Circular Letter No.:	2022-41
Date:	25 August 2022

CIRCULAR LETTER

TO : ALL LIFE INSURANCE COMPANIES, NON-LIFE INSURANCE COMPANIES, AND PROFESSIONAL REINSURERS

SUBJECT : ADOPTION OF OWN RISK AND SOLVENCY ASSESSMENT FRAMEWORK

As a member of the International Association of Insurance Supervisors ("IAIS"), the Insurance Commission adopts the Insurance Core Principles ("ICPs") including the establishment by insurance companies within their respective risk management systems of an Enterprise Risk Management ("ERM") Framework for solvency purposes to identify, measure, report and manage insurers' risks in an ongoing and integrated manner.

As a key component of the ERM Framework, the Commission directs entities covered by this Circular[1] to adopt and implement the Own Risk and Solvency Assessment ("ORSA") Framework.

Rule I. General Provisions

A. Legal Basis.

Section 437 of Republic Act No. 10607, otherwise known as the "Amended Insurance Code", mandates the Insurance Commission to issue "instructions and circulars as may be deemed necessary to secure the enforcement of the provisions of the Code, and to ensure the efficient regulation of the insurance industry **in accordance with global best practices** and to protect the insuring public."

B. Enterprise Risk Management for Solvency Purposes.

ICP 16 requires insurers to establish within its risk management system an ERM Framework for solvency purposes to identify, measure, report and manage

[1] See Rule I(E).

insurers' risks in an ongoing and integrated manner. ICP 16 requires the insurers' ERM Framework to contain the following, among others:

1. Identify all reasonably foreseeable and relevant material risks and risk interdependencies for risk and capital management[2];
2. Quantify risk and risk interdependencies under a sufficiently wide range of techniques for risk and capital management, including the performance of stress testing to assess the resilience of its total balance sheet against macroeconomic stresses[3]; and
3. Reflect the relationship between the insurer's risk appetite, risk limits, regulatory capital requirements, economic capital and processes and methods for monitoring risk.[4]

C. ICP 16 Requirements on ORSA.

ICP 16 requires insurers to perform the following relative to ORSA:

1. Regularly perform ORSA to assess the adequacy of risk management and current, and likely future, solvency position[5];
2. Encompass in the ORSA all reasonably foreseeable and relevant material risks[6];
3. Identify the relationship between risk management and the level and quality of financial resources needed and available[7];
4. As necessary, assess the insurer's resilience against severe but plausible macroeconomic stresses through scenario analysis or stress testing[8];
5. As necessary, assess aggregate counterparty exposures and analyze the effect of stress events on material counterparty exposures through scenario analysis or stress testing[9];
6. Determine, as part of its ORSA, the overall financial resources it needs to manage its business given its risk appetite and business plans[10];
7. Base its risk management actions on consideration of its economic capital, regulatory capital requirements, financial resources, and its ORSA[11];
8. Assess the quality and adequacy of its capital resources to meet regulatory capital requirements and any additional capital needs[12];

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[2] ICP 16.1
[3] ICP 16.2
[4] *Ibid.*
[5] ICP 16.10
[6] ICP 16.12
[7] *Ibid.*
[8] *Id.*
[9] *Id.*
[10] ICP 16.13.
[11] *Ibid.*
[12] *Id.*

9. Analyze its ability to continue in business, and the risk management and financial resources required to do so over a longer time horizon than typically used to determine regulatory capital requirements.[13]

D. ORSA Not A Replacement for Regulatory Capital Requirements.

Primarily serving as a tool to enhance an insurer's understanding of the interrelationships between its risk profile and capital needs considering all reasonably foreseeable and relevant material risks, the ORSA shall not serve as a replacement for regulatory capital requirements. As such, the ORSA shall not be utilized to calculate the following:

1. The required Net Worth requirement as provided in Section 194 of the Amended Insurance Code; and
2. The required Risk-Based Capital ("RBC") as provided in Circular Letter ("CL") No. 2016-68.

E. Coverage.

The conduct of ORSA shall be mandatory for the following regulated entities (hereinafter referred to as "*Covered Entities*"):

1. Life insurance companies with premium income exceeding PHP10 Billion;
2. Non-life insurance companies with gross premiums written income exceeding PHP2 Billion; and
3. Professional reinsurers with gross premiums written income exceeding PHP2 Billion.

An insurance company or professional reinsurer whose premium income or gross premiums written based on its latest available Audited Financial Statements ("AFS") does not meet the above-enumerated thresholds may still be required to conduct the ORSA as determined by the Commission when circumstances warrant, including but not limited to the type and volume of business written, ownership, organizational structure, or change in risk appetite or risk profile of the Covered Entity.

Covered Entities are required to conduct their respective ORSAs as part of their risk-management systems starting from the close of Fiscal Year ("FY") 2023.

F. Cessation of Mandatory Conduct of ORSA.

The requirement to conduct an ORSA shall cease to apply to Covered Entities when the Commission verifies that the company:

[13] ICP 16.14.

1. Falls below the threshold above-enumerated for the last three (3) consecutive financial reporting periods; and
2. Is expected not to exceed the above-enumerated thresholds in the next three (3) financial reporting periods.

This is, however, without prejudice, to the authority of the Commission to require the conduct of an ORSA when circumstances warrant.

G. When to Conduct ORSA.

Covered Entities are required to conduct ORSA at least once every year and at any time when there are significant changes to the Covered Entity's risk profile, or where applicable, of the insurance group of which the Covered Entity is a member.

Rule II. ORSA Framework

A. Objective.

The conduct of ORSA aims to support the risk management system of Covered Entities by providing a forward-looking assessment, both quantitative and qualitative, of the insurance and reinsurance companies' current and future solvency position under stressed scenarios considering all types of risks. The ORSA shall provide Covered Entities a better understanding of the following:

1. Risk profiles, both current and future, and respective key drivers;
2. Adequacy of capital available to support their business model;
3. Material changes to their risk profiles;
4. Risks to which insures are or will be exposed to, regardless whether said risks are explicitly covered by regulatory capital requirements;
5. Key drivers of their financial positions and balance sheet values; and
6. Identification of potential management actions to mitigate risks.

B. Required Documentation.

In operating the ORSA, Covered Entities are required to develop appropriate documentation systems, which include, at least the following documents:

1. ORSA Policy[14];
2. Record of each ORSA;
3. Outcomes of the ORSA and their use in the decision-making processes of the Covered Entity;
4. Internal Report on each ORSA;
5. Evidence that the Covered Entity's Board approval and steering of the ORSA process; and

[14] See Rule II(B) of this Circular.

6. Report to be submitted to the Commission.[15]

C. ORSA Policy.

Prior to the conduct of the ORSA, Covered Entities shall adopt their respective ORSA Policies. The ORSA Policy should contain, at the minimum, the following components:

1. A description of how the ORSA process incorporates the business model and the strategic plan of the Covered Entity, with special consideration of its risk appetite, risk tolerance limits, and the overall "economic available capital resources"[16] needed;
2. A description of the roles and responsibilities of all those involved with the ORSA;
3. The timing and frequency of the ORSA assessment and of the ORSA reports, including the triggers for an ad hoc ORSA;
4. The actuarial, financial, or other scientific methodologies used in risk assessment, as well as the assumptions, parameters, and other components necessary for such assessment;
5. An inventory of all decision-making processes of the Covered Entity where ORSA outcomes are required to be used. This inventory shall include all decision-making processes that have or may have a material impact on the financial and solvency condition of the Covered Entity;
6. A description of the different lines of reporting to be produced by the ORSA process;
7. The IT software and infrastructure where the ORSA process is executed and the relevant control systems;
8. In case some elements or activities related to the ORSA process are outsourced, a description of such elements and activities along with the relevant control procedures;
9. Any other information relevant to the ORSA process.

Covered Entities shall be required to submit their respective ORSA Policies to the Commission **no later than 30 June 2023**. Entities who meet the criteria for mandatory ORSA after FY 2023 shall be required to submit their respective ORSA Policies no later than 30 June of the year after meeting the criteria in Rule I(E).

Any subsequent change in the ORSA Policy shall require the Covered Entity to submit to the Commission the amended ORSA Policy **within one (1) month** from adoption of the amendments.

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[15] See Rule II(F) of this Circular.

[16] The term "economic available capital resources" shall refer to capital considered for purposes of the business model and the ORSA process.

D. Elements of ORSA.

The ORSA is expected to assess the following elements:

1. *Current solvency position of the Covered Entity.*

The current solvency position of the Covered Entity is determined by a comparison of the current "economic available capital resources" and the current total "economic capital target." Economic capital target corresponds to the level of capital the Covered Entity needs to manage its business given its risk appetite and business model.[17] Economic available capital resources refer to the amount of available capital resources of sufficient quality that the Covered Entity possesses to absorb losses.

2. *Foreseeable future solvency position of the Covered Entity.*

In the estimation of the future financial and solvency position, the Covered Entity, in its ORSA assessment, is required to perform the following:

a. Make reliable projections over a certain horizon for the "economic available capital resources" and for the total "economic capital target" considering both the business in force and future new business; and
b. Consider adverse tests and scenarios that may materially affect the risk of capital resources.

3. *Effect on the foreseeable future solvency position of sufficiently changing and realistic adverse events and scenarios.*

In order to be able to reflect adverse tests and scenarios, a Covered Entity is expected to design a sufficiently broad range of adverse tests and scenarios tailored to their individual risk profile and business model, such as but not limited to sensitivity analysis, stress tests and reverse stress tests.

4. *Continuous compliance with the regulatory solvency requirements.*

5. *Identification of the measures the Covered Entity may adopt.*

In the case that the solvency position is positive, or when economic available capital resources exceed economic capital target (economic available capital resources > economic capital target), and no negative trend can be observed for the foreseeable future evolution in the time horizon considered, the Covered Entity possesses the appropriate risk appetite set in its business model.

If the economic available capital resources is less than the economic capital target (economic available capital resources < economic capital target) or when

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[17] See Rule II(E) to determine Total Economic Capital Target.

negative trends are observed, the Covered Entity is required to implement corrective actions which consist of the reduction of risk appetite, mitigation of risks, an increase in the capital resources, or a combination thereof.

6. *Breakdown of Total "Economic Capital Target" into the risks the Covered Entity is exposed to and the areas of activity where each risk stems from.*

The Covered Entity is expected to assess the material risks which contribute to the economic capital target and determine whether the levels of the material risks are currently according to the risk appetite and within the risk tolerance of the business model.

7. *Qualitative analysis of the overall risk-profile of the Covered Entity and determination of whether its exposure to material risks is consistent with the risk appetite and risk tolerance contained in the business model, strategic plans and policies.*

E. Determination of Economic Capital Target.

In order to determine the economic capital target, a Covered Entity should undertake the following:

1. *Identify all risks the Covered Entity is exposed to considering its business model.* - The Covered Entity is expected to be able to identify both current and emerging risks for all its activities regardless of whether they are quantifiable and whether they are considered in the determination of the required RBC. The following are non-exhaustive lists of risks related to life and non-life insurers:

   a. Life Insurers - Credit risk, underwriting risk, market risk, operational risk, liquidity risk, strategic risk, and reputational risk.
   b. Non-Life Insurers - Credit risk, underwriting risk, market risk, operational risk, catastrophe risk, flood risk, liquidity risk, strategic risk, and reputational risk.

2. *Assessment of whether the Covered Entity's risk profile is materially different from assumptions applied in the calculation of the RBC.* - With this assessment, a Covered Entity is expected to identify whether the material risks it has identified are:

   a. Adequately captured in the determination of the required RBC;
   b. Not adequately captured in the regulatory requirement; or
   c. Partially captured in the regulatory requirement.

3. *Measurement of quantifiable risks and sub-risks.* Covered Entities are expected to measure as many risks and sub-risks as possible, particularly the material ones. If risks are material, Covered Entities are expected to employ available specific methodologies to measure said risks in a prudent manner as part of total "economic capital target." For risks which cannot be quantified at all, Covered Entities are required to describe them in a qualitative manner.

4. *Aggregation of sub-risks and risks for the determination of total economic capital target.* All measured risks and sub-risks should be aggregated to determine a Covered Entity's total economic capital target. However, in assessing the impact of certain risks, it is necessary to consider the benefits from diversification of risks. Covered Entities may adopt their respective methodologies based on global best practices.

F. ORSA Report.

Insurance companies and professional reinsurers required to conduct ORSA shall submit to the Commission its ORSA Report which shall contain, at the minimum, the details provided in **ANNEX A** of this Circular.

Covered Entities shall be required to submit their respective ORSA Reports covering FY 2023 on or before the fourth quarter of 2024. For entities who meet the criteria for mandatory ORSA after FY 2023, their respective ORSA Reports shall be submitted no later than the fourth quarter following the subject FY.

Rule III. Other Provisions

A. Separability Clause.

If any provision of this Circular shall be held unconstitutional or invalid, the other provisions not otherwise affected shall remain in full force and effect.

B. Effectivity Clause.

This Circular shall take effect immediately.

DENNIS B. FUNA
Insurance Commissioner

ANNEX A - Details of ORSA Report

I. **Business model:** Main features of the business model and description of the risk appetite and the relevant levels of risk tolerance, including the preferred "economic available capital resources."

II. Information on the governance of the ORSA process

A. Name of the entity;
B. Information about the time horizon used for the purpose of the ORSA assessment and a justification of its appropriateness;
C. Design of the ORSA process, monitoring procedure in place for ensuring its on-going appropriateness, internal reporting structure to ensure the communication of the ORSA results to all relevant bodies;
D. Any changes made to the ORSA process or its governance, and to the ORSA policy, with respect to the last ORSA report;
E. Role and responsibilities assigned for the ORSA purposes in the Board, the "ORSA operational owner" the risk management function, the staff responsible for the compliance as part of the internal control system, the actuarial experts involved and the Internal Audit of the insurer. In case of outsourced activities, the staff of the Covered Entity responsible for its monitoring;

III. Detailed information on the ORSA.

A. Methods and assumptions underlying the assessment, in particular:
    1. Exposures to risks (risk map)
    2. Methods and assumptions used to calculate the "economic capital target" and the "economic available capital resources". Methods applied to allocate the overall "economic capital target" to the material risks.
    3. Risk mitigation techniques and management actions considered in the ORSA assessment.
    4. Quantitative analyses (sensitivity analysis, stress testing techniques) made on material risk factors, with the indication of the assumptions and results.
    5. The results of the assessments carried out in terms of risk profile of the Covered Entity.
B. Type and quality of the data used in the ORSA assessment of risks as well as for the description of the macroeconomic assumptions underlying the calculation. Justification of the quality of the data in terms of completeness, accuracy and appropriateness. Description of any expert judgment used.
C. Assessments carried out to verify the continuous compliance with the regulatory Risk-Based Capital requirement.
D. Processes performed and assessments made by the Covered Entity to verify ongoing compliance with the regulations on technical provisions, regulatory Risk-Based Capital requirement and regulatory 'available capital resources'.

IV. Conclusions and use of the ORSA

A. Impact of the assessments made on the "economic capital target" in a medium to longer term;
B. Detailed description of the conclusions drawn by the Covered Entity on the basis of the assessments made, with the indication of the actions taken or planned;
C. Links between the results of the assessments made, the "economic capital target", and the risk appetite and risk tolerance thresholds set up in the business model;
D. Links between the results of the assessments made and the business model;
E. Estimate of the costs connected with obtaining any additional capital resources with respect to the current level in case of being necessary; and
F. Self-assessment of the ORSA, with indication of the areas of possible improvement both in terms of process and of actions regarding capital resources and organization.