

The Actuarial Profession
making financial sense of the future

Momentum Conference

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Risk Management's important ORSA they say...

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Agenda

- What is the ORSA?
- Challenges
- What does the ORSA mean for me?

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Agenda

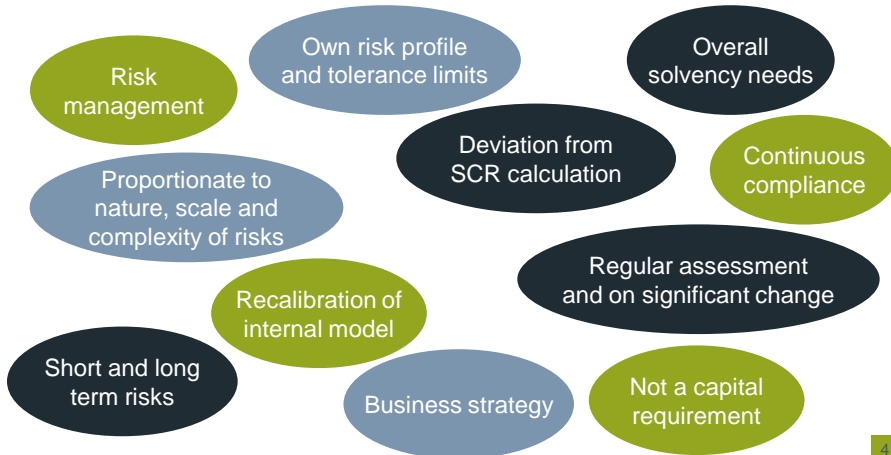
- What is the ORSA?
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ORSA is a central part of Solvency II

		Pillar 1	Pillar 2	Pillar 3
Technical	All Insurers <ul style="list-style-type: none"> • Balance sheet items • Standard formula SCR • MCR 	Internal Model option <ul style="list-style-type: none"> • Approval process • Technical standards 	<ul style="list-style-type: none"> • Supervisor review <div>“Own Risk and Solvency Assessment” (ORSA)</div>	<ul style="list-style-type: none"> • Supervisory and public disclosures
Governance and business management		<div>Technical tests</div> <div>Internal model ‘Use test’</div>	<ul style="list-style-type: none"> • Governance • Risk management • Internal controls • Internal audit • Actuarial function • Outsourcing <div>Key role in governance</div>	<div>The ORSA fits into Pillar 2, but documentation will be a key disclosure to supervisors under Pillar 3</div>

What is an ORSA?

The ORSA is a Pillar 2 requirement defined in Article 45 of the Framework Directive



Other key ORSA requirements

- Performed at least annually
- Documentation
 - *ORSA policy*
 - *Record of each ORSA process*
 - *Internal ORSA report*
- Disclosed privately to the regulator in the *Report to Supervisors*
- Summary of ORSA process in *Solvency and Financial Condition Report*
- Management will sign off the results; need to take active role in ORSA

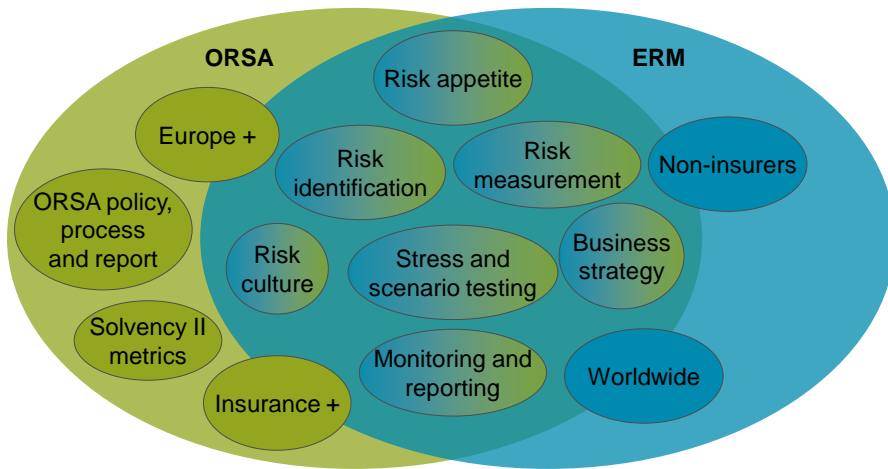
What does the ORSA process look like?



How does the internal model fit into the ORSA?

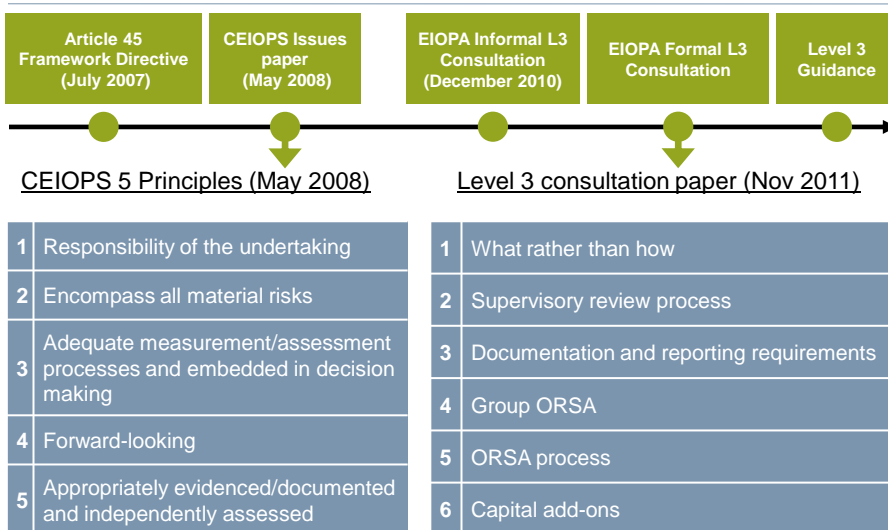
- Internal model firms expected to use their internal model for their ORSA
- Pillar 1 and Pillar 2 internal models not expected to be significantly different
- ORSA process can be used to demonstrate internal model compliance
- ORSA is not necessary an internal model “through the back door” – need to remember concept of proportionality

How does the ORSA compare to an Enterprise Risk Management (ERM) framework?



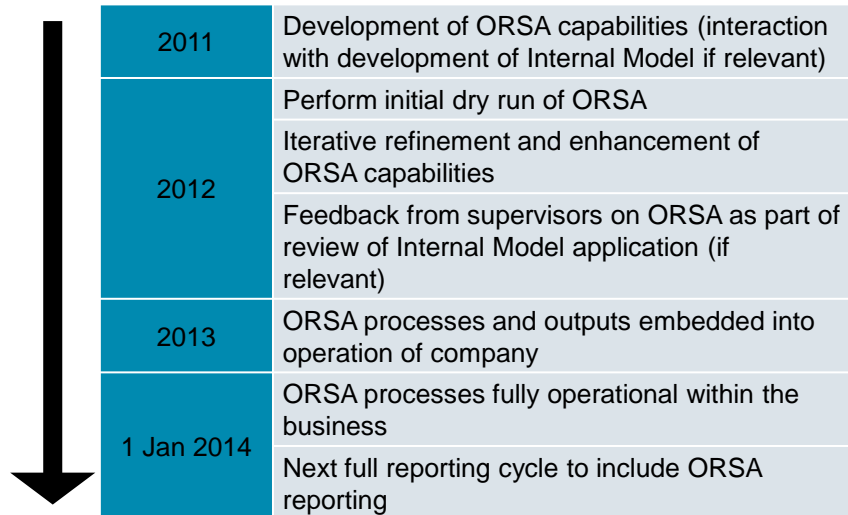
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Existing and expected future guidance



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Potential timeline to implementation



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Why should we bother with good risk management?

“Not to prevent people from taking risks but to allow people to understand and manage in the optimal way the risks that they take”

Risk in opportunity	Opportunity in risk
Threat	Opportunity
Safety	Innovation
Survival	Incentive
Loss	Profit

Need a balanced attitude to risk management

Risk management is not just about compliance

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Which area is the likely to be the most challenging in the ORSA?



Source: Towers Watson survey taken at the *Spotlight on Solvency II* seminar in March 2011

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Challenges

Five big ORSA challenges:

1. Your risk universe and anticipating the next “big thing”
2. Making risk appetite operational (embedding)
3. Creating a positive risk culture
4. Managing the flow of risk information
5. Modelling

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1. Anticipating the next “big thing”

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

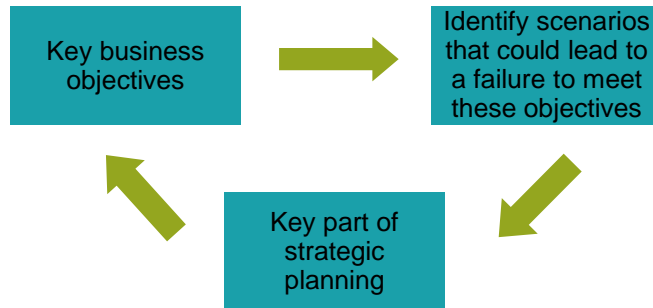
Source: Towers Watson publication “Extreme risks: the 2011 update” September 2011

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1. Understanding your risk universe

- Get the right people in the room
- Understand the changing environment
- Facilitate discussion in a structured way (e.g. reverse stress testing)

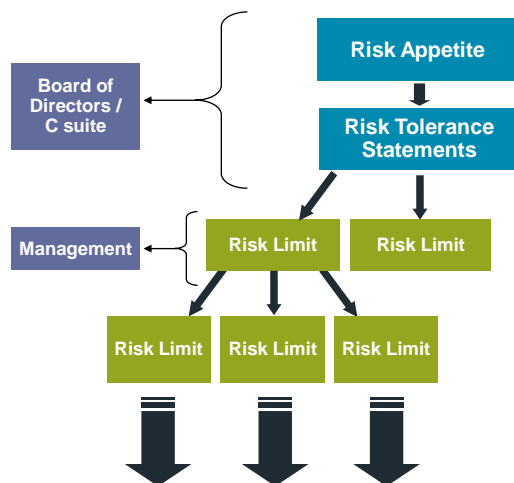


- Board's responsibility is to introduce the process and challenge the outcomes

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2. Making risk appetite operational – what is risk appetite?



- The amount of total risk exposure that an organisation is willing to accept or retain

- Defined formally by the Board to provide guidance/principles to management

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2. Making risk appetite operational



2. Making risk appetite operational

Success factors

- Iterative process
- Simultaneous top-down, bottom-up approach
- Focus on getting the right skills
- Buy in from all involved
- Good risk information processes

3. What characterises a good risk culture?

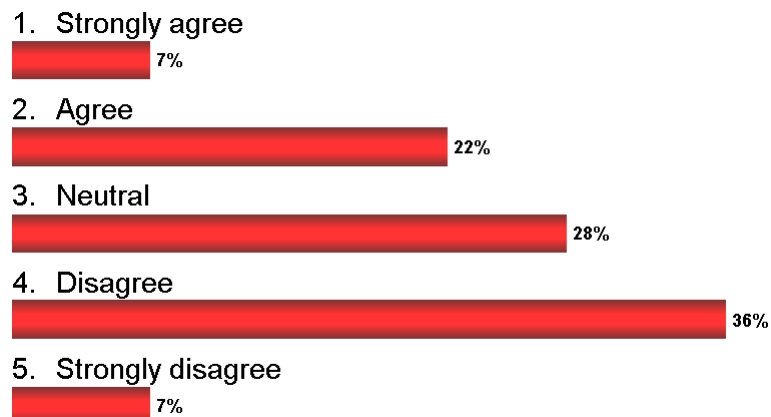


Reform in the Financial Services Industry: Strengthening Practices for a More Stable System
Institute of International Finance, 2009
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3. Risk culture

We have an effective way of measuring and managing risk culture in our organisation



Source: Towers Watson survey taken at the *Spotlight on Solvency II* seminar in March 2011

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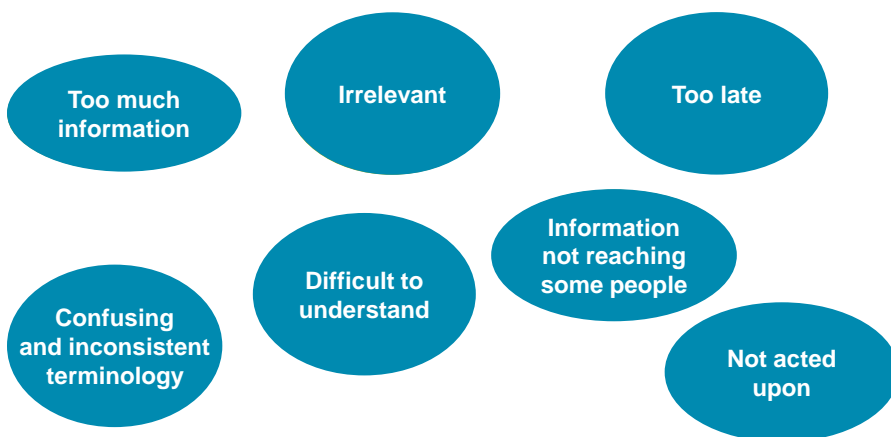
3. Example interventions to improve risk culture

Leadership	<ul style="list-style-type: none"> • Board education • Development of risk appetite • Leadership communication
Rewards	<ul style="list-style-type: none"> • Compensation governance • Audit of compensation plans • Alignment of plan design with risk appetite and strategy
Performance Management	<ul style="list-style-type: none"> • Goal setting in alignment with strategy • Risk-based personal objectives
Communication	<ul style="list-style-type: none"> • Risk reporting • Company-wide risk awareness and engagement
Organisational Change	<ul style="list-style-type: none"> • Coordinating multiple change initiatives • Addressing rational and emotional dimensions of organisational change

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4. Managing the flow of risk information



Information misunderstood is a waste of everyone's time

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5. Modelling

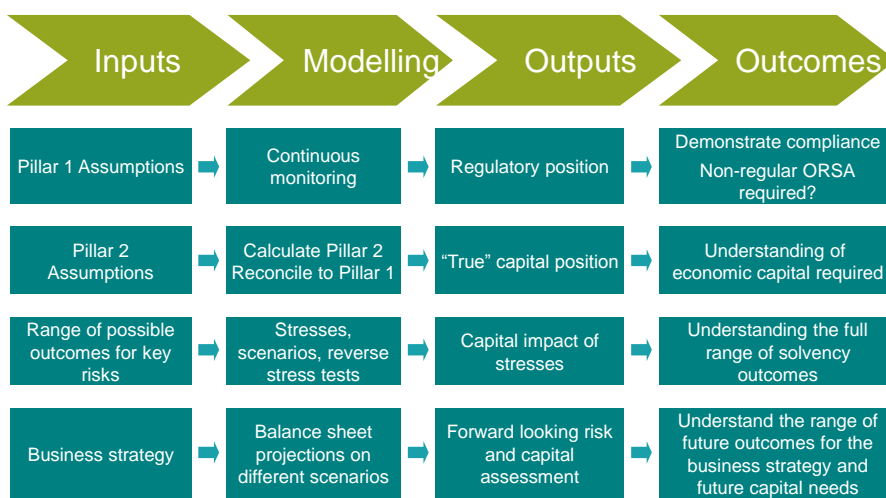
- Standard formula vs. internal model
- Complexity vs. accuracy
- Continuous modelling
- Forward-looking
- Stress and scenario testing
- Need for speed

Models aren't everything!

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5. The key to effective modelling is focusing on the intended outcomes (why are we modelling?)



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What does the ORSA mean for me?

The world is changing:

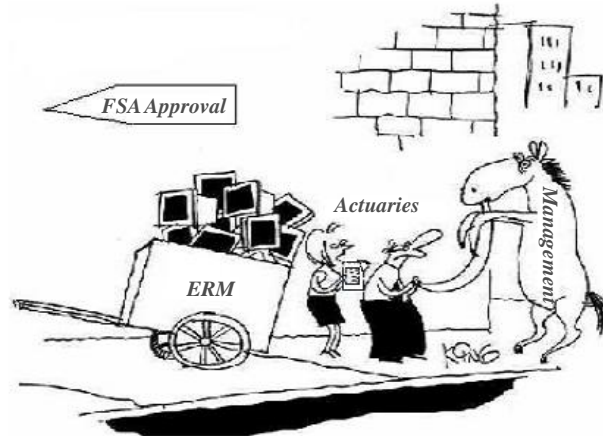
- Risk is being put on the agenda
- The CRO will become a VIP

As actuaries we need to be different:

- Get involved in risk management (ERM)
- Expand our skill set
- Wider business involvement
- Focus on communication and collaboration

Grasp the opportunity

What does the ORSA mean for me?



"It says here you can lead a horse to solvency too"

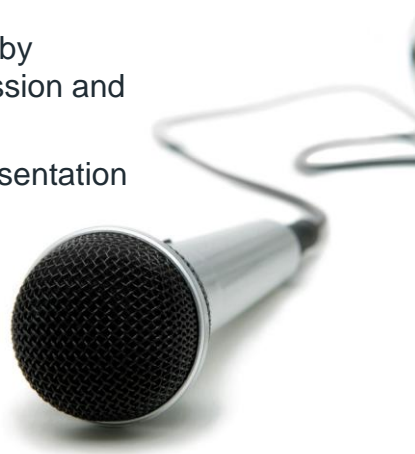
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Questions or comments?

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The views expressed in this presentation are those of the presenter.



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