CRO Forum Paper on the Own Risk and Solvency Assessment (ORSA):

Leveraging regulatory requirements to generate value

May 2012

1. Introduction

1.1. Purpose of the paper

In this discussion paper the CRO Forum provides a set of standards that could be applied by insurance undertakings with respect to conducting a self assessment of risk and capital solvency called Own Risk and Solvency Assessment ('ORSA'). Although the ORSA is driven by regulatory requirements it has an intrinsic value to internal stakeholders to manage risk, capital and solvency at an enterprise level in an insurance undertaking.

We recognise and value the respective work of EIOPA[i], NAIC[ii], IAIS[iii], as well as the Dutch Insurance Association (VVV[iv]) on this topic. These papers highlight how ORSA captures best risk management practice that companies would conduct, even if there were no regulatory requirement to do so. In this paper we would like to clarify some of the key elements of the ORSA as well as provide some additional guidance on the application of the ORSA for undertakings. The CRO Forum has therefore prepared this paper with the following objectives:

- articulating an understanding of the ORSA and its components, providing a possible structure for reporting one's own risk and solvency assessment;
- elaborating on the ORSA standards for Solvency II and beyond. It also aims at engaging with other trade and professional associations on this critical risk and capital management concept; and
- influencing regulatory insurance groups in EEA jurisdictions to achieve common expectations pertaining to ORSA reporting, specifically limiting a prescribed format by regulators with what should essentially be management's own tool for reflecting upon business initiatives and their forward looking sustainability.

1.2. What is ORSA and how is it incorporated into business?

In its Issue Paper on ORSA, EIOPA defined the ORSA as "*the entirety of the processes and procedures employed to identify, assess, monitor, manage, and report the short and long term risks an insurer faces or may face and to determine the own funds necessary to ensure that the insurer's overall solvency needs are met at all times*". This definition is the reference the CRO Forum uses to understand the scope of ORSA and the various processes and procedures it comprises, whether used in relation to our own internal risk and capital management framework, or in relation to the standards and guidance set by the regulators[v].

The ORSA is commonly used as an umbrella concept which includes a framework, a set of processes, a report, a policy, as well as a regular capital assessment with forward-looking perspective. When referring to the ORSA, it is useful to clearly distinguish between these various components:

- As a framework supported by internal processes, the ORSA may typically cover a number of risk governance elements such as risk tolerance definition (or risk appetite), risk policy including risk limit setting and monitoring, use-test definition (for internal model users in relation to the internal model validation requirements), capital projections and capital allocation principles.
- The ORSA Report will evidence undertakings approach to the on-going ORSA processes, the effectiveness of these processes, as well as providing a point in time reflection of current and future solvency adequacy.
- The ORSA policy will set out the principles of ORSA, description of ORSA processes and the undertakings reporting requirements. This will be dealt with under the general policy approval process, as for all other policies of the undertaking.
- As a risk and capital assessment, the ORSA also includes a forward-looking component, taking into account medium term risks and events that could materialize, which shall be reported to the supervisors. Forward looking assessments, however, must be excluded from public disclosure, to avoid compliance issues with existing reporting requirements like IFRS or listing rules of the various stock exchanges.

2. A flexible, principle-based approach that is adaptable to undertakings' needs

The CRO Forum has identified a **few common design features** of the ORSA report that would contribute to providing assurance that each undertaking subject to the ORSA requirement achieves equivalent objectives:

- the ORSA report is defined, and clearly and consistently articulated, by each undertaking – it can take many different forms and level of formalism (e.g. elements may possibly be documented separately, developed by different teams and functions, and particularly articulated differently in each company);
- the primary target audience of the ORSA report is the Administrative and Management Supervisory Body (AMSB) and the senior management – the objective of the ORSA report will enable the AMSB to undertake strategic decision making which will keep us within appetite, whilst considering our risk and capital profile and sensitivity to stressed conditions;
- the ORSA report requires involvement of several functions within the undertaking; and
- the ORSA report to supervisors aims at evidencing the existence of solid and consistent ORSA practices by providing a summary of the results of the ORSA assessment. This provides assurance to the supervisor of the sustainability of the undertaking's risk strategy over the planning period measured by the undertaking's own view of its capital needs (ORSA needs), whilst demonstrating compliance to the minimum solvency requirements.

The articulation of the ORSA requirements and the ORSA report needs to be **tailored by the undertaking** to reflect their specific organisational structure, their risk management practice and their business needs, while still identifying the major components that need to be delivered (including documentation on policies, processes, internal report and supervisory report). Specific areas where undertakings may tailor the ORSA report are:

- the purpose of the ORSA report, which could be either (or combination) of the following (i) to support the business plan and business strategy, (ii) to provide an annual review of the risk management system (including solvency), or (iii) to provide objective assessment of all decision making processes, etc. it is expected that the use of the ORSA report will also vary due to different business models;
- the ownership of the ORSA report production, e.g. 1st line of defence, 2nd line of defence or joint ownership;
- the timing of the ORSA report production, e.g. aligned to YE reporting, business plan reporting, mid-year, etc.;
- the location and level within the organisational structure at which the ORSA report(s) are produced, e.g. at Group level, Regional level, BU level, legal entity level, etc. Notwithstanding the ORSA requirement that the risk and solvency position of individual insurance undertakings should be visible, subject to proportionality;
- the length of the report(s), for the long form internal and regulatory report will differ due to a range of factors, amongst others including; the extent of information already provided to an organisation's Board, the maturity of the ORSA reporting process and the extent to which organisations choose to summarise or cross-refer to reporting outputs from ORSA processes that are submitted to the AMSB and senior management;
- the definition of Solvency II Pillar 2 capital measure and its differences to Solvency II Pillar 1 capital basis, to better reflect management's view of its own risks and economic value; and
- The structure of the report, while including specific standard elements (see section 4.2) may differ among undertakings. This allows the organization to tailor the report to its own specific needs. Also, the level of detail and focus of the report on specific sections may vary depending on the needs of the undertaking.

Supervisory requirements should appropriately take into account the specifics of each company's framework and internal process articulation to avoid duplication and inconsistencies e.g. in the documentation and the internal communication and use.

3. Value of the ORSA report to undertakings and their supervisors

The areas of value for the ORSA reports may differ depending on the target audience. However below we have included commonalities of how it will add value to internal stakeholders and regulators.

3.1. Value of the ORSA and its reports to internal stakeholders

The internal ORSA report will strengthen and/or add value to internal stakeholders, in particular the AMSB by:

- providing the AMSB and the senior management with a view **of the current and forecasted risk and capital position**, and risks taken, according to the company's strategy, and enabling them to act on this information. The ORSA report will evidence the ORSA processes that are delivering the risk and capital results information consistently, accurately and in a timely manner and also enable the AMSB to identify areas for improvement in the risk management system;
- providing **a holistic and objective assessment** of the risk and capital profile, bringing together qualitative and quantitative information from across the organisation that may be included in business planning;
- identifying possible management actions available to senior management or identify scenarios or points in future where management actions may need to be considered (to support the improvement of the risk and capital position, and also those embedded within solvency modelling);
- providing the AMSB and the senior management with a view on the current design of the risk and capital management framework, particularly the internal model, its limitations and results of the validation of the model and its outputs; and
- providing internally driven challenge and analysis with a regulatory perspective from within the organisation, and ultimately reducing the potential for regulatory intervention and probability of getting a capital add-on.

3.2. Value of the ORSA and its reports to supervisors

The ORSA report will add value to supervisors by:

- providing the supervisor with assurance that the company has executed the ORSA capital assessment to align its risk and capital positions with the company's strategy – both now and in the near future;
- providing the supervisor with a view of the undertaking's key risks (and their diversification as well as accumulation potential), risk appetite (or equivalent concept), stress scenarios, and identify the scenarios or occasions when actions will be taken to manage these risks;
- providing the supervisor with insights into emerging risks within the specific organisation as well as help identify possible emerging risks to the insurance industry as a whole;
- providing the relevant supervisor with an acceptable level of assurance that the risk and capital profile is being managed at both a group and/or local level, in the context of a coherent risk management and risk appetite framework; and evidencing to the supervisor that the underlying ORSA processes are delivering the risk results information consistently, accurately and in a timely manner.

4. ORSA reporting

4.1. Elements of ORSA reporting

The ORSA report must reflect a company's own risk and capital management processes. With due consideration to the nature, scale and complexity of the risks inherent to an undertaking, **the aim of the ORSA framework is critical in defining the purpose, design and primary audience of the ORSA report.**

Depending on the concrete circumstances of the undertaking and its approach for the ORSA (e.g. one dedicated ORSA report versus a summary of individual reports) we believe that the option of two approaches should be available, either to:

A. produce an internal ORSA report and an ORSA supervisory report; or to
B. submit the same ORSA report to both audiences.

The latter approach would result in an efficient process and identical coverage. The former would enable undertakings to separately customise their internal ORSA report to ensure that it is fully focused on the management needs and standards (in terms format, scope, communication channel etc), and additionally to meet the expectations of the supervisors in the supervisory report.

The ORSA report should be submitted to the AMSB for their review, but not approval (as envisaged in the L3 text). Given the forward-looking and current forecast capital positions included in the report, AMSB approval would require a level of independent attestation, which would not be appropriate for a management report.

4.2. ORSA report: Possible Structure

As we have mentioned, undertakings will structure their internal ORSA practices based on the specifics of their business. The ORSA report will also be tailored to its purpose and to (*inter-alia*) managements use the report. For illustrative purposes, we provide a possible report structure to demonstrate the broad content and provide a tangible idea of what the ORSA report could look like.

Please note that:

- This report structure is provided for illustrative purposes only! Undertakings will structure their reports tailored to their business as best they see fit.
- Over time, as audiences become familiar with the content of the ORSA report, it is expected that the 'stable' content related to frameworks or descriptions of systems (that is less likely to change in the medium term) will likely be less prominent (or non-existent) in the ORSA report. The more 'dynamic' content (that changes with each report) will likely be the main content of the ORSA report. This should be coordinated to suit its audiences, considering the options A and B provided in 4.1 above.

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1. Current Solvency Assessment and Analysis by Risk Type

   In this section undertakings would provide balance sheet information and an assessment of how their capital levels have been adequate in dealing with 'quantified' (generally speaking pillar I-type or risks covered by the internal model or with specific stress/scenario testing) risks, as well as 'non-quantified' risks (including strategic risk, risk to reputation, liquidity risk).

2. Business Planning and Projected Solvency Assessment

   After assessing the current solvency position, the undertaking could provide an overview of the medium term business plans, commencing the forward looking element of the ORSA capital assessment.

   With an understanding of the undertaking's business plans, this section could include projections of an undertaking's risk and capital positions (based on the business plans), as well as identify resilience to stressed conditions (via stress and scenario testing).

3. ORSA Assessment

   Given that the ORSA is not simply a description of the risk and solvency framework, in this section, one would provide an assessment of the ORSA practice itself, including a list or summary of changes since the last ORSA.

4. Description of the Undertaking

   In this section, the undertaking could provide information on business structure and operating model. It may also be useful to shape their operating/market environment and provide some high level input on the Governance and approach to ORSA.

5. Risk and Capital Management Framework

   This section could provide an overview of the integrated approach of risk and capital management strategy. Regarding risk management, one would expect to attain a broad understanding of the undertaking's risk framework and how this deals with exposure to various external forces (articulated through the risk appetite). For the Capital management aspect, undertakings may wish to provide some insight into their investment choices and how capital management drives and responds to the undertaking's exposures.

6. Internal Model Overview

   This section will provide an overview of the internal model and how it interacts with decision-making, reporting, and risk & capital management. Essentially the undertaking will provide a view on the internal model, its limitations and results of the validation of the model and its outputs

5. Interaction with stakeholders

By definition the "Own" Risk and Solvency Assessment is an internally driven process which focuses on a holistic view of the risks and solvency of each organisation, entity or group and is thus seen as a driver of improvement to risk practices within the industry. Therefore we urge supervisors to remain cognisant of the fact that the ORSA report will take different forms and scope, as it represents each undertaking's own risk and solvency assessment. **It is therefore per definition neither possible nor desirable to externally define reporting standards that would eventually drive the ORSA requirements into a compliance exercise.** The ORSA should follow internal principles and use, and its report will primarily, and in the majority of the undertakings, fulfil the needs of the AMSB and the senior management. It will subsequently be shared with the supervisors to provide them with the assurance that the ORSA requirements are fulfilled.

The CRO Forum recognises practical challenges with achieving common approaches to the ORSA for internationally active groups supervised both locally at the legal entity level and at group level via the group supervisor. For groups, the coordination of the distribution of the ORSA report amongst the College of Supervisors should be discussed and agreed with the group lead supervisor: in this context, it is valuable to have the option to submit a single Group-wide ORSA report to the group lead regulator, with clear responsibility for circulation of the information (distribution of the information and the feedback and review process needs to be established).

It is important to ensure that local supervisors do not develop different requirements for the ORSA report in their jurisdiction. The CRO Forum has identified a number of pragmatic elements that could simplify the interaction between undertakings and their supervisors:

- one ORSA report covering the respective jurisdiction (but which is based on the same report) should be submitted to the relevant supervisors per year. At the discretion of the undertaking, or in answer to very important changes to the undertaking's risk profile, the ORSA report may be produced more frequently;
- depending on the application of the ORSA guidelines by the undertaking, one single ORSA report may be provided to the group supervisor, which addresses ORSA requirements at the various locations and levels of the organisation. Alternatively, undertakings may provide targeted reports to the supervisors at the level of their single legal entities or a 'country' report covering the relevant information for all legal entities active within a single jurisdiction; and
- the ORSA report may be aligned with the regular supervisory report (RSR) – references between the reports would allow reducing duplication in the content of the reports (in particular standing sections), and a more efficient production.

In addition to fulfilling its regulatory reporting requirements the ORSA process and some of its qualitative output may be useful to other external stakeholders in describing the quality and effectiveness of an undertaking's Enterprise Risk Management.

6. Conclusion: Towards global standards, ORSA beyond the Solvency II

While the ORSA is considered well advanced in its development in the Solvency II context, the CRO Forum recognises that similar requirements are in place and being developed outside the European Union, for example in North America, Mexico, Bermuda, South Africa, Australia, and Switzerland as well as being included within the International Association of Insurance Supervisors' (IAIS) Insurance Core Principles.

The CRO Forum welcomes these developments, as they provide incentives for enhanced risk management practices. This reinforces the need to maintain an ongoing dialogue with other trade and professional bodies, as well as between supervisory authorities, to allow internationally active undertakings to develop of a common understanding and implement consistent solutions for the ORSA.

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[i] Issue Paper on ORSA by EIOPA (formerly CEIOPS), 27 March 2008

[ii] NAIC – ORSA Guidance Manual:
http://www.naic.org/documents/committees_ex_isftf_group_solvncy_exposure_draft_orsa_guidance.pdf

[iii] IAIS Insurance Core Principles (ICP: 16)

[iv] Verbond Van Verzekeraars - ORSA Good Practice Document:
http://www.verzekeraars.nl/UserFiles/Image/ORSA_good_practices.pdf

[v]The definition mentioned in the ORSA Issue Paper was subsequently updated in sec. 3.1 of EIOPA consultation paper *Draft proposal for Level 3 Guidelines on Own Risk and Solvency Assessment (Article 45)* dated December 2010: 'The main purpose of the ORSA is to ensure that the undertaking engages in the process of assessing all the risks inherent in its business and determines its corresponding capital needs. To achieve this, an undertaking must have adequate, robust processes for assessing, monitoring and measuring its risks and overall solvency needs, while ensuring that the output from the assessment is embedded into the decision making processes of the undertaking. Conducting an assessment of the overall solvency needs properly involves input from across the whole undertaking'.