capacity of an outsourced significant activity or function of an insurer or in any other capacity in respect of an insurer to which the CGC applies. Corporate governance provisions particular to insurance managers will be the subject of a separate consultation exercise currently anticipated to be carried out in April 2018.
3.2	6	This paragraph has been amended to specifically refer to the United Kingdom as this change will allow for the United Kingdom's exit from the European Union.
3.3	7	This paragraph has been amended to take account of the overlying corporate governance requirement introduced in the Insurance (Amendment) Bill 2017 (the "Bill"). "Adequate" has been added for consistency of wording with other provisions in the CGC. "Or may be" has been added to better reflect the forward looking nature of risk management which includes, for example, consideration of risks associated with prospective decisions.
5.1 5.3 5.4 7.6	9	Overall, new paragraph 9 combines and refines old paragraphs 5.1, 5.3, 5.4 and 7.6. Changes include: New sub-paragraph 9(1)(b)(ii) replaces the second part of the old paragraph 5.3 with a requirement more consistent with risk management provisions elsewhere in the CGC.

		New sub-paragraph 9(1)(c)(iii) is a new requirement advocating appropriate consideration of the longer term. This forward-looking emphasis is consistent with old sub-paragraph 5.5(c) as well as its replacement provisions within the new ERM and ORSA proposals. New sub-paragraphs 9(1)(c)(iv) and 9(2) are similar to (and replace) old paragraph 5.4 but with refined wording. A similar requirement previously appeared in the Bill. New sub-paragraphs 9(1) and 9(2) are also similar to (and replace) old paragraph 7.6. However new 9(1) and (2) are more specific on the types of principles that old 7.6 was referring to. This more direct wording supports the Authority's view that corporate ethical values must be strongly held, conspicuous and supported by appropriate systems and controls if they are to be effective in practice to balance commercial drivers and support an appropriate corporate culture. (Also see old paragraph 7.6 below)
5.5	11	New sub-paragraph 11(a) amends old sub-paragraph 5.5(a) such that capital adequacy is now to be specifically assessed against 'economic capital needs' (which is determined through the ORSA process and encompasses the old requirement to cover liabilities arising out of the risk exposure). New sub-paragraph 11(b) is a simplified replacement of old sub-paragraph 5.5(b). Old sub-paragraph 5.5(c) has been deleted and is replaced by provisions within the new ORSA proposals.
5.6	12	The wording of this paragraph has been re-ordered to make it clear that staff are part of the management resources required. It also specifies that staff are required to have appropriate integrity and need to be individually and collectively fit for their role(s).
5.8	14	New sub-paragraph (a) has been amended to specifically include records in relation to an insurer's internal organisation as well as its business. New sub-paragraph (b) has been amended to specify that records must kept in an orderly manner.
5.9	15	This paragraph has been amended to better reflect that governance documentation also needs to record the governance systems in

		operation. For example, where significant, it would include the outcomes and rationale of decisions; monitoring, reviews, reports and assessments, as well as actions taken and follow up activities. Also, the examples provided under old sub-paragraphs 5.9(a) to (c) have been deleted as being included within the term "significant systems of governance".
5.10	16	In this paragraph, "effective" has been added for consistency of wording with other provisions in the CGC (effectiveness outside of an actual disruption might be assessed, for example, by periodically simulating a disruption and testing the continuity arrangements).
6.2(a)	18(1)	This sub-paragraph has been amended for consistency of wording with other provisions in the CGC (i.e. use of the terms adequate and appropriate). It has also been amended to require an insurer's board to have a suitable mix of directors and for the board to be suitable for the insurer's governance framework. These changes are considered to provide additional reference to component parts of appropriate governance arrangements rather than being additional requirements.
6.3	19	New sub-paragraph (a) has been amended to clarify that a board's composition must include appropriate independent representation to ensure it is able to exercise objective judgement (which may in some cases result in a greater number of independent non-executive directors being appointed than the minimum required in old paragraph 6.2/new paragraph 18, and particularly in the case of an insurer with third party policyholders). New sub-paragraph (b) is a new provision requiring the board of an insurer to set out its approach with regard to its ability to be objective and independent and to have systems to document and support its implementation of that approach.
6.4, 6.6, 7 and Sch 1	20, 22, Part 3 and Sch 1	A requirement to "implement" has been applied to various provisions applicable to the board for consistency of wording with other provisions in the CGC. To avoid any confusion as to what is meant, the term 'implement' has been defined in the interpretation section (new Part 16) in order to specify that such implementation may be delegated as appropriate. This acknowledges that the board is ultimately responsible for implementation but is likely to delegate implementation activities to executive management or other persons as appropriate. These changes are considered by the Authority to be clarifications.

6.5, 7, 10	21, Parts 3 and 6	References to the delegation of functions have been amended to now refer to activities and/or functions. This is considered to be a clarification that the provisions apply to all significant delegations.
6.6	22	This paragraph has been rearranged so that the desired outcome (which previously appeared in sub-paragraph (b)) is now included in sub-paragraph (a). Also, for consistency of wording with other provisions in the CGC, it has also been amended to include the requirement to be “effective”.
-	24	This is a new paragraph which sets out certain documents that are expected to be provided in a timely manner to the directors of an insurer prior to each of its board meetings.
6.8	25	This paragraph has been extended to include more detail of matters expected to be included in minutes.
7.1	26(4)	New sub-paragraph (d) is a new provision to reflect that the board of an insurer is responsible for oversight of the embedding of the insurer’s corporate culture. New sub-paragraph (e) / old sub-paragraph (d) has been amended to include delegation of “activities or functions” (which include any relevant authority).
7.2	27	New sub-paragraph (a) has been amended to state that “clear definitions” of “roles”, responsibilities etc. need to be maintained as part of an insurer’s records. It has also been amended to state that the provision includes the requirement to separate the oversight function from management responsibilities (which is needed to prevent conflicts, promote objectivity and support effective oversight). New sub-paragraph (c) has been revised to be clearer and to reflect that arrangements must ensure accountability.
7.4	29	New sub-paragraph (1), for consistency of wording with other provisions, now requires that the means of monitoring and holding senior management to account must be maintained.
7.6	9	Old paragraph 7.6 in relation to governance principles has been deleted but has not been lost as it is included and clarified within new paragraph 9. Old paragraph 7.6 refers to unspecified governance principles which need to be given due regard within strategies, significant policies and other systems of governance. New paragraph 9 refines this into certain

		minimum requirements concerning the manner in which commercial goals should be pursued by insurers, and requires these to be recognised and given effect throughout its governance framework. These changes recognise that it is important that an insurer is able to articulate and demonstrate both internally, as well as externally to relevant stakeholders including the Authority, the ethical values it believes in and adheres to in devising its strategies and carrying out its operations.
7.8	32	This paragraph has been amended to include specific reference to business objectives. Also, new sub-paragraph (e) has been amended to refer to relevant and material changes to internal and external environment as an important consideration in maintaining suitable objectives, strategies and policies.
7.9	33	This paragraph has been amended for consistency of wording with other provisions of the CGC (i.e. to include the requirement for the required measure to be “adequate, appropriate and effective”). It has also been made more specific as to whom the remuneration policy must apply, what the required outcomes are and to require management of conflicts in relation to the policy.
7.10	34	This paragraph has been amended to emphasise the need for clearly defined roles in respect of an insurer’s financial reporting system and for its board to engage appropriately with the external audit process.
7.12	36	This paragraph has been updated in relation to the proposals for ERM and ORSA in relation to old-paragraph 15 and Schedule 1 / new part 11 and Schedules 1 and 2. It reflects the responsibilities and information needs of an insurer’s board of directors to properly direct and oversee the risk management, financial management and regulatory capital compliance of the insurer.
7.13	37	This paragraph has been amended to refer to an internal control system rather than a framework. This is for consistency of terminology with the risk management system of which internal control system is part. Also, new sub-paragraph (b) has been amended to take account of reporting from the actuarial function.
7.14	38	This paragraph has been amended to take account of new paragraph 70 in respect of anti-money laundering and combating the financing of terrorism.
7.15	39	This paragraph has been amended to link the corporate cultural requirement to the overlying requirements of new paragraph 9 (in

		respect of general conduct and the application of ethical principles) and new paragraph 10 (compliance, which is unchanged from old paragraph 5.2). It also refers to the culture supporting implementation by an insurer of its own objectives, strategies and policies, which include, for example, its risk appetite policy and the standards of conduct it has adopted for its business. References to "sustain" and "on an ongoing basis" reflect that the promotion of a suitable corporate culture is a continuous requirement.
8	41	This paragraph has been amended to include additional provisions in respect of the responsibilities of directors of insurers, including that they should act reasonably and objectively, put the interests of the insurer and its policyholders before their own and not use their position for undue personal gain or to the detriment of the insurer. New sub-paragraph (h) replaces old sub-paragraph (d). The new sub-paragraph develops the requirement to specifically require objectivity and to take due account of the interests of the insurer and its policyholders. In the new sub-paragraph the term "independent" requires the director to be independently minded (i.e. to be their own person and not be unduly influenced by any other party).
9	42	New sub-paragraph (a) / old sub-paragraph (b) has been amended to reflect the criteria of "sound and prudent" in respect of executive management and to include that it must be "effective" in carrying out its role. It has also been amended to take account of other relevant changes made in the CGC. New sub-paragraph (b) is old sub-paragraph (a) which has been moved to this point and shortened. New sub-paragraph (c) has been amended consistent with changes made at old paragraph 7.15 / new paragraph 39. New sub-paragraph (e) / old sub-paragraphs (e) and (f) has been amended to better reflect executive management's role of in facilitating oversight by the board. It has also been updated in relation to the proposals for ERM and ORSA in relation to old-paragraph 15 and Schedule 1 / new part 11 and Schedules 1 and 2, and to specifically include business plans. New sub-paragraph (g) is a new provision recognising the responsibilities of senior management in relation to record keeping.

10	43	New sub-paragraph (a) is a new provision to specify that outsourcing must not reduce the level of oversight or accountability over outsourced activities or functions. New sub-paragraph (e)(i) / old sub-paragraph d(i) has been amended to specify that outsourcing must not unreasonably increase operational risk. New sub-paragraph (e)(v) / old sub-paragraph d(v) has been amended to specify that an insurer's outsourcing must not unreasonably impair the Authority's supervision in respect of the insurer's compliance.
11	44	New paragraph 44 is a new provision requiring an insurer to have a suitable actuarial function to provide expertise in respect of the calculation of its technical provisions and in other relevant areas.
11.1	45	This paragraph has been amended to take account of the requirement for an actuarial function.
11.2	46	This paragraph has been amended to take account of the requirement for an actuarial function.
11.3	47	This paragraph has been amended to take account of the requirement for an actuarial function. In addition, new sub-paragraph (a), consistent with other provisions, now requires the controls in question to be "effective". It has also been amended to be clear that this paragraph applies only to the "appointed actuary". In respect of an actuarial function other than the appointed actuary the other provisions of the CGC would still apply to managing any relevant conflicts of interest as may arise.
12.1	48	New sub-paragraph (a) has been amended to include the words "or may be" which is consistent with the change referred to in new paragraph 7 / old paragraph 3.3.
12.2	49	The first paragraph has been amended to include the words "or may be" which is consistent with the change referred to in new paragraph 7 / old paragraph 3.3. New sub-paragraph (b) is a new provision specifying what an insurer's internal audit function must be capable of.

		New sub-paragraph (d) / old sub-paragraph (c) has been amended to require an insurer's internal audit to have sufficient "authority" as well as status to ensure that it is suitably responded to by the insurer. New sub-paragraph (g) / old sub-paragraph (f) has been amended to include the words "or may be" which is consistent with the change referred to in new paragraph 7 / old paragraph 3.3.
12.3	-	The last sentence of old paragraph 12.3 has been deleted. This reflects that the Authority does not consider it appropriate for the board of an insurer to carry out the insurer's internal audit function.
12.4	51	This paragraph has been amended to reflect that the Authority does not consider it appropriate for the board of an insurer to carry out the insurer's internal audit function
13.2	53	This paragraph has been amended to include the words "or may be" which is consistent with the change referred to in new paragraph 7 / old paragraph 3.3. New sub-paragraph (a) has been amended to reflect that an insurer's compliance function needs to have suitable independence to support its objectivity and therefore its effectiveness. Concerning the independence required of an insurer's compliance function, for example, where an objective compliance check is needed in respect of an activity of the insurer, the person responsible for carrying out the activity should not also carry out the compliance check as they are conflicted and their objectivity is impaired. New sub-paragraph (b) is a new provision to specify what an insurer's internal compliance function must be capable of.
15.1	59	Sub-paragraph (a) has been amended to include the requirement for a risk management function. It has also been amended to include the words "or may be" which is consistent with the change referred to in new paragraph 7 / old paragraph 3.3. Old-sub-paragraphs (i) and (ii) are now included within new sub-paragraph (a). New sub-paragraph (b) / old sub-paragraph (d), for consistency with other provisions in the CGC, has been amended to include the requirement to "establish".

		New sub-paragraph (d) is a new provision recognising at a high level the need for an insurer to take account of its current and prospective financial position in determining its risk management actions. This reflects that an insurer must manage its risks within its financial constraints. It also recognises the importance of the ORSA in this regard. Although this is new wording, the requirement to integrate risk and financial management, including undertaking forward-looking, ORSA-type activities, is not new to the CGC but is a development of existing requirement as referred to in Appendix 1 (overview of ORSA and its rationale).
15.2	60	In new sub-paragraph (a) the term “relevant” has been included (previously it was in old sub-paragraph (b)). This is for consistency with wording elsewhere in the CGC. New sub-paragraph (a) has also been amended to include the words “or may be” which is consistent with the change referred to in new paragraph 7 / old paragraph 3.3. New sub-paragraph (c) is a new provision specifying that an insurer needs to have management policies in place to manage all of its main risks. New sub-paragraph (d) / old sub-paragraph (c) has been amended to take account of the requirements for a risk appetite framework as referred to in new paragraphs 64 and 65 (these paragraphs encompass and expand on the “risk tolerance limits” referred to in old sub-paragraph 15.2(c)). New sub-paragraph (e) is a new provision specifying the need to include an ERM system and ORSA process within the risk management system to coordinate risk and financial management. Although this is new wording, the requirement to coordinate risk and financial management is not new to the CGC but is a development of existing requirements as referred to in Appendix 1 (overview of ORSA and its rationale).
-	61	New paragraph 61 is a new provision requiring an insurer to have a risk management function, and specifying what that function must be capable of. Concerning the independence required of an insurer’s risk management function, independence is needed where the risk management function is performing a material checks and balances role or where the board otherwise requires objective assurances from the risk management function in the fulfilment of its oversight duties.
5.5(c)	62	This paragraph (together with the ORSA) expands on and replaces old sub-paragraph 5.5(c). In addition to requiring forward-looking analysis in

		respect of assessing current and prospective capital and liquidity adequacy (as old 5.5(c) requires), the requirement has been developed and extended to also include assessment of current and prospective risk management and assessing prospective compliance with regulatory capital requirements. The requirement to determine economic capital needs is not considered by the Authority to be a new requirement as it is an implied necessity in order to comply with old paragraph 5.5.
-	63	This new sub-paragraph requires an insurer to have in place a coordinated and informative risk management policy which explains how the insurer approaches its current and prospective risk management. New sub-paragraph (1)(a) requires a joined up approach to be taken in respect of managing relevant material risks on a strategic and operational basis, which takes account of the interrelationships between those risks. For example, the need to coordinate asset and liability risk management. New sub-paragraph (1)(b) requires the risk management policy to be forward-looking and consider at least the insurer's forecast time horizon (which is expected to be between 3 and 5 years but no less than 3 years without the Authority's approval). The risk management policy is an important factor in the ORSA and therefore needs to be considered for at least the same period as the ORSA and take into account any relevant, material factors likely to occur in that time period (e.g. business plans, anticipated group restructuring or foreseeable external events). New sub-paragraph (1)(c) requires the risk management policy of an insurer to recognise on a current and prospective basis the relationship between key elements of its coordinated risk and financial management control framework (these elements are explained further later in this document). It should be noted that the requirement to coordinate risk and financial management is not new to the CGC but is a development of existing requirements as referred to in Appendix 1 (overview of ORSA and its rationale). New sub-paragraph (2) requires that ERM system is suitably documented and therefore verifiable.
-	64	This new paragraph (together with new paragraph 65) requires an insurer to establish its "risk appetite framework" and to make appropriate use of it. This is not a new concept in the CGC but develops

		the requirements in relation to risk tolerance limits as referred to in old sub-paragraphs 7.12(c) and 15.2(c) and paragraph 21. New sub-paragraphs (1)(a) requires an insurer to determine its "risk appetite". Risk appetite describes the insurer's approach to risk and reward expressed in terms useful to its operations and stakeholders (i.e. the types of business it wants to assume, the risks it will face in doing so and the limits it will apply to avoid over extending itself in the process). Accordingly, the risk appetite of an insurer is the overall risk it is willing to take in pursuit of its business objectives and plan. In determining an appropriate risk appetite in respect of an insurer prudence dictates that the risk appetite – - overall does not exceed its risk capacity (see new sub-paragraph (2) below); and - is supported by component restrictions used day to day to ensure it takes on only the risks it intends to take and can afford to take (see new sub-paragraph (1)(b) below). New sub-paragraph (1)(b) requires an insurer to set out in respect of each of the relevant and material categories of risk it faces, risk limits and variability tolerances around those limits. The risk tolerance margin may allow for a degree of flexibility in the levels of risk accepted in practice (equally, and insurer may wish to apply zero flexibility and apply 'hard' limits in its risk acceptance policy). In any event, the risk limits and tolerances must provide appropriate trigger points to alert management to any material divergence over and above the amount of risk the insurer planned to accept (or is capable of accepting) so that timely preventative/remedial action can be taken. New sub-paragraph (2) defines "risk capacity" which recognises the limitations applicable to an insurer's risk appetite. Risk capacity is the point beyond which an insurer will be in breach of one or more of its significant constraints, such as its – - capital and liquidity adequacy, as determined by the insurer's board and senior management consistent with the relevant requirements of the CGC; - the regulatory capital requirements calculated in accordance with the Authority's specifications; and

		- any other constraints applicable to the insurer's circumstances such as exhaustion of borrowing facilities, restrictions from currency controls, operational limitations or avoidance of undesirable reputational matters. New sub-paragraph (3) requires that an insurer's risk limits and tolerances take account of any interrelationship between its categories of risk. This ensures that the insurer has regard to the full potential impact of its risks for management purposes. (Note: in summary the relationship between the elements of the risk appetite framework is as follows: risk limits must lie within risk tolerances, risk limits and tolerances collectively must not exceed overall risk appetite and risk appetite must not exceed risk capacity.) New sub-paragraph (4) relates to risks such as reputational, regulatory and political risks which may be impracticable to quantify. However, a difficulty in quantification should not lead to imprudent risk taking. Therefore, where the nature of an insurer's business and markets is such that it is exposed to risks that are hard to quantify, it must still have prudent regard for those risks on a qualitative basis and address them within its risk and financial policies. This might include, for example, the insurer – - establishing and maintaining a surplus risk capacity based on a reasonable assessment of the risk; - transferring the risk; and/or - having contingencies in place to mitigate the risk or having facilities to obtain additional funding should the risk materialise.
-	65	This new paragraph requires an insurer to integrate and use its risk limits and tolerances appropriately within its strategy and operations to deliver a risk profile as envisaged in the insurer's business objectives and plans. Also, consistent with sub-paragraph 64(1)(b), proper use also includes preventing the insurer from exceeding its risk appetite.
15.3	66	This paragraph develops and replaces old paragraph 15.3 of the CGC. New sub-paragraph (a) is a new provision recognising the dynamic nature of effective risk management, which needs to adapt in a timely manner to significant changes in internal and external risk environments. New sub-paragraph (b) reflects the continual nature of risk management by making reference to a 'feedback loop' in facilitating oversight and

		timely and appropriate actions in relation to risk, solvency and liquidity matters.
16.1	67	New sub-paragraph (1) has been amended to make reference to an internal control system rather than a framework. This is for consistency with the risk management system of which the internal control system is part. It has also been amended to specifically include the actuarial function as part of the internal control system. New sub-paragraph (2) has been amended to recognise more widely the need for the risk management system (including the internal control system) of an insurer to be internally coordinated such that it takes account of the relevant and material findings of its component expert functions, as well as its external auditor. In this manner the risk management system is expected to be able to adapt appropriately to the insurer's internal and external risk environment and facilitate objective oversight by the insurer's board.
16.2	68(2)	New paragraph 68(2) has been amended to include the words "or may be" which is consistent with the change referred to in new paragraph 7 / old paragraph 3.3.
17	69	New sub-paragraph (a) / old sub-paragraph 17(a) has been amended to specifically require the allocation of sufficient anti-fraud resources, for anti-fraud policies to be in place and to specify that the anti-fraud policies, procedures and internal controls need to be effective. New sub-paragraph (a)(i) / old sub-paragraph 17(a) has been amended to include reference to prevention, which was previously included under old paragraph 17(c). New sub-paragraph (a)(ii) is a new provision requiring appropriate remedial action in respect of fraud. Concerning this requirement, it should be noted that, in accordance with new paragraph 4 / old paragraph 1.2, this provision is without prejudice to any other relevant legal or regulatory requirement, as well as any guidance given by the police or other relevant authority. New sub-paragraph (c) has been amended to take account of the 'prevention' requirement being moved to sub-paragraph (a)(i). New sub-paragraph (d) has been amended to include a new emphasis that an insurer's fraud prevention measures must be covered by its internal audit programme.

-	70	This is a new provision to acknowledge the importance of anti-money laundering ("AML") and combating the financing of terrorism ("CFT") matters within wider governance arrangements. Whilst other statutory documents deal with the detailed requirements in relation to AML/CFT, this proposed amendment recognises the interrelationship AML/CFT has with an insurer's risk management system, including its internal audit programme.
18(b)	71(b)	New sub-paragraph (b) has been amended firstly to be clear that the whistleblowing reporting structure is internal, and secondly to require whistleblowing arrangements to recognise that an unsatisfied whistleblower may elect to raise concerns with the Authority.
19	72	The amendments to this paragraph are aligned with Authority's separate, more detailed, developments in respect of conduct of business applicable to commercial insurers. In new sub-paragraph (1) / old paragraph 19.1, the opening sentence is amended to require implementation measures to include policies and internal controls and, consistent with other provisions in the CGC, to require the implementation measure to be adequate, appropriate and effective. It is also amended to require the implementation measures to be integral to the corporate culture. New sub-paragraph (2)(a) / old sub-paragraph (a) is a new provision to specifically require an insurer to manage any conflicts of interest which might adversely affect any advice given by or on behalf of the insurer to its policyholders in order to ensure they are treated fairly. New sub-paragraph (2)(c) is a new provision to specifically require an insurer to ensure that any advice given by the insurer, or another party acting on behalf of the insurer (e.g. through an agency), to its policyholders, is appropriate to their disclosed circumstances in order to ensure they are treated fairly. New sub-paragraph (2)(f): is a new provision which recognises, notwithstanding requirements already imposed for example by the Data Protection Act 2002, that the protection of a policyholder's private information is an element of fair treatment. New sub-paragraph (2)(g) / old sub-paragraph (e) has been amended to reflect the need for timeliness in dealing with claims and complaints.

20	74	New sub-paragraph (1)(c) / old sub-paragraph (c) has been amended to specifically include the requirement for effective systems (in addition to controls) to support provision of information to the Authority and other relevant authorities. It also specifies that such information needs to be appropriate and effective (rather than just accurate). The systems being referred to include any of the systems referred to in the CGC as may be applicable, for example: the financial reporting system and information and communication systems as referred to under new paragraphs 34 and 35 (old paragraphs 7.10 and 7.11) respectively. New sub-paragraph (2) is a new provision to require insurers to report to the Authority in a timely fashion in respect of any matter in relation to the insurer of which the Authority would reasonable expect notice. This includes any change or incident that might materially impact the insurer or the fair treatment of its policyholders, as well as any significant deviation of the insurer from the requirements of the CGC or any material issue affecting an insurer's external or regulatory reporting.
21	75	The following relates to definitions which are new, removed or updated – "actuarial function" (and "appointed actuary") updates the old definition of "actuary" to take account of the new requirement for an actuarial function (new Part 7 / old paragraph 11); "annual accounts" has been amended to remove the provisions relevant to insurance managers, which takes account of the deletion of old paragraph 3.1(c); "ALM" is an abbreviation of "asset-liability management", and is an update simply to support the use of the shorter form ("ALM") in the CGC; "capital adequacy" is a new definition which corresponds to compliance with the requirement under new sub-paragraph 11(a) / old sub-paragraph 5.5(a); "capital adequacy requirement" is a new definition which refers to the requirement under new sub-paragraph 11(a) / old sub-paragraph 5.5(a); "CGC" has been updated to include a relevant cross reference to new paragraph 1 / old paragraph 2;

		"constitutional documents" has been deleted as it is not required; "economic capital needs" is a new definition of a new term used in relation to risk and capital management; "ERM" (enterprise risk management) is a new definition of a new term used in relation to risk management on an integrated basis for an insurer as a whole, including across all of its business operations (put another way, enterprise-wide risk management); "financial management" is a new definition of an existing term used in relation to the dual requirements of capital and liquidity adequacy under new sub-paragraph 11(a) and 11(b) / old sub-paragraph 5.5(a) and 5.5(b) respectively; "forecast time horizon" is a new definition of a new term used to describe the standard minimum forward-looking period to be taken into account in connection with an ORSA and risk policy; "implement" is a new definition of an existing term which has been included to clarify that implementation requirements in the CGC applicable to an insurer's board are without prejudice to appropriate delegation by the board; "liquidity adequacy" is a new definition which corresponds to compliance with the requirement under new sub-paragraph 11(b) / old sub-paragraph 5.5(b); "liquidity adequacy requirement" is a new definition which refers to the requirement under new sub-paragraph 11(b) / old sub-paragraph 5.5(b); "ORSA" (own risk solvency assessment) is a new definition which refers to the required process as set out under new Schedule 2 / old sub-paragraph 5.5(c) (and other ORSA-type requirements of the existing CGC which are referred to in more detail in Appendix 1 (overview of ORSA and its rationale)); the two "outsourced…" definitions have been amended to include reference to outsourced activities as well as functions; "regulatory capital requirements" is a new definition which refers to the Authority's proposed updated minimum margins of solvency (the MCR and SCR). Ongoing compliance with the

		MCR/SCR, and their adequacy for an insurer's particular risk profile, is an aspect of its ORSA; "risk appetite" is a new definition which refers to an insurer's chosen type and level of total risk it is willing to accept within (i.e. not exceeding) its risk capacity; "risk appetite framework" is a new definition which comprises an insurer's risk appetite which lies within its risk capacity, as well as the various risk limits and tolerances which lie within its risk appetite; "risk capacity" is a new definition which refers to an insurer's total level of risk it could theoretically accept before it breached one or more of its financial or other constraints; "risk limits" is a new definition which refers to an insurer's chosen level of risk acceptance for a particular category of risk; and "risk tolerances" is a new definition which refers to the level of variability around a risk limit which an insurer is willing to allow for the purposes of operational flexibility.
Sch 1, underwriting risk, (d)	Sch 1 2(4)	This sub-paragraph has been amended to include the words "or may be" which is consistent with the change referred to in new paragraph 7 / old paragraph 3.3. The wording of this sub-paragraph's cross references to capital and liquidity adequacy compliance have been updated for changes to terminology, and a new requirement has been specified for compliance with the regulatory capital requirements (MCR/SCR).
Sch 1' underwriting risk (e)(i) and (f)	Sch 1 2(5)(a) and 2(6)	The wording of this sub-paragraph's cross references to capital and liquidity adequacy compliance have been updated for changes to terminology, and a new requirement has been specified for compliance with the regulatory capital requirements (MCR/SCR).
-	Sch 1 2(8)	This is a new provision requiring an insurer to promptly document and formalise any outwards reinsurance or any other risk transfer mechanisms it uses.
Sch 1, insurance provisions risk (d)	Sch 1 3(4)	The wording of this sub-paragraph's cross references to stress testing and other techniques has been updated to take account of the change in location of those requirements.

		Also, the wording of this sub-paragraph's cross references to capital and liquidity adequacy compliance has been updated for changes to terminology, and a new requirement has been specified for compliance with the regulatory capital requirements (MCR/SCR). Further, the words "and other financial resources" have been deleted such that the requirement now requires capital to cover potential increases in insurance provisions. This is to reflect that adverse claims experience (including in respect of reasonably foreseeable atypical and catastrophe events) need to be addressed when determining economic capital needs and corresponding capital adequacy.
-	Sch 1 4(1)	This is a new provision requiring an insurer to only invest in assets which it can properly manage from a risk, capital and liquidity perspective.
-	Sch 1 4(2)(a)	This is a new provision requiring an insurer to articulate within its investment policy the nature, role and extent of its investment activities and how it complies with any relevant regulatory rules.
-	Sch 1 4(2)(b)	This is a new provision requiring an insurer to have specific procedures in respect of potentially higher risk investments in order to ensure it controls them properly.
Sch 1, investment risk (a)(ii)	Sch 1 4(2)(d)	This sub-paragraph has been amended to refer to the abbreviation ALM rather than to asset-liability management.
Sch 1, investment risk (b)	Sch 1 4(3)	The wording of this sub-paragraph's cross references to capital and liquidity adequacy compliance has been updated for changes to terminology, and a new requirement has been specified for compliance with the regulatory capital requirements (MCR/SCR).
Sch 1, investment risk (g)	Sch 1 5	New sub-paragraph 5(1) / old sub-paragraph (g) of investment risk has been given its own heading and has been amended to refer to the abbreviation ALM rather than to asset-liability management. In addition it has been amended to refer to the liability profile as part of the risk profile. New sub-paragraph 5(2) is a new provision requiring an insurer to articulate within its ALM policy the nature, role and extent of its ALM activities and their relationship with certain other activities.

Sch 1, derivative risk	Sch 1 6	The first sentence of this paragraph has been amended to include the words “or may be” which is consistent with the change referred to in new paragraph 7 / old paragraph 3.3.
-	Sch 1 6(1) and (2)	These two paragraphs are new provisions requiring an insurer to limit any use of derivatives to prudent, non-speculative purposes appropriate to the nature of its business.
Sch 1, derivative risk (a)(v) and (b)	Sch 1 6(3) and (4)	These sub-paragraphs have been updated to reflect the above mentioned changes in respect of ALM, the risk appetite framework and internal control system.
Sch 1, group risk	Sch 1 11	This paragraph has been expanded to provide more examples of types and sources of group risk.
Sch 1, strategic risk	Sch 1 19	This is a new provision to specifically include strategic risk as a risk category. Strategic risk has crossovers with other risk categories. However, its inclusion helps emphasise, in respect of an insurer, the importance for its board to provide sound and prudent direction and oversight of the insurer. This includes, for example, making proper use of objective processes, notably internal audit and external audit, as well as technical assessments to ensure it is in a position to properly direct and oversee the insurer’s risk and financial management.
-	Sch 2 1	This paragraph establishes the requirement for an insurer to have an ORSA process in place (the ORSA is a part of the insurer’s risk management system as referred to in sub-paragraph 60(e)). For further information in relation to the ORSA refer to Appendix 1 (overview of ORSA and its rationale) and 2 (ORSA example of summary format).
-	Sch 2 2	This paragraph sets out the ORSA’s main overlying requirements. The requirements of sub-paragraph 2(1) are expanded on in the remainder of Schedule 2. Sub-paragraph 2(1), first sentence, provides that an ORSA must be calculated at least annually (also see sub-paragraph 2(3) below). Sub-paragraphs 2(1)(a) and 2(1)(b) provide that the principal areas of assessment for an insurer’s ORSA are the adequacy of its risk management, capital and liquidity, as well its compliance with its regulatory capital requirements. The financial assessments, in particular,

		include consideration of the insurer's prospective financial situation over an appropriate forecast period (see sub-paragraph 2(2) below). Sub-paragraph 2(1)(c) provides that the ORSA must assess if and where the insurer's particular risk profile deviates significantly from the assumptions underlying the regulatory capital requirements in order to consider any implications for its risk or capital management. Sub-paragraph 2(2) provides that an appropriate forecast period for an insurer would ordinarily be expected to be between 3 and 5 years, and no less than 3 years without approval from the Authority. Sub-paragraph 2(3) reflects that the ORSA is a continual process which, notwithstanding its minimum annual calculation, must include an appropriate re-calculation at any point where the insurer's risk profile has changed significantly from its risk profile as was assessed in its last ORSA calculation.
-	Sch 2 3	Sub-paragraph 3(1) states that an insurer's board and senior management are responsible for its ORSA. This reflects the central role of the ORSA in supporting sound and prudent management. Sub-paragraph 3(2) adds to sub-paragraph 3(1) and reflects the need for an insurer's board to have a close and active involvement with the ORSA as it is fundamental to informing a number of board-level matters. Sub-paragraph 3(3) requires appropriate dissemination of board-approved ORSA output to relevant staff. Sub-paragraph 3(4) requires that the Authority be informed of the results of each ORSA. However, the detail of what is required to be reported will be the subject of a separate consultation. This may include, for example, a summary form of routine reporting for lower risk insurers.
-	Sch 2 4	The ORSA is an important mechanism which must be used effectively if it is to support an insurer in managing its risks and resources on an ongoing basis. Sub-paragraph 4(a) recognises that an insurer's ORSA is essential to properly informing its business strategy, which needs to take account of the insurer's current and prospective risk and financial situation. Sub-paragraph 4(b) outlines some key areas where the ORSA has an important role in respect of an insurer which are:

		- Risk management: where, for example, the ORSA helps by identifying the insurer's significant financial constraints which is essential information for it to determine an appropriate risk appetite. - Capital management: where, for example, the ORSA helps the insurer to assess and decide upon the quality and quantity of capital it needs to retain against its risk profile, including contingent planning for re-capitalisation if losses absorb the insurer's available capital resources beyond the margins (or buffer) established within its capital retention policy (re-capitalisation scenarios are likely to be relevant in planning against plausibly extreme adverse claims or for catastrophe exposures). - Business planning: the ORSA helps the insurer in formulating and maintaining policies in core decision areas such as risk retention and risk transfer. - Product development and design: the ORSA helps the insurer in deciding how to prudently allow for risks in its products so that the insurer (without being prejudicial to the fair treatment of its policyholders) offers products which expose it only to the types and levels of risk it wishes to take in pursuit of its business objectives, priced in a manner which takes account of the insurer's longer-term financial needs.
-	Sch 2 5	The ORSA is a management information tool and therefore must be supported by an appropriate policy setting out in respect of an insurer what the ORSA is, why it is significant, how it links in with other key aspects of governance and how the insurer is to approach its calculation and use in practice. This paragraph specifies some minimum components expected of an ORSA policy. Sub-paragraph 5(a) refers to the processes and procedures to be used. Essentially the ORSA is ongoing process which requires an insurer to act on the basis of having suitably assessed its current and prospective risk, and financial position, and reassessing that position as needed when its circumstances change significantly or are likely to change significantly. Processes and procedures are necessary to ensure the ORSA operates on a consistent basis and as intended.

		Paragraph 5(b) refers to roles and responsibilities, including those applicable to the board, senior management and any other persons charged with duties in relation to the ORSA. Clarity in in this respect is essential if an ORSA process is to be efficient and effective in practice. Sub-paragraph 5(c) refers to recognising the link between an insurer's risk profile, its risk appetite framework and its current and prospective economic capital needs. For example, the insurer's developing risk profile should be controlled by way of its risk appetite framework, its risk profile dictates the nature and amount of capital it needs and the quality and amount of capital it has will be a constraint on its risk appetite framework. It is essential that the ORSA policy reflects how the relevant and material aspects of governance interrelate. Sub-paragraph 5(d) refers to the methods and methodologies to be used in the process and procedures. This includes information on bases for recognition and valuation, measurement techniques, data and timing of predetermined and change-driven ORSA calculations. The following provides further comment on two of those areas: - Sub-paragraph 5(d)(i) requires information on the recognition and valuation bases the insurer has decided to use within its ORSA in respect of its assets and liabilities. This does not require the use of recognition and valuation bases that are different to those used in the accounting standards adopted by the insurer in its audited financial statements, or (if different) as contained in its regulatory capital requirements. However, if for any reason an insurer does use different recognition and valuation bases, this needs to be fully explained and justified within its ORSA policy. - Sub-paragraph 5(d)(iii) requires information on data quality. This includes, for example, how the insurer takes account of any inadequacy, sub-quality or other factor leading to uncertainty within the data used in its ORSA.
-	Sch 2 6	This paragraph deals with various elements of an ORSA. Sub-paragraph 6(a) provides that an insurer's ORSA needs to address all of its relevant and material risks and this includes any unquantifiable risk (which is dealt with in sub-paragraph 6(f) below) and any off-balance sheet risk. Sub-paragraph 6(b) provides that the ORSA of an insurer needs to consider its forecast time horizon (i.e. as referred to in paragraph 2(2) above).

		Sub-paragraph 6(c) provides that an insurer needs to consider changes to its risk profile and, within its ORSA's forecast period, any likely future changes to its risk profile. It also identifies some likely causes of change, including: - Sub-paragraph 6(i) to 6(iii): the insurer's strategies, plans, risk and internal control systems, and reasonably anticipated future management actions. - Sub-paragraph 6(iv): the insurer's economic and financial environment, which encapsulates any relevant and reasonably foreseeable factor that might be expected to materially impact the insurer's risk profile (for example, a change in structure or ownership affecting availability of capital to the insurer, a proposed change in legal or regulatory frameworks applicable to the insurer's markets which may restrict its access to those markets, notification of a future closure of a key outsourced provider of the insurer which may lead to disruption or reduced standards of service, notification of legal or regulatory action which might lead to reputational damage or fines against the insurer etc.). Sub-paragraph 6(d) provides that an insurer needs to consider how it is positioned to deal with the uncertainty inherent in its business by assessing its ability to absorb possible losses that could occur under various plausible and adverse forecast scenarios. Sub-paragraph 6(e) provides that an insurer's ORSA must use appropriate recognition and valuation bases in order to properly reflect its risks and financial condition. If an insurer uses recognition and valuation bases in its ORSA that differ from those required or allowed to be used in its regulatory capital requirements, it must report this to the Authority (see paragraph 7 below). Sub-paragraph 6(f) provides (by way of reference to paragraph 62(2)) the need for an insurer's ORSA to have processes and techniques (including forward-looking quantitative methods, including stress testing, reverse stress testing and scenario analysis) which are adequate and appropriate to the nature, scale and complexity of the insurer, its activities and the risks to which the insurer is or may be exposed. Sub-paragraph 6(g) requires an insurer's ORSA to take account of any potentially significant but unquantifiable risks of the insurer in such a

		manner as to be useful to its risk and capital management policies (for additional comments see sub-paragraph 64(4) above). Sub-paragraph 6(h) recognises that the ORSA is a key mechanism for coordinating risk and capital management and therefore needs to specifically identify the link between the two. For example, and without prejudice to minimum regulatory capital requirements, an insurer only needs to hold capital against the risks it retains, and therefore the capital it needs will depend upon the framework it has in place to control its risk retention (e.g. risk appetite framework and risk mitigation measures). Equally, an insurer can only retain such risks as it has capital to properly support. Sub-paragraph 6(i) and 6(j) reflect the need for an insurer to have a forward-looking approach to assessing the level and makeup of its prospective capital position over its forecast time horizon. This includes assessment of the capital necessary to comply with its ongoing regulatory capital requirements, and any surplus capital against any other capital needs it has identified in respect of its retained risk. Sub-paragraph 6(k) reflects the need for an insurer to have a forward-looking approach to assessing its ability to meet its money outflow obligations over its forecast time horizon.
-	Sch 2 7	Sub-paragraph 7(a) requires an insurer to be in a position to report to the Authority on any differences between its economic capital needs as identified by its ORSA and its regulatory capital requirements. The report will include qualitative information and, where any material difference is identified, quantitative information. Sub-paragraph 7(b) requires an insurer to be in a position to report to the Authority on any differences between the recognition and valuation bases used in its ORSA and the recognition and valuation bases required or allowed to be used in its regulatory capital requirements.
-	Sch 2 8	Sub-paragraph 8(1) details the required output from an insurer's ORSA. The outputs listed below follow on from the various components of the ORSA process referred to above. In summary the outputs cover – - Current and prospective economic capital needs, capital adequacy and compliance with its regulatory capital requirements. - Current and prospective compliance with own funds requirements.

		- Current and prospective capital position surplus to own funds requirements. - Current and prospective liquidity position. - Treatment of any unquantifiable risks and corresponding policies. - Deviations of insurer's risks from assumptions underlying the regulatory capital requirements. Sub-paragraph 8(2) requires an insurer to obtain certain input from its actuarial function to support its ORSA in respect of its prospective regulatory capital requirements.
-	Sch 2 9	This paragraph recognises the need for an insurer to keep appropriate records and validations in relation to its ORSA process.

5 Responding to this consultation

Feedback is encouraged on all of the proposals set out in this paper and responses to this document should be provided by email, by 27 October 2017, to:

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APPENDIX 1 (overview of ORSA and its rationale)

Introduction

The ultimate aim of insurance is to create and protect value for policyholders whilst using capital resources efficiently. The main purpose of both risk and capital management of an insurer is to protect its policyholders and capital providers from adverse effects relating to the insurer's business. It is natural, therefore, for insurers to combine the management of their risk and capital such that their capital resources are sufficient to cover the liabilities as may arise from their risks but avoids being excessive and, therefore, inefficient from a capital provider perspective.

Consistent with this, an ORSA represents an insurer's own forward-looking view on a unified basis of its risk profile and the capital and other means (such as risk transfer) it needs to address those risks. In many ways the process of the ORSA is as important as its outcomes as it promotes the awareness necessary for effective risk and capital management and solvency control both in the short and longer-term.

The ORSA is not just an annual regulatory requirement. It is a continual process which links an insurer's current and longer-term risk and capital management to assess whether its risk management and financial position are adequate and are likely to remain so in the future.

Because of the ORSA's self-assessment nature it is for an insurer's board and senior managers to determine what is needed to perform an effective ORSA given the nature, scale and complexity of the insurer's risks and the factors relevant to how its risk profile may change in the foreseeable future. Accordingly, the Authority does not propose to prescribe how to perform an ORSA but has set out certain principles and outcomes, as well as record keeping and reporting requirements, to communicate the Authority's views on ORSA best practice and to allow for suitable regulatory supervision.

The Authority recognises that its ORSA proposals will require a bedding-in time and potential further discussion between industry and the Authority in relation to the requirements and their proportionate implementation.

Why the ORSA is needed in addition to regulatory capital requirements

The ORSA is needed in order to fully implement a risk-based insurance regulatory framework for the Island.

Regulatory capital requirements (in the Island and elsewhere) contain some inevitable limitations. This is because the practicalities of setting a generally applicable solvency level require the calculations to be based on general industry assumptions.

The ORSA, however, is required to ensure that capital is matched to each insurer's particular risk profile.

The insurer is therefore in a position to identify any potential limitations of the regulatory capital requirements for its particular profile of risks.

Consequently, pursuant to providing an appropriate level of protection for policyholders, a key role of the ORSA is to address any shortfall of the regulatory capital requirements in covering the particular risks of each individual insurer.

The ORSA is not a new concept for the Island's insurers

From a market perspective, as indicated in the introduction above, ORSA-type activities (i.e. coordinating risk and capital management for current and longer term purposes) are a natural undertaking so that an insurer is in a position to manage its risk and capital in a manner consistent with its key stakeholder interests.

From a regulatory perspective, ORSA-type activities were prominently recognised within the Authority's regulatory requirements in 2010 with the introduction of the CGC.

For ease of reference, the ORSA-type requirements in the current CGC include –

- **paragraph 5.5** (requirement for prudent, forward-looking, risk-based capital and liquidity adequacy);
- **paragraph 7.12(e)** (board to coordinate risk, capital and liquidity management activities);
- **paragraph 15.3(c)** (risk management reports to facilitate board's assessment of capital and liquidity adequacy);
- **schedule 1, paragraph (d) to (f) of Underwriting Risk** (underwriting strategy, including risk transfer and other risk mitigation, to include risk retention consistent with maintaining capital and liquidity adequacy);
- **schedule 1, paragraph (d) of Insurance Provisioning Risk** (insurance provisions to take account of adverse atypical claims experience and catastrophe events, and include stress testing, to assess capital and liquidity adequacy and the availability of future capital if needed to increase provisions); and
- **schedule 1, paragraph (b) of Investment Risk** (capital and liquidity adequacy must include consideration of investment risks).

It can be seen therefore that the new ORSA proposals are not a new activity but develop further the existing requirements of the CGC.

Differences between ORSA and regulatory capital requirements, and why the regulatory capital requirement cannot simply be regarded as a substitute for the ORSA

The following points provide examples of the potential limitations of the regulatory capital requirements in relation to the ongoing risk management and capital needs of a particular insurer:

- The purpose of the ORSA is to properly inform risk and capital management. The purpose of regulatory capital requirements is to trigger different levels of regulatory intervention.

- The ORSA matches capital resources to an insurer's specific risk profile. The regulatory capital requirements match capital resources to general industry risk assumptions. Consequently, the regulatory capital requirements may not include a particular risk of the insurer or may not adequately provide against a particular risk of the insurer. This might occur, for example, when

    - the risk is unusual for the type of business undertaken;
    - the assumption in the regulatory capital requirements does not adequately match the specific risks of the insurer (for example, in respect of operational risk which can vary significantly between insurers, or in respect of default risk where an insurer holds cash balances for less than 12 months); or
    - the risk has been purposefully left out of the regulatory capital requirements (for example, in respect of insurers subject to a 1 in 10 solvency confidence level, risks associated with any loans to associates or catastrophe risk exposure).

- The ORSA considers a minimum 3 year forecast time horizon. The regulatory capital requirements consider a 1 year forecast time horizon.

- An insurer might elect to apply a different solvency confidence level than the minimum prescribed in the regulatory capital requirements applicable to the insurer.

These limitations are also the reason why the regulatory capital requirements cannot simply be regarded as a substitute for the ORSA, together with the risk and capital management actions it informs, in meeting the corporate governance responsibilities of incumbent boards and senior managers.

What is expected of boards and senior management?

To give full effect in the Island to a risk-based solvency framework in relation to insurance business, it is essential for the boards and senior management of each insurer -

- to be highly aware of the insurer's material risks and risk profile as they change and are expected to change over time, and to respond to such changes appropriately;

- to identify whether the regulatory capital requirements are not, or are not expected in the foreseeable future to be, adequate to fund those risks to any material degree and, if so, to take the steps needed to address the economic capital needs of the insurer based on its particular risk profile and in line with its own sound and prudent risk and capital strategies; and

- to keep the Authority informed of any material issues that may require its attention.

This is not a new regulatory requirement but rather develops further an existing requirement and reflects best practice. As such, boards and senior management should be familiar with the requirements in principle.

ORSA results and conclusions will not necessarily lead to regulatory capital requirements add-ons

If the results or conclusion relating to an insurer's ORSA suggest that its regulatory capital requirements potentially fall short of addressing fully its risks, this will not automatically lead to a capital add-on (i.e. an extra regulatory capital requirement) being imposed by the Authority on the insurer concerned.

The Authority will consider the significance of the matter and how the insurer has dealt with it or intends to deal with it. The Authority will only resort to a capital add-on where it believes that its intervention is necessary in accordance with its regulatory objectives.

For example, the Authority's intervention would not be considered necessary where –

- the insurer has access to additional capital resources which, although they may not comply with the underlying criteria for eligibility for 'own funds' in the regulatory capital requirements, may nevertheless be of sufficient quality and quantity to cover the risks involved;

- the difference has arisen due to parameters falling outside of the regulatory capital requirements calculation, such as the use of a longer forecast horizon than the regulatory capital requirements 1 year standard; or

- the matter is being resolved using a risk treatment method other than holding capital, such as by risk transfer.

Timing of the ORSA

In relation to the minimum annual requirement to perform an ORSA, this should be performed by an insurer at an appropriate time having regard to the insurer's circumstances. For example, it may be appropriate for the performance of the ORSA to coincide with the insurer's financial year end or, where the insurer has a particular insurance program renewal period, it may be appropriate to closely precede that renewal process.

ORSAs of small Insurers (additional comments)

Maintaining a suitable ORSA framework on an ongoing basis may be challenging for a small insurance company, depending on the nature, scale and complexity of its business.

However, the Authority does not believe that a small insurer should be able, on account of its size alone, to have weaker governance.

A small insurer proposing to write business direct to members of the general public, for example, will need to provide a commercial level of governance (including having a comprehensive and technically competent ORSA process) in respect of that business and be able to demonstrate such to the Authority.

This also includes addressing any issues in connection with the scale of the insurer's business due to its small size. For example, small insurers may not be well diversified and therefore could potentially be more susceptible to external sources of risk.

ORSAs of 1 in 10 solvency confidence level companies (additional comments)

It may be that some simplifications to the proposed ORSA requirements may be appropriate in cases where an insurer has no third party policyholders. The Authority therefore welcomes comments from the Island's captive sector in relation to the proposed ORSA requirements and its proportionate implementation.

Where an insurer's regulatory capital requirements use a 1 in 10 solvency confidence level its ORSA will need to address risks associated with elements omitted from its regulatory capital requirements, including any loans made by the insurer and exposure to catastrophe events.

APPENDIX 2 (ORSA example of summary format)

The following provides an example of a summary format for an ORSA. It is envisaged that the Authority, in due course, may issue a general format guide to promote consistency in respect of ORSAs in order to facilitate comparability (where appropriate) and regulatory oversight. In the interim, this summary format is provided for illustration purposes. It is not intended to be exhaustive or to represent a settled view of the Authority, and would be subject to change is used as a basis for any future guidance.

1. <u>Introduction and background</u>
   In respect of the insurer's ORSA, its:
   a) Statement of purpose
   b) Ownership (who is responsible for performing, reporting and reviewing it)
   c) Scope, frequency and limitations
   d) Sign-off (who/what body is responsible for technical and ultimate sign offs)

2. <u>Executive Summary confirmation statement</u>
   a) The insurer's current risk profile is understood and appropriate for the nature of its business and within its risk appetite (or if not appropriate action was / is to be taken and, where required, the Authority informed)
   b) The insurer's regulatory capital requirements throughout the reporting period have been met (or if not appropriate action was / is to be taken and the Authority informed)
   c) The insurer's [point in time] capital and liquidity positions are adequate and appropriate (or if not appropriate action was / is to be taken and, where required, the Authority informed)
   d) The key drivers of the insurer's risk are understood
   e) The insurer's capital and investment plans to meet the capital and liquidity adequacy requirements and regulatory capital requirements projected over the forecast time horizon are appropriate including under stressed conditions (or if not appropriate action was / is to be taken and, where required, the Authority informed)

3. <u>The insurer's risk profile</u>
   a) The insurer, its business, market and drivers
   b) Outcome of insurer's risk identification and assessment, including aggregation
   c) The insurer's risk appetite, including as relates to its –
      (i) capital strategy for anticipated normal conditions
      (ii) capital intentions in terms of shocks and extreme shocks
   d) The insurer's strategic plan and link to its risk appetite

4. <u>The insurer's current and future solvency position</u>
   a) The base case setting out –
      (i) The insurer's current and forecasted capital adequacy, liquidity adequacy and regulatory capital requirement position based on the current business plan over the forecast time horizon
      (ii) material assumptions (e.g. losses, asset returns, inflation, claims inflation) including justification of those assumptions
   b) Data used in the insurer's ORSA assessment – including comment on the availability, source and reliability of the data
   c) Stress testing, reverse stress testing, scenario analysis and reverse scenario analysis in respect of the insurer; namely –
      (i) what might reasonably foreseeably happen and what impact would it have
      (ii) what plausible circumstances would render the insurer's current capital levels inadequate or cause it to breach its regulatory capital requirement
   d) The insurer's capital management plan
   e) Risk mitigation in relation to the insurer, including its:
      (i) Risk mitigation strategies:
         1. Risks not accepted
         2. Risks accepted and managed
         3. Risks accepted and mitigated/hedged
         4. Subsequent risks taken on as a result
      (ii) Reinsurance or other risk transfer strategy
   f) Management actions in relation to the insurer, including its:
      (i) Strategic flexibility (expected flexibility within the normal course of events)
      (ii) Management options in the face of more extreme events

5. <u>Validation Challenge and Assessment</u>
   a) The insurer's management review and conclusions (including any significant weaknesses identified in the ORSA process and any remedial actions planned and progress on any previous remedial actions not yet concluded satisfactorily)
   b) The insurer's board's review and challenge to ensure the process effectiveness and the validity of the outcomes for decision making in relation to the insurer. Specifically in relation to the insurer's:
      (i) Policy
      (ii) Process
      (iii) Scenarios
      (iv) Results

c) Reconciliation to the insurer's regulatory capital requirements and assessment of additional risks, or higher impact of risks, considered as part of its ORSA process
d) Evidence of link between the insurer's ORSA process, strategy and financial management activities