

# ORSA – engaging the business in Solvency II

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# What is the ORSA?

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# Existing and expected future guidance from EIOPA



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## Article 45 Framework Directive (July 2007)

- Overall solvency needs
- Continuous compliance
- SCR vs. risk profile
- Proportionality
- Strategic decisions
- Significant change in risk profile
- Shared with regulator
- Not a capital requirement

## Issues Paper (May 2008)

- Issued to “bridge the gap” and supplement Article 45
- Five principles
  1. Board responsibility
  2. All material risks
  3. Adequate processes and embedded in the decision making
  4. Forward-looking
  5. Evidenced and independently assessed

## Level 3 Guidance (Nov 2011)

- Expands on CEIOPS issues paper
- 24 guidelines
- Focus on what is to be achieved rather than how
- More guidance for internal model users and groups
- Clarified requirements for firms outside SII Directive

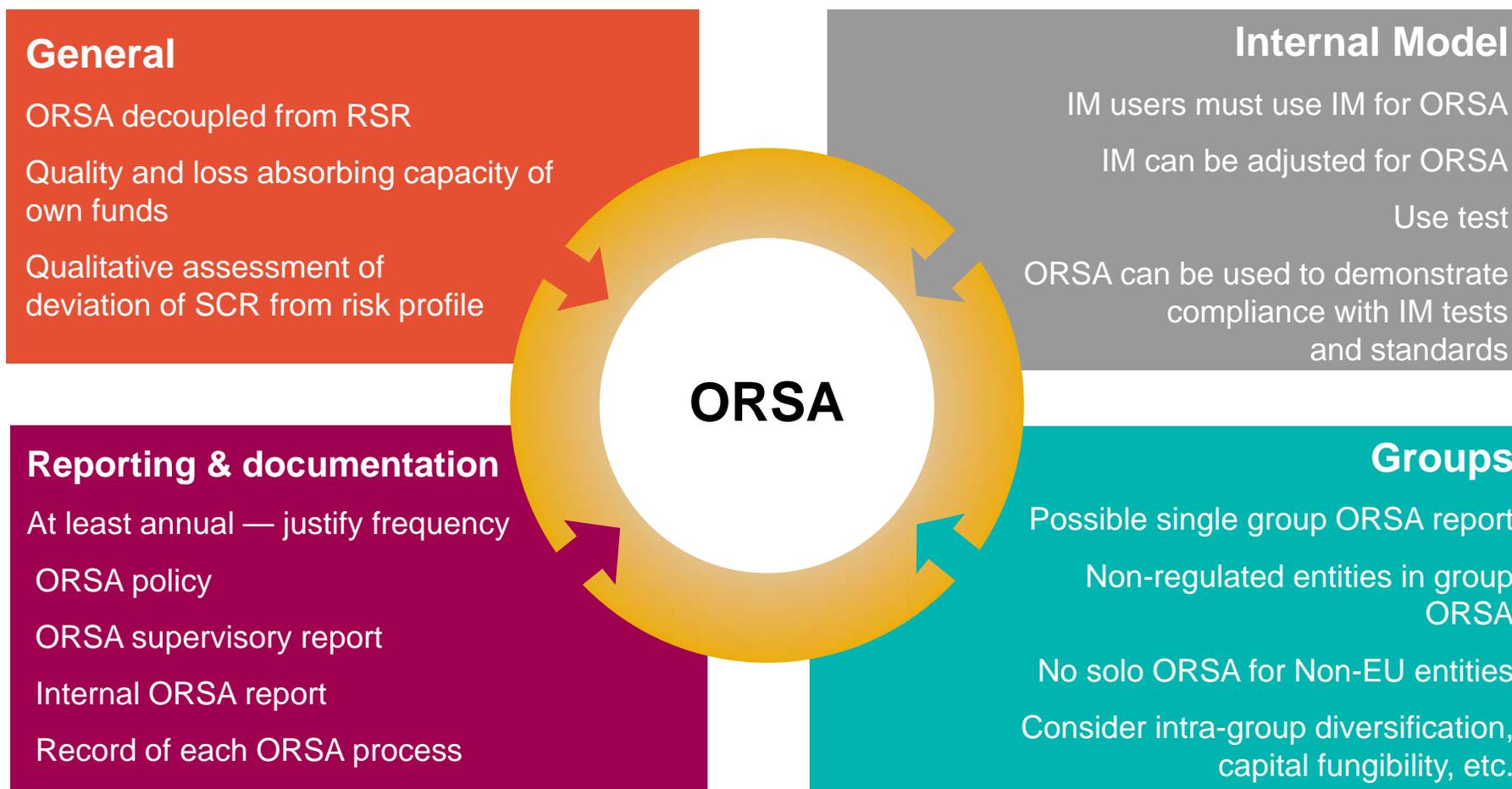


**More on L3**

# Level 3 guidance summary



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# Other reference points – Emerging regional and national standards



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Territory/ Domicile	Regulatory/ Supervisory Authority	Risk and Solvency Assessment	Status/Comment
	European Insurance and Occupational Pensions Authority (EIOPA)	Own Risk and Solvency Assessment (ORSA)	Expected to come into force on 1 January 2014
	US National Association of Insurance Commissioners (NAIC)	Own Risk and Solvency Assessment (ORSA) for the Solvency Modernization Initiative	Group Solvency Issues Working Group finalized Guidance Manual in 2011; pilot implementation in 2012 for five to ten insurance groups
	Bermuda Monetary Authority (BMA)	Commercial Insurer's Solvency Self Assessment (CISSA)	Implemented in 2011, CISSA applies to long-term and short-term insurers and combines ERM and ORSA requirements
	Swiss Financial Market Supervisory Authority (FINMA)	Risk Management/Internal Control System Tool (RM/ICS Tool)	Developed in 2007 by FINMA as part of the Swiss Quality Assurance (SQA)
	Australian Prudential Regulation Authority (APRA)	Internal Capital Adequacy Assessment Process (ICAAP)	Following a consultation period, draft prudential standards released late 2011 — final standards expected to apply from 1 January 2013
	Superintendent of Financial Institutions Canada (OSFI)	Dynamic Capital Adequacy Testing (DCAT)	OSFI published guidance (2009) on using stress, scenario and sensitivity testing beyond DCAT; internal target capital ratio guideline (2011) further emphasizes internal risk and capital assessment

# Summary of requirements



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## What is an ORSA

- A continuous process
- Determined by firm (i.e., “own”)
- Own risk profile and risk appetite
- Short- and long-term risks
- Both qualitative and quantitative
- Overall solvency needs
- Over business planning period
- Adequacy of regulatory capital
- Continuous compliance

## What an ORSA is not

- A point-in-time activity
- Pre-defined by regulator
- A regulatory report, a template or form to complete
- Just a mathematical calculation
- A requirement to develop an internal model
- A capital requirement
- Just a process to tick a regulatory box

# The ORSA process



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# What the ORSA will deliver



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- ✓ **A risk appetite that is used and understood**
- ✓ **Positive risk culture**
- ✓ **An assessment of the risk profile and a review of the appropriateness of the SCR**
- ✓ **An understanding of the key risk drivers**
- ✓ **A system to monitor the regulatory solvency position**
- ✓ **Wider thinking about risk, including contingency planning**
- ✓ **Forward-looking identification, monitoring and reporting of risk**
- ✓ **An assessment of future capital needs**

# What are the challenges for companies?

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# What challenges are companies facing?



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1

Getting started with ORSA

2

Making risk appetite operational

3

Creating a positive risk culture

4

Risk Management, Actuarial and the Business working together

5

Achieving the correct balance of Management Information (MI)

6

Modelling

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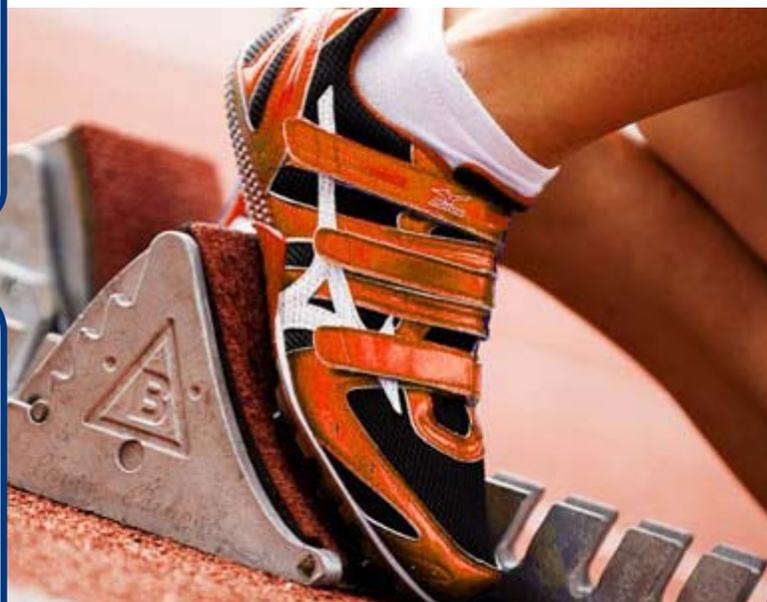
Forward-looking risk management



# 1. Getting started with ORSA

- Focus on deliverables
- Top down and bottom up
- Iterative approach

- Get the right people involved
- Education is important
- Utilise current processes and documents
- Culture is important
- Regular checkpoints and review



## 2. Making risk appetite operational

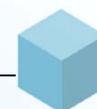


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### Strategic

- Stakeholders
- Link to Business strategy
- Risk and return preferences
- Key performance indicators



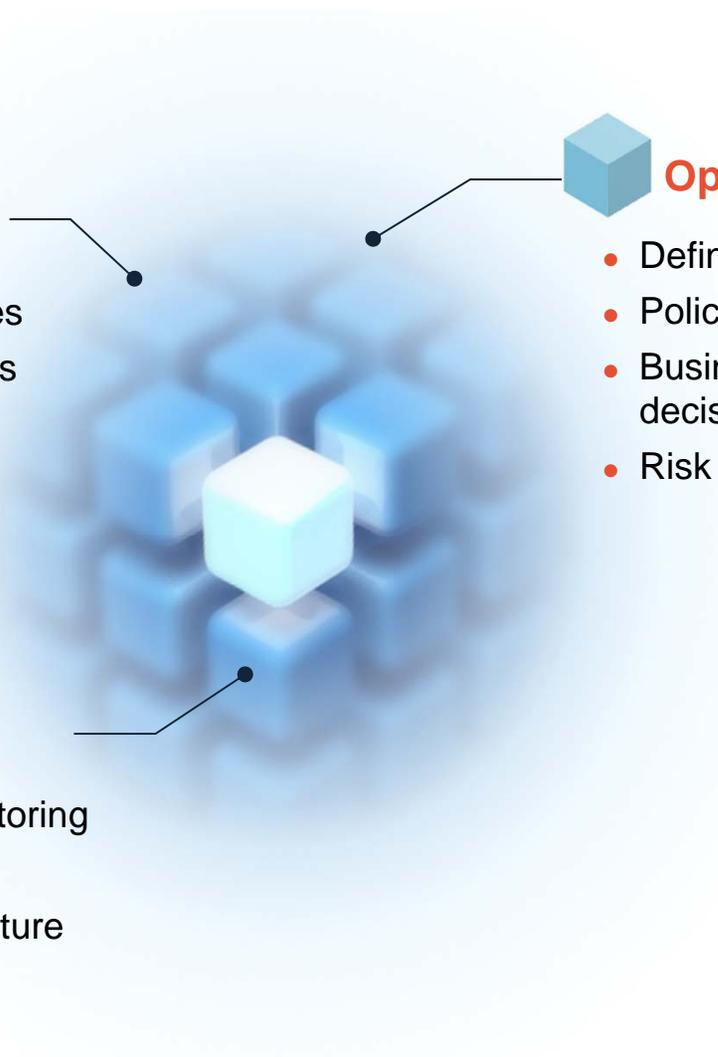
### Operational

- Define limits and trigger levels
- Policies and procedures
- Business planning and strategic decisions
- Risk mitigation planning



### Monitoring

- Continuous solvency monitoring
- Dashboard reporting
- Decision-making infrastructure
- Escalation processes



### 3. Creating a positive risk culture



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“Vertical escalation of threats and fears”

“Active learning from mistakes”

“An effective governance structure”

“Committed leadership”

“Continuous and constructive challenging of the organisation’s actions and preconceptions”

“Horizontal information sharing”

“Incentives that reward thinking about the whole organisation”

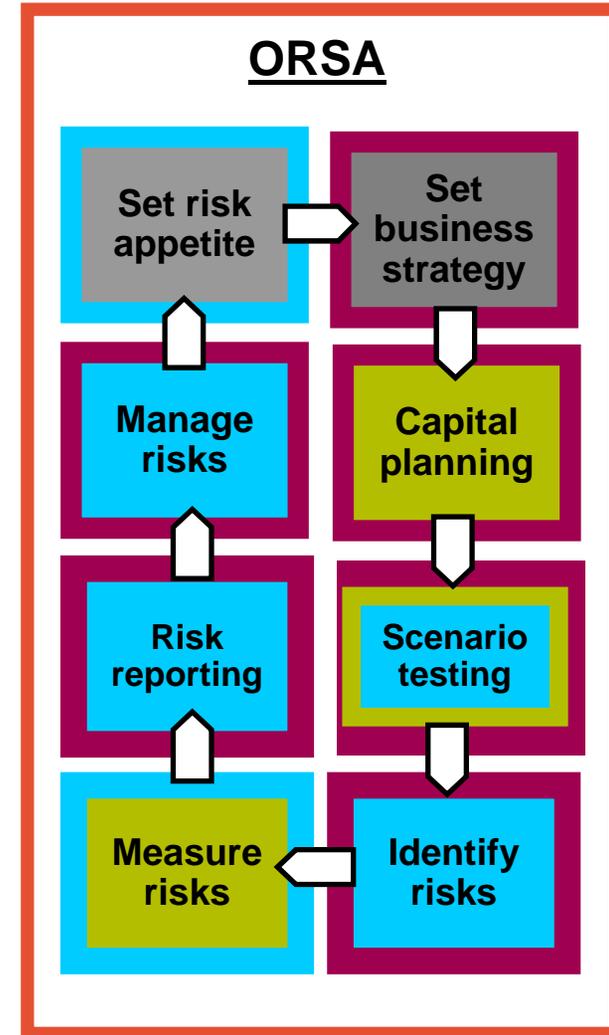
“Management objectives linked to risk management objectives”



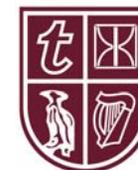
# 4. Risk management, Actuarial and the business working together



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## 5. Achieving the correct balance of MI

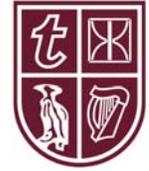


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Challenge		Best Practice
Too much information	▶	<ul style="list-style-type: none"><li>• Filter for audience</li></ul>
Irrelevant	▶	<ul style="list-style-type: none"><li>• Focus on important risks</li></ul>
Confusing or difficult to understand	▶	<ul style="list-style-type: none"><li>• Simple but effective tools</li><li>• Common terminology</li></ul>
Information not reaching the right people	▶	<ul style="list-style-type: none"><li>• Clear escalation process</li></ul>
Not acted upon	▶	<ul style="list-style-type: none"><li>• Clear actions</li></ul>
Too late	▶	<ul style="list-style-type: none"><li>• Regular distribution</li></ul>

**Information misunderstood is a waste of everyone's time**

# 6. Modelling



Modelling	Key Questions
Continuous monitoring	<ul style="list-style-type: none"><li>• Do we understand what drives our balance sheet?</li><li>• Would we know if solvency was breached at any time?</li><li>• Will our solvency monitoring system trigger timely actions?</li></ul>
Pillar 2 capital	<ul style="list-style-type: none"><li>• What is the “true” cost of capital?</li><li>• What capital should be allowed for in pricing?</li><li>• Is the capital we hold for Pillar 1 appropriate?</li></ul>
Scenario testing	<ul style="list-style-type: none"><li>• How does the range of solvency outcomes compare with our risk appetite?</li><li>• What combinations of risk events do we need to worry about?</li></ul>
Capital planning	<ul style="list-style-type: none"><li>• Do we have enough capital or a plan to raise it?</li><li>• What are the key levers in our strategy or business plan that affect capital needed (e.g., mix, volume)</li></ul>

**Key to effective modelling is focusing on the outcomes**

## 7. Forward-looking risk management



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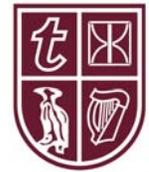
	Impact	Likelihood		
		Low	Very low	Very, very low
<b>Financial</b>	High		Sovereign debt	
	Medium	Banking crisis		
	Low		Insurance crisis	
<b>Economic</b>	High	Depression	Hyperinflation	
	Medium	Currency crisis		Resource scarcity
	Low			End of fiat money
<b>Other</b>	High		Climate change	Major war
	Medium	Euro break-up	Political crisis	Infrastructure failure
	Low	Protectionism		Killer pandemic

# Where should companies be in their ORSA developments?

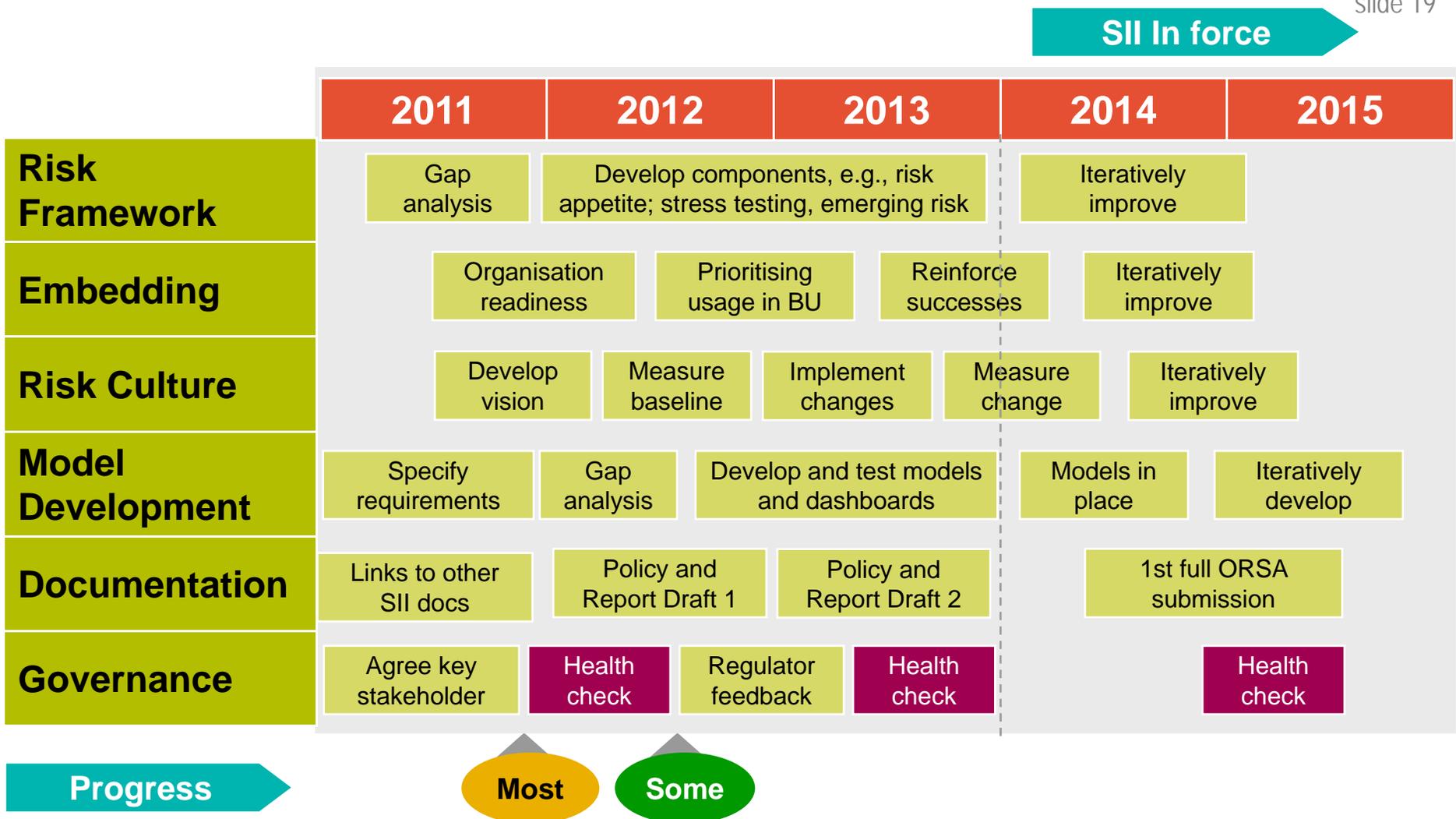
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# Progress on ORSA varies widely across Europe



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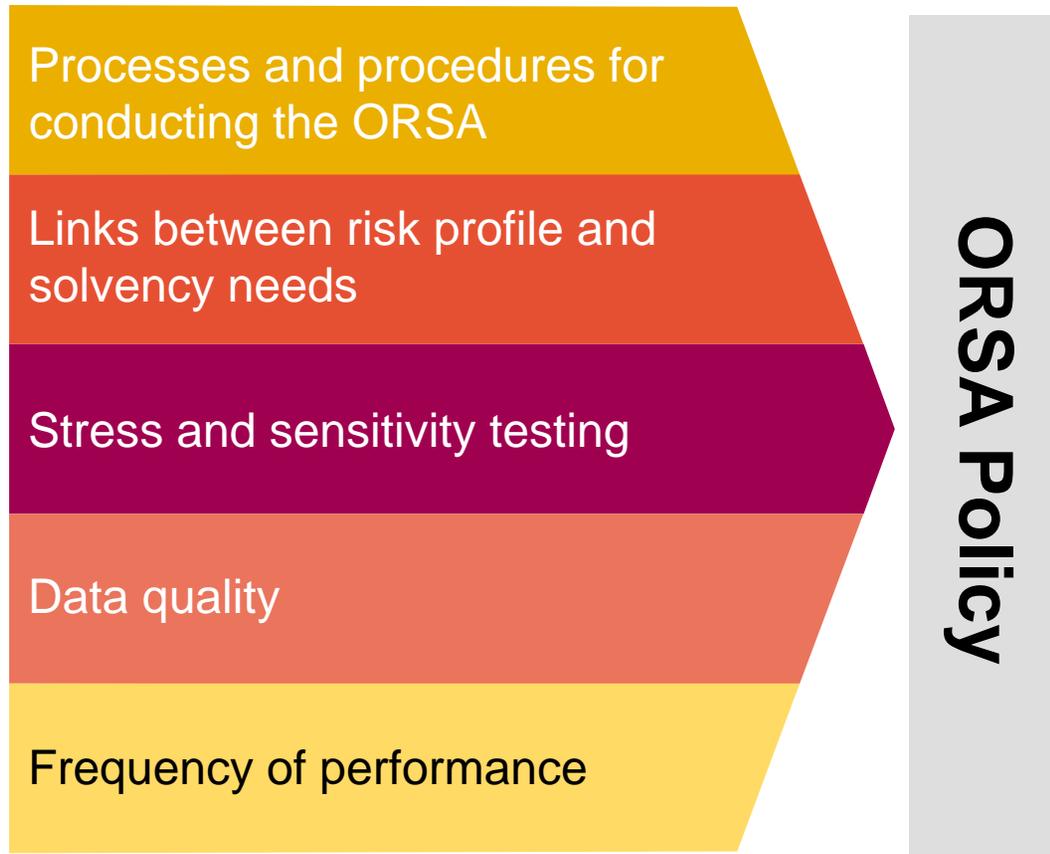


# What can you be doing now to make progress? ORSA Policy

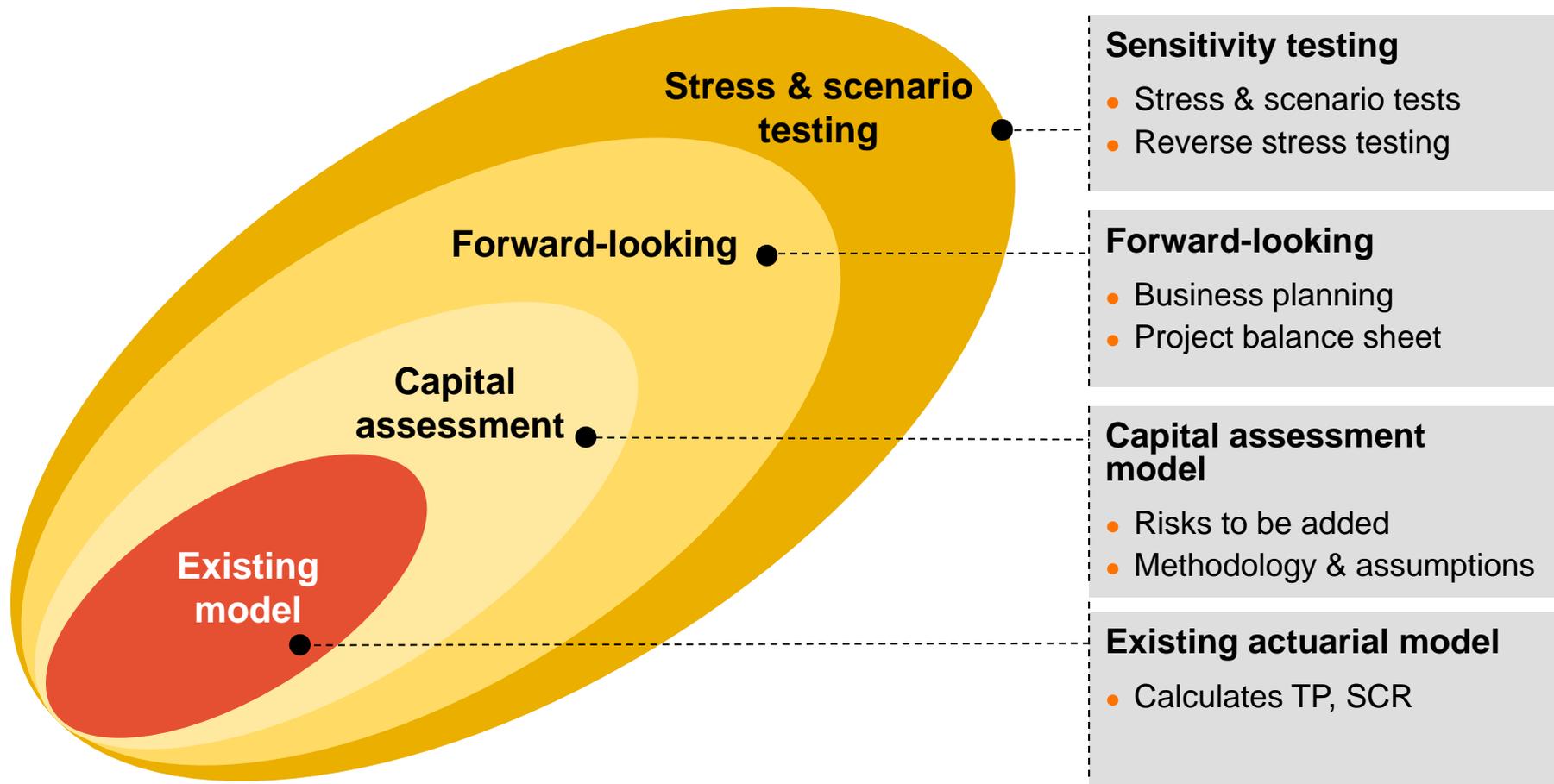


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- Expected that companies will be required to have a written ORSA policy
- Detailed and wide-ranging document
- Making an early start will set the ORSA project in the right direction
- Helps to link the ORSA with business plans and processes



# Expanding existing models for use in ORSA



# ORSA embedding approach

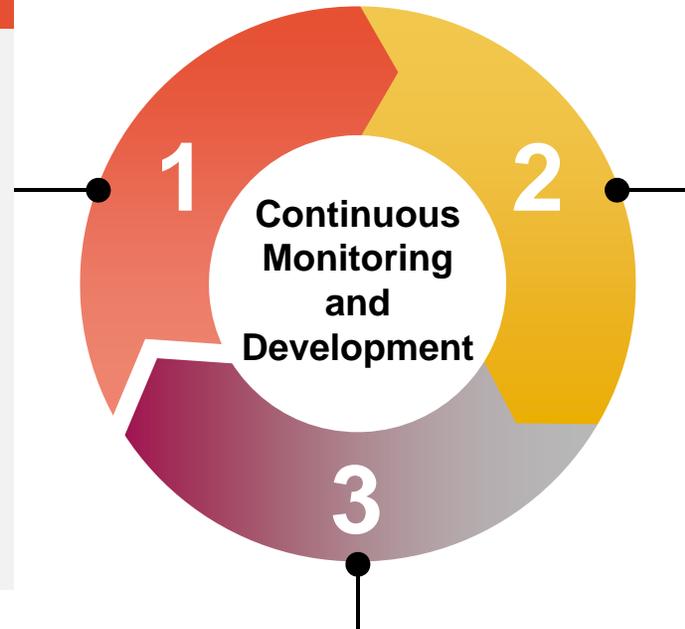


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## 1. Organisational Readiness

**Is the organisation ready to embed the model?**

- Is there a clear vision of the target end state?
- Is there a common understanding of the existing risk culture?
- Does management have the will to make the necessary changes?
- How engaged are key functional areas such as human resources, finance, pricing and underwriting?
- Will an education programme be in place to support the new risk framework?
- Is there a communication strategy for the wider business?



## 2. Defining Uses and Setting Priorities

**How does the business want to use the model?**

- Is there sufficient understanding of current model capabilities/limitations and associated MI?
- What are the short-, medium- and long-term objectives for model use?
- Is there a model development plan with realistic costs associated?
- What are the business benefits of each use?
- Is there a process for achieving a consensus on prioritising uses?

## 3. Reinforcing Success and Evidencing Embedding

**How to implement the necessary changes in processes, documentation and behaviors?**

- Does senior management set the tone from the top?
- Is there a positive feedback loop between new MI, working practices, policies, performance management and training?
- Does the more frequent and granular information promote improvements to the governance structure?
- Do the current Board agendas/minutes reflect the use of improved MI?
- Are there processes/tools to monitor progress towards target end state?

# Identifying how the ORSA will be used

## – Prioritisation matrix



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Uses Categories	Model Uses	Decision dimensions					Overall Assessment
		Business benefit	Current capabilities	Organisational readiness	Cost	Ability to evidence	
Risk & Capital Management	Solvency reporting						
	Continuous Solvency monitoring						
	ORSA reporting	High	High	Medium	Low	High	✓
	Risk management & appetite	High	Low	Medium	Low	High	✓
	Regular risk monitoring & MI						
	Business planning	High	Medium	Low	Low	Medium	✓
Business Management	Product design, UW & pricing						<b>Recommended initial focus</b>
	Reinsurance						
	M&A and Reorganisation						
	ALM & hedging						
	Bonuses & profit sharing	High	Low	Low	High	Low	✗
	Performance mgmt & compensation						
Reporting & KPI	IFRS						
	Regulatory GAAP						
	Rating agencies						

# ORSA Health Check — Typical findings



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<b>Risk Framework</b>	<ul style="list-style-type: none"><li>• Companies have aspects in place, but challenge is to link it all together</li><li>• Typical gaps in updating risk appetite and making operational; reinforcing a positive risk culture and wider thinking about risk</li></ul>
<b>Embedding</b>	<ul style="list-style-type: none"><li>• Works best when this is a priority for the leadership team with clear vision</li><li>• Often policies such as remuneration, performance management, recruitment need to be updated to reflect risk considerations</li><li>• Important to reinforce any early successes</li></ul>
<b>Risk Culture</b>	<ul style="list-style-type: none"><li>• Firms increasingly recognising the importance of a positive risk culture but typically struggle with process for measuring objectively</li></ul>
<b>Model Development</b>	<ul style="list-style-type: none"><li>• Challenge for Standard Formula firms</li><li>• Few deviating too far from internal model calibration</li><li>• Some developing capital projections and solvency monitoring with various degrees of sophistication</li></ul>
<b>Documentation</b>	<ul style="list-style-type: none"><li>• Most have found it difficult to keep the ORSA Report a light report</li><li>• Drafting ORSA Policy helps clarify the process and governance</li></ul>
<b>Governance</b>	<ul style="list-style-type: none"><li>• Most have established projects and identified stakeholders. CRO typically the sponsor of the ORSA project</li><li>• Question whether terms of reference and membership of existing committees need to be modified to reflect new responsibilities</li></ul>

# It's not all bad news – realising the benefits of the ORSA!



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- **Better risk awareness and foresight**
  - More insightful decision making
  - Forward looking and proactive risk management
- **Focusing management attention on risks that matter**
  - Focus on regular, current and relevant information
- **Increased alignment of risk appetite and business strategy**
  - ORSA pulls together existing ERM components
- **Improve capital efficiency**
  - Reduce cost of capital through better management of volatility
  - Uncover natural hedges

# Q&A



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