ISLE OF MAN
FINANCIAL SERVICES AUTHORITY
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APRIL 2024

OWN RISK AND SOLVENCY ASSESSMENT THEMATIC REPORT AND FEEDBACK

ISLE OF MAN NON-LIFE INSURANCE SECTOR

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Contents

1. Glossary of Terms

TERM	MEANING IN THIS REPORT
Board	Board of Directors (of the firm)
CGC	Corporate Governance Code of Practice for Insurers 2021
HOAF	Head of Actuarial Function
ORSA	Own Risk and Solvency Assessment
P&L	Profit and loss account
Reports	ORSA reports
SCR	Solvency Capital Requirements
The Authority	The Isle of Man Financial Services Authority
The Firm(s) or the Insurer(s)	Low impact authorised insurer(s)
Thematic reviews	Thematic questionnaires and desk-based inspections
Schedule 2	Schedule 2 (ORSA) of the CGC

2. Executive Summary

2.1 Introduction

Thematic reviews are an important tool in the Authority's approach to the supervision of firms. They are designed to help the Authority understand and assess industry-wide or sector risks, with a focus on those risks that, without mitigation, could cause the most harm to the regulatory objectives[1] of the Authority.

2.2 Thematic review scope and process

Scope

In accordance with the supervisory methodology framework, effective from 1 April 2023, low impact firms are primarily subject to thematic reviews, rather than firm-specific (risk or event-driven) inspections. Therefore, the Prudential Supervision Division (non-life insurance) undertook an ORSA thematic review between September 2023 and February 2024.

The primary objectives of this thematic review included the following:

- To identify any common themes in respect of the ORSA process and reporting; and
- For the Authority to provide feedback on its observations to industry.

Process

Completed ORSA questionnaires were requested and received from all Insurers (except dormant insurers and ISPV firms). 93 Insurers provided responses to the questionnaire.

From the responses to the questionnaires, a selection of Insurers were requested to provide additional information in order to enable the Authority to complete a desk-based review. Ten were selected using a risk-based approach, ensuring that the sample was spread across all insurance managers.

The observations and conclusions contained in this report are based upon evidence available from the thematic questionnaires and further information provided by the selected Insurers.

Thematic reviews help the Authority to understand industry-wide or sector risks

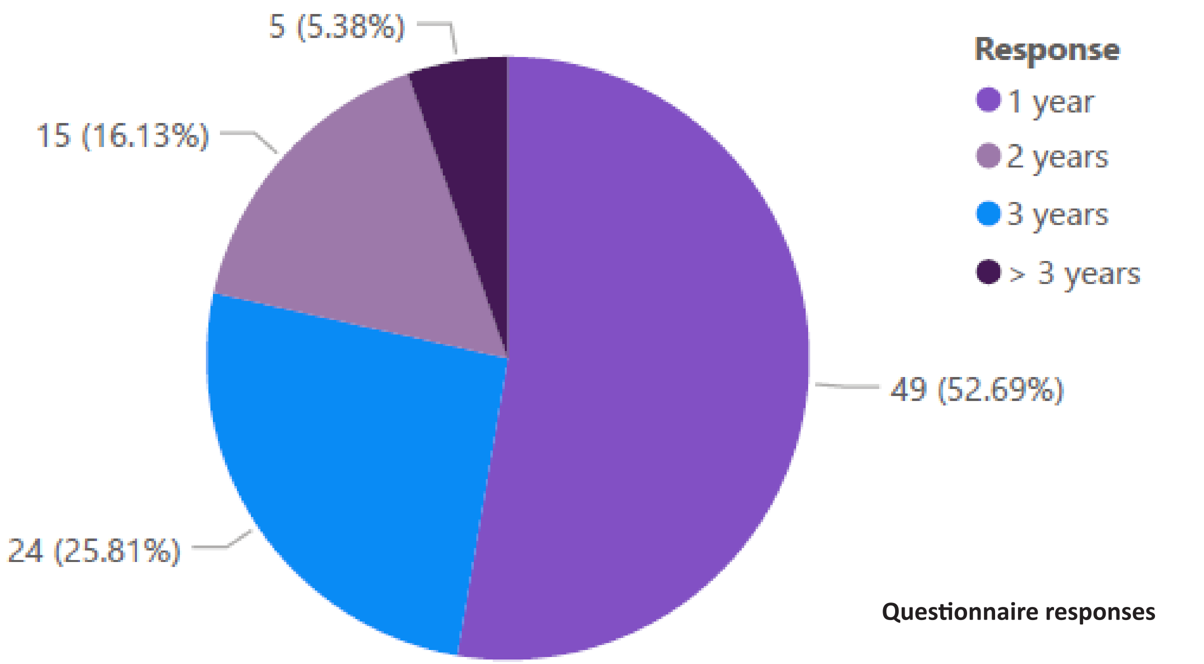
93
Insurers provided questionnaire responses

10
Firms selected to complete a desk-based review

[1] The regulatory objectives of the Authority include: securing an appropriate degree of protection for policyholders, members of retirement benefit schemes and the customers of persons carrying on a regulated activity; the reduction of financial crime; and the maintainance of confidence in the Isle of Man's financial services, insurance and pensions sector through effective regulation.

3. Detailed observations

What is the forecast time horizon for the ORSA?



Questionnaire responses

3.1 Strategy

3.1.1 Forecast time horizon

Regulatory standard

The forecast time horizon must be a period that is appropriate to the nature of the insurer's risk profile and business planning period (paragraph 2 (2) of Schedule 2).

Observations

Questionnaire responses

53% of all Insurers (who were also all class 12 insurers) adopted a one-year forecast time horizon for the ORSA and the rationale for this varied greatly. Examples of the rationale provided included reference to: uncertainty in prospective business; Insurers' business planning periods; and lack of meaningful information to forecast beyond 12 months. A number of responses simply referred to the CGC requirements as the rationale for the selected forecast period.

For the majority of Insurers that adopted a three-year projection period (26%), the CGC requirements were identified as the basis for the forecast time horizon. 21% of these firms were non-class 12 insurers.

For those Insurers that selected forecast time horizons longer than three years, group reporting requirements were detailed as the rationale. 80% of firms with a longer than three-year time horizon were non-class 12 insurers. 90% of all the non-class 12 Insurers adopted a three-year or longer projection period.

KEY OUTCOME

Insurers should consider the appropriateness of the use of any modifications and adequately document the real and valid rationale for the forecast time horizons used in the financial projections.

3.1.2 Business objectives

Regulatory standard

Guidance note 32 (a) of the CGC requires the Board of an insurer to establish, implement and maintain adequate and appropriate business objectives.

Observations

Questionnaire responses

All respondents stated that their Report outlined the Insurer's business objectives.

KEY OUTCOME

The inclusion of business objectives within the Report can be useful for the user to understand what they are and how they link to material risks.

3.1.3 Business plans

Does the business plan to achieve the business objectives over the forecast time horizon indicate that the firm meets its:

Regulatory standard

The Board must review and approve the significant business plans of an insurer (guidance note 32 (c)). An insurer must assess at least annually, its current and prospective economic capital needs, capital adequacy, liquidity adequacy and regulatory capital compliance (guidance note 36(e) of the CGC).

Observations

Questionnaire responses

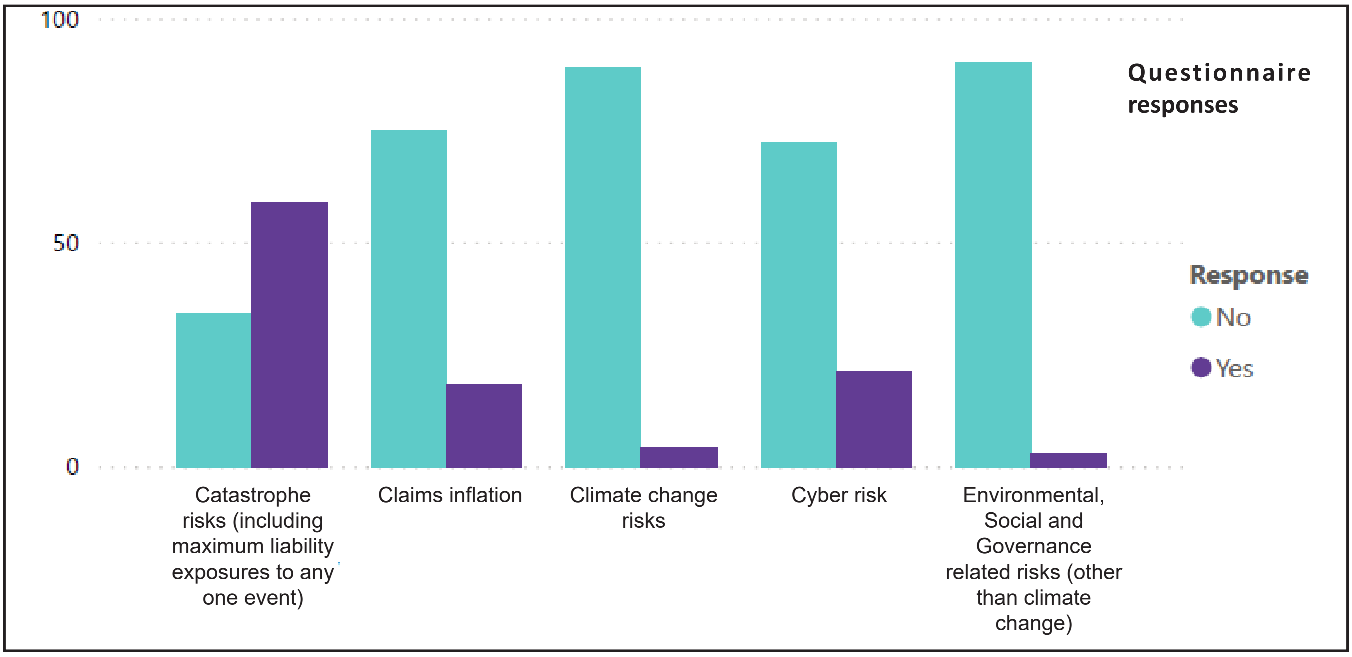
All respondents confirmed that they met their regulatory and capital adequacy requirements over the forecast time horizon for the base projections. 99% of Insurers confirmed that they met their liquidity adequacy requirements.

KEY OUTCOME

The Report should be underpinned by a robust and realistic business plan, include sufficient detail of the business plan and how it links to the insurer's business objectives and strategy.

3.2 Risks

In particular, has the ORSA report identified and assessed any of the following risks to be material to the firm over its forecast time horizon?



Regulatory standard

Paragraph 6 (a, c & g) of Schedule 2 require an ORSA to encompass, suitably categorise and assess all reasonably foreseeable, relevant and material risks to which the insurer is or may be exposed and whether quantifiable or not.

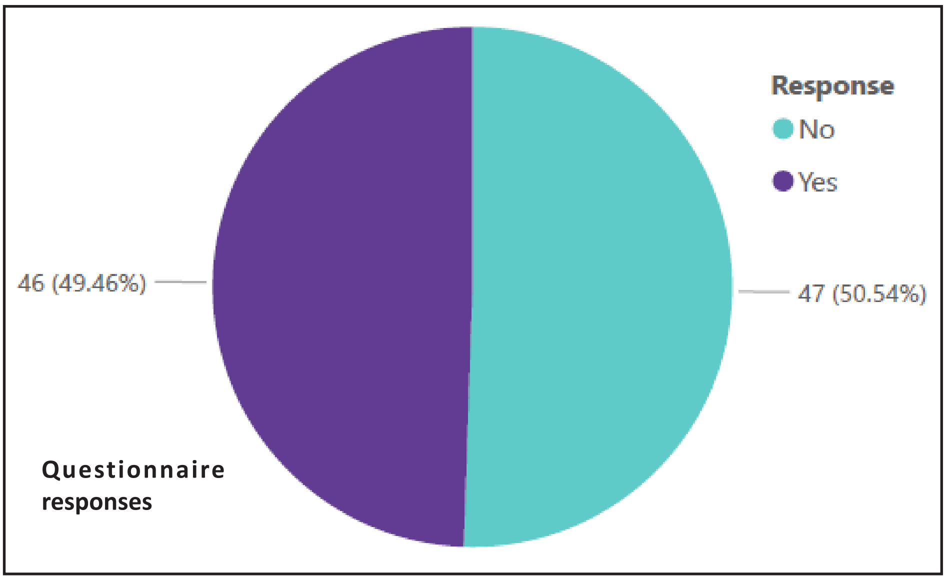
Observations

Questionnaire responses

All Insurers, apart from one, confirmed the Report identified and explained the material risks (current and emerging) to the firm achieving its business objectives over its forecast time horizon. The extent of consideration of specific risks is illustrated above. The questionnaire responses also indicated that just under half of Insurers (49%) had undertaken qualitative assessments of material risks.

37 Insurers confirmed the Report took account of the risk of significant loans provided to their group. Group loan considerations included stress testing (by downgrading the parent's credit rating or consideration of the loan default or loan write off) or risk assessment of the loan default on the risk register, where applicable.

Does the ORSA report include qualitative assessments of identified material risks that cannot be quantified?



KEY OUTCOME

The Report should be forward looking and quantify, where possible, the material risks the Insurer may be exposed to in the future. Where risks cannot be quantified, the Insurer should undertake a qualitative assessment of material risks. The rationale for any conclusions, for quantifiable or qualitative assessments, should be clearly documented. The Insurer should be horizon scanning and, where considered material, emerging and topical risks should be assessed (for example, claims inflation, cyber and ESG risks). Any conclusions should be clearly documented.

3.3 Stress testing

3.3.1 Forward-looking stress tests

Regulatory standard

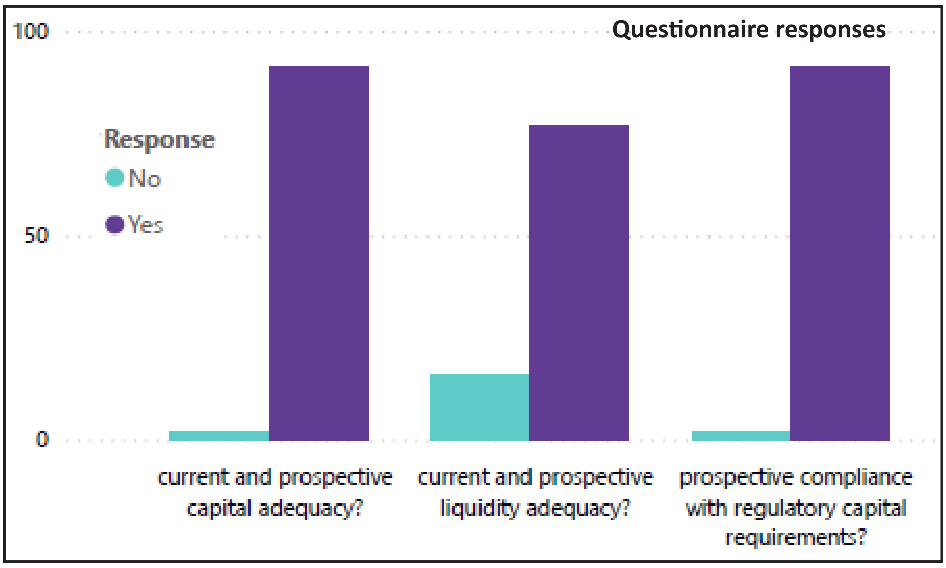
An insurer must carry out an ORSA at least annually to assess compliance with regulatory capital, capital adequacy and liquidity adequacy requirements (paragraph 2(1)(b) of Schedule 2). An ORSA must consider the impact of a range of plausibly adverse scenarios in the medium and long term business strategy of the insurer (paragraph 6(d) of Schedule 2). An ORSA must include adequate and appropriate forward looking quantitative methods such as stress testing, reverse stress testing and scenario analysis of material risks (paragraph 6(f) of Schedule 2 and guidance note 62(2) of the CGC).

Observations

Questionnaire responses

98% of Insurers confirmed that they included forward looking quantitative stress testing and scenario analyses in their Reports. The questionnaire responses also highlighted that the majority of Insurers confirmed that they had considered current and prospective capital adequacy, current and prospective liquidity adequacy and prospective compliance with regulatory capital requirements in the forward looking stress tests.

Do the stress tests and scenario analyses consider the forecast time horizon?



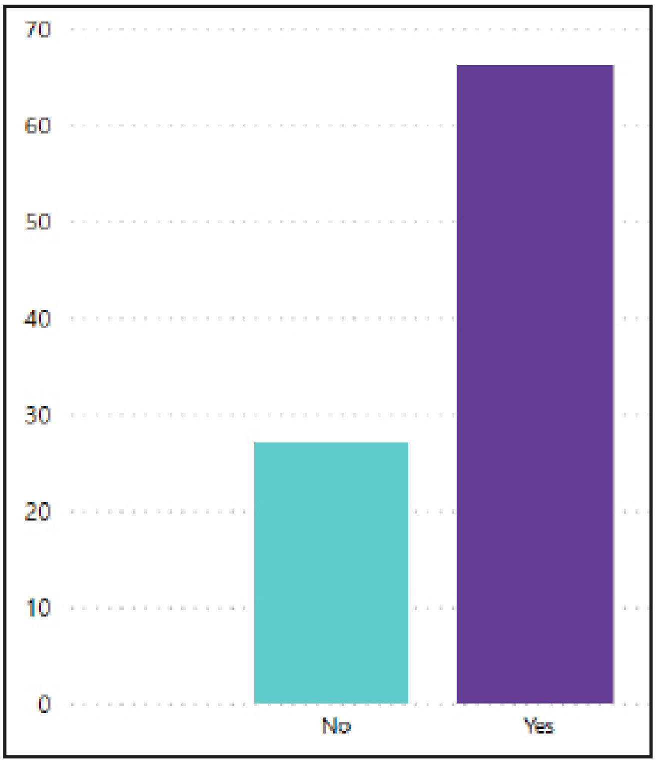
KEY OUTCOME

Insurers should stress test all of their material key risks that are quantifiable. The tests should include testing of one or more variables and the rationale for stresses applied should be documented. The feasibility of management actions should be considered and documented.

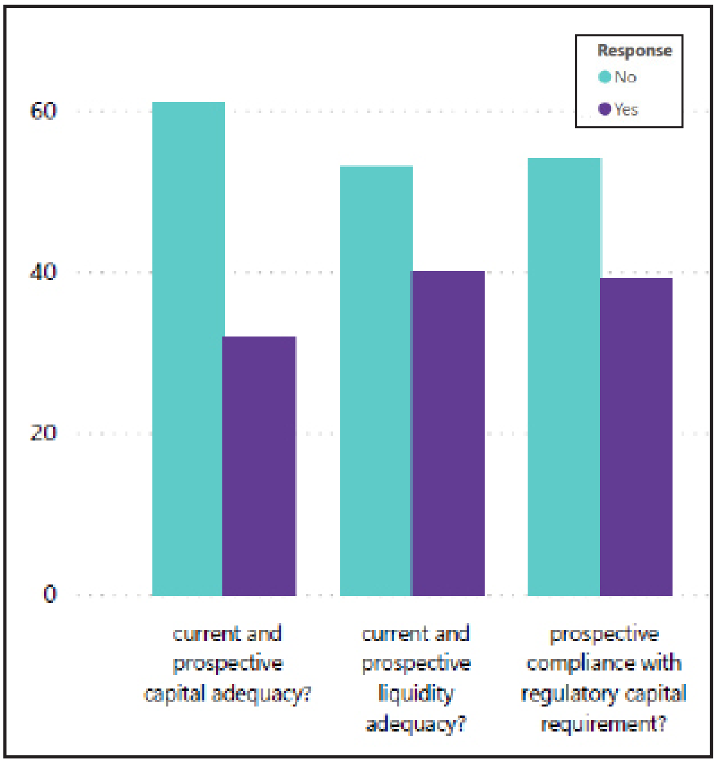
98% of Insurers included forward looking quantitative stress testing and scenario analyses in their reports

3.3.2 Reverse stress tests

Does the ORSA report include reverse stress testing?



Over the forecast time horizon, under the reverse stress test(s), does the firm meet its:



Questionnaire responses

Regulatory standard

An ORSA must include adequate and appropriate forward looking quantitative methods such as stress testing, reverse stress testing and scenario analysis (paragraph 6(f) of Schedule 2 and guidance note 62(2) of the CGC).

Observations

Questionnaire responses

29% of Insurers confirmed that they did not perform reverse stress tests in the Report.

71%
Of firms performed a reverse stress test

KEY OUTCOME

Where appropriate, reverse stress tests should identify the point at which a firm is considered as failing or the business model becomes unviable. Insurers may find it useful to define what business failure means for them and assess the impact on economic capital, liquidity and regulatory capital.

An ORSA must include quantitative methods such as stress testing, reverse stress testing and scenario analysis

3.4 Other compliance

3.4.1 Own funds assessment

Regulatory standard

An insurer as part of its ORSA must assess the quality, adequacy and composition of its own funds to meet its regulatory capital requirement (paragraph 8 (1) (c) of Schedule 2).

Observations

Questionnaire responses

94% of firms stated that they had considered the quantity, quality and composition of own funds used to meet regulatory capital requirements.

KEY OUTCOME

The Report should include a summary of and assess the quality of own-funds in the base and stressed projections and illustrate how this may develop over the forecast horizon. This assessment is particularly relevant where there are tier 2 & 3 own funds.

3.4.2 Economic capital needs

Regulatory standard

An insurer must as part of its ORSA assess the quality, adequacy and composition of its other capital and other financial resources (as applicable) to meet its additional capital required to address its economic capital needs (paragraph 8 (1) (d) of the Schedule 2).

Observations

Questionnaire responses

52% of firms stated that they considered additional capital and other financial resources to meet the additional economic capital needs. 48% did not.

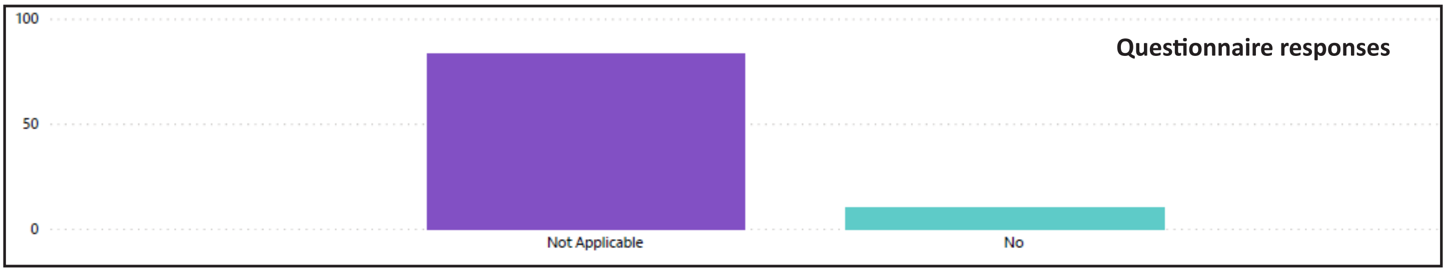
KEY OUTCOME

We expect Insurers to determine economic capital by considering the key risks they face and determining the additional capital required over and above the minimum regulatory capital requirements, taking into account the effectiveness of applicable controls to mitigate risks.

SCR should not be used as a substitute for case specific, risk-based capital adequacy.

3.4.3 Assessment of the adequacy of the standard formula for non-class 12 insurers

Has the ORSA assessed that the risk profile of the firm materially deviates from the assumptions underlying the SCR calculation?



Regulatory standard

Paragraph 7 of Schedule 2 requires non-class 12 insurers to determine whether their risk profile deviates from the key assumptions underlying the regulatory capital requirement and estimate any material impact on economic capital requirements due to any material deviation.

KEY OUTCOME

This is an area that may benefit from actuarial input where the HOAF's expertise could result in a detailed and well-articulated analysis.

A Head of Actuarial Function's expertise could result in a well-articulated analysis

Observations

Questionnaire responses

All the non-class 12 Insurers confirmed that they had assessed that the risk profile of the firm did not materially deviate from the assumptions underlying the SCR calculation.

All class 12 Insurers did not undertake the assessment and therefore answered "not applicable" in the questionnaire. There were no Insurers that identified a deviation between the risk profile and assumptions underlying the standard formula.

3.5 Board direction and oversight

Regulatory standard

The board and senior management are responsible for the ORSA process, with the board in particular required to take an active part in how the assessment is performed by senior management, challenging results and approving significant matters in relation to the ORSA process (paragraph 3 (1&2) of Schedule 2).

Observations

Questionnaire responses

All the Insurers confirmed that the Board approved the Report, steered how the assessment had been performed and challenged the results and significant matters within the Report.

KEY OUTCOME

Examples of good Reports should include:

- **Clear lines of responsibility for each participant in the ORSA process, as well as when those responsibilities were met;**
- **Documentation of the challenge by Boards including a summary of the outcome of those challenges;**
- **Clear sign-off from the Board of the Report; and**
- **Where the detail above is not included within the Report, there should be clear sign posting to supporting evidence as part of the documentation of the ORSA process conducted.**

3.6 ORSA policy

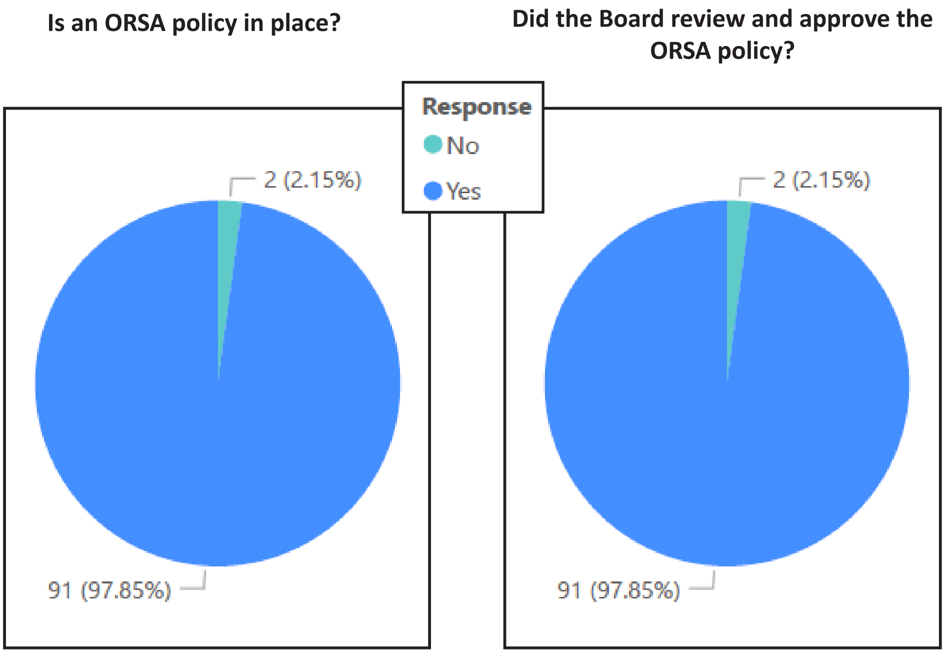
Regulatory standard

An insurer must establish, implement and maintain an ORSA policy which includes the requirements of paragraph 5 of Schedule 2 at a minimum.

Observations

Questionnaire responses

91 firms have confirmed that they have an ORSA policy in place and the Board has approved the policy.



Questionnaire responses

KEY OUTCOME

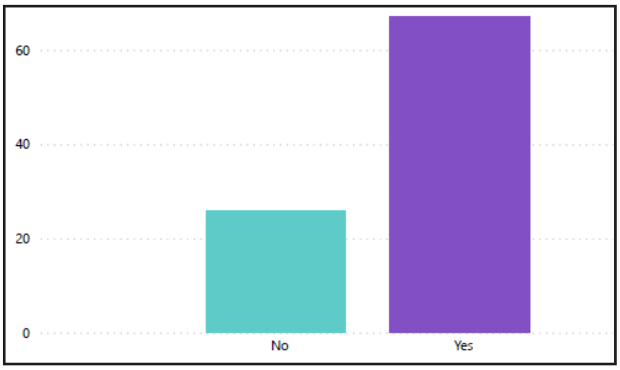
Insurers should assess their ORSA policy against the requirements of Schedule 2 of the CGC and make improvements where required. In addition, when completing the ORSA process, the insurer should ensure that the ORSA policy is followed.

Insurers should take account of the findings of the Report and insights gained during the ORSA process in the risk management, financial management, business planning and product development and design.

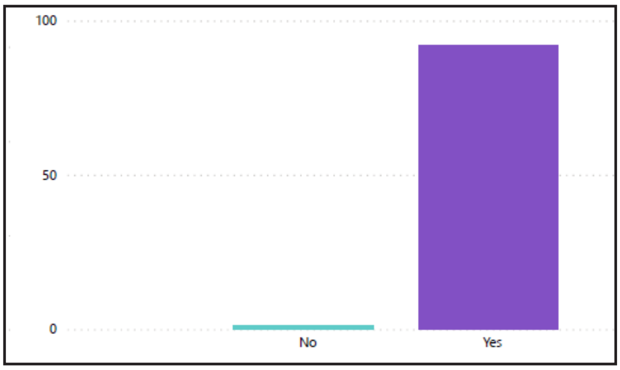
3.7 Risk management

3.7.1 Adequacy of risk management

Does the ORSA assess the adequacy of the firm's risk management?



Does the ORSA link the firm's risk profile assessment, risk appetite (including limits and tolerances) and overall economic capital needs



Questionnaire responses

Regulatory standard

An insurer must assess the adequacy of its risk management and the relationship between its risk management, its economic capital needs and its capital availability (paragraph 8 (1) (a) and 5 (c) of Schedule 2).

Observations

Questionnaire responses

72% of firms stated that the Report assessed the adequacy of the Insurer's risk management. 99% stated that the Report demonstrated the link between the risk profile assessment, risk appetite and overall economic capital needs of the Insurer. 99% of firms confirmed that they had established a risk appetite framework.

KEY OUTCOME

One of the objectives of the Report should be to assess whether the Insurer's risk management is appropriate for its risk profile and include the rationale for any conclusions.

3.7.2 Target SCR coverage

Regulatory standard

The Board of an insurer must establish, implement and maintain the risk strategies and significant risk policies and procedures of the insurer, including its risk appetite framework (Guidance note 36 (c) of the CGC).

Observations

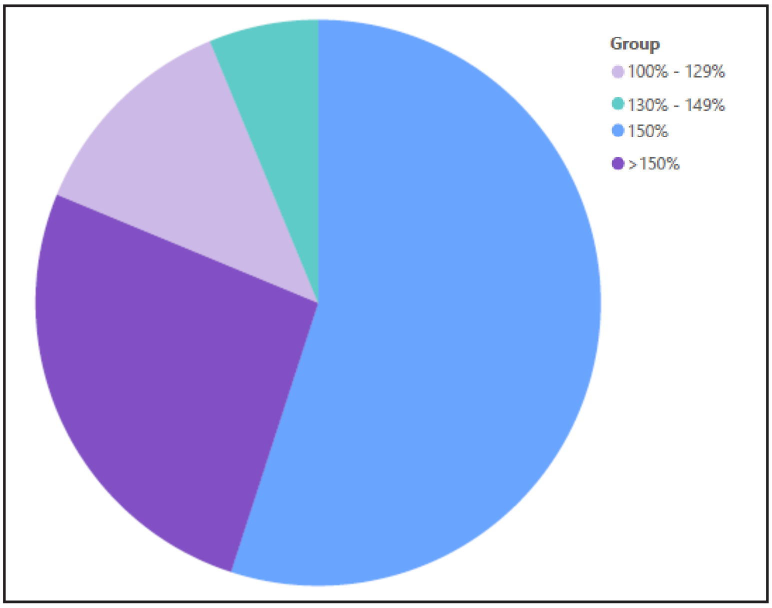
Questionnaire responses

88% of firms have adopted a policy of holding a specific SCR coverage ratio in excess of 100%. We also noted that a significant number of firms had adopted 150% as their target solvency coverage.

KEY OUTCOME

Each Insurer should determine the adequacy of their target SCR coverage ratio based upon the nature, scale and complexity of the Insurer's business and document the rationale.

Has the firm adopted a policy of holding a specific SCR coverage ratio in excess of 100% - State percentage



Questionnaire responses

3.7.3 Actuarial input

Regulatory standard

An insurer's actuarial function must provide input as to whether the insurer will comply continuously with the requirements regarding the calculation of its technical provisions and identify uncertainties connected to that calculation (paragraph 8 (2) of the Schedule 2).

Observations

Questionnaire responses

15 firms (16%) (including class 12 as well as non-class 12 insurers) utilise the services of an actuary in the valuation of technical provisions, completion of regulatory returns and/or preparation of the Report.

Only 70% of non-class 12 Insurers obtained actuarial input into the ORSA.

KEY OUTCOME

The HOAF's involvement should be clearly documented in the Report.

3.8 Structure and presentation

KEY OUTCOME

The following are good examples of structure and presentation in Reports:

- Concise and not unnecessarily long;
- Good use of sign posting to external documents or appendices;
- Avoidance of duplication of content between sections and the use of vague or general statements;
- Clear structure, with an introduction for each section and links to the ORSA process;
- Future actions clearly stated; and
- Detailed rationales included, where applicable, as well as further information explaining any statements made.

4. About this report

The thematic review was not intended to be a comprehensive review or examination of Insurers' systems, controls or activities.

This report does not in any way limit, and therefore should be read in conjunction with, any applicable legal and regulatory requirements. Accordingly, any references to Acts, Regulations, Codes or Guidance within this report are for ease of reference only.

The observations and conclusions contained in this report are based upon evidence available at the time of the thematic review and based upon information provided by the Insurers. Insurers cannot simply rely on the content of this report and should continue to assess their own level of compliance with the CGC.

This report is written on an exception only basis. A lack of comment in this report should not be taken to represent tacit approval.

It remains the ultimate responsibility of Insurer's Board and Senior Management to ensure the financial wellbeing and effective management of the Insurer, including compliance with regulatory requirements.