ORSA – an international development

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Agenda

- What is an ORSA?
- Global reach
- Comparison of requirements
- Common challenges
- Potential solutions

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Origin of ORSA

- FSA ICAS
- Solvency II
- IAIS ICP16

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What is an ORSA?

- Insurer's own assessment of:
  - A. its risks
  - B. capital needed to protect against those risks
- Documentation of assessment

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ORSA – a key management tool

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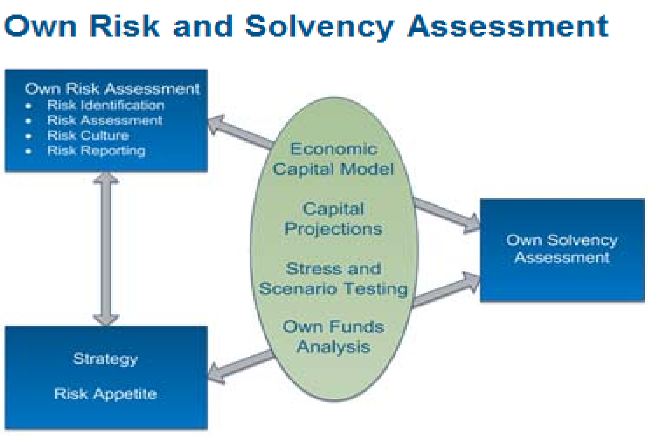
ORSA – how the pieces fit together



Objectives of the ORSA

- Board responsibility
- Own risk assessment
- Own solvency assessment
- Forward-looking
- Management information
- Enhance understanding
- Group-wide
- Continuous process
- Adequate documentation

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Challenges in achieving objectives

- Risk that ORSA becomes a compliance exercise
- Challenges in
  - Planning and organisation
  - Training
  - Communication
  - Culture
- Need leadership and need to achieve buy-in

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IAIS – ICP16

- Assess overall solvency needs
- Insurer should undertake a continuity analysis (forward looking assessment)
- Responsibility with Board and senior management
- Perform regularly and following significant change to risk profile
- Group ORSA required
- Supervisor should review output of ORSA
- Document rationale, calculations, actions arising from ORSA
- Proportionality recognised
- Independent review where proportionate

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Comparison criteria

- ✓ Quantitative assessment
- ✓ Qualitative assessment
- ✓ Forward looking
- ✓ Continuous compliance
- ✓ Deviation from assumptions
- ✓ Role of board
- ✓ Use of ORSA
- ✓ Frequency
- ✓ Group assessment
- ✓ First submission
- ✓ Exemption
- ✓ Proportionality
- ✓ Required documentation
- ✓ Independent review

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Territories covered include

- ✓ **IAIS (International)**
- ✓ **European Union**
- ✓ **United States**
- ✓ **Australia**
- ✓ Canada
- ✓ Switzerland
- ✓ Singapore
- ✓ Malaysia
- ✓ Bermuda

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Common Requirements




- Large degree of consistency in requirements
- Quantitative assessment
  - stress tests, reverse stress tests, sensitivities and scenario analyses
- Qualitative assessment
- Forward looking perspective
- Performed on regular basis
- Proportionality recognised

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Specific Points to Note
Solvency II

- Additional requirements
  - Demonstrate compliance on continuous basis with:
    - Capital requirements
    - Technical provision requirements
  - Assess deviation of risk profile from assumptions of SCR
- Extensive documentation
- No explicit requirement for independent review
- 2014 Implementation through FLAOR

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Specific Points to Note
NAIC

- Less emphasis on the Role of the Board
  - No explicit requirements to steer/challenge the process
  - A copy of the summary report must be provided to the Board
- Report must be signed
  - By the individual responsible for oversight of ERM process
- Less emphasis on Use of the ORSA
- Flexibility on risk capital measure
  - Economic, rating agency and/or regulatory frameworks

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Specific Points to Note
NAIC

- Group emphasis
  - Performed consistent with the way the business is managed
  - Whether group, legal entity or other basis
  - Not necessarily required for every legal entity
- Thresholds
  - Annual direct written premium of less than $500 million; or
  - Part of group with annual direct written premium of less than $1 billion

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Specific Points to Note
NAIC

- Preparedness - Milliman survey March 2013
  - 80% of participants don't currently prepare such a report
  - 33% with no risk appetite statement
  - Strategic, reputational and operational risks hardest to assess
  - Marginal beneficial effect expected
- 2015 Implementation

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Specific Points to Note APRA

- Capital triggers required
  - Provide time to rectify problems and restore capital
- Independent review required
- 2013 Implementation

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Specific Points to Note APRA

- Initial feedback from APRA on Summary Statements
  - Significant room for improvement
  - Quality not related to Insurer size
  - Problem areas included:
    - Independent review
    - Stress testing
    - Risk appetite
    - Risk assessment
    - Internal controls

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ORSA – an international development

Practical challenges in implementing an ORSA

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Questions the ORSA should help answer

- Understanding of risk profile of the company?
- Does company have sufficient capital to support business plan?
- Will company stay within risk appetite going forward?
- What risks are not covered by regulatory capital?
- What risks should be monitored more frequently?
- What scenarios could cause solvency issues?
- What mitigation options are available in these scenarios?
- Key sensitivities to capital & profits?
- Material changes to risk profile over recent period?
- What would cause company to re-run ORSA?

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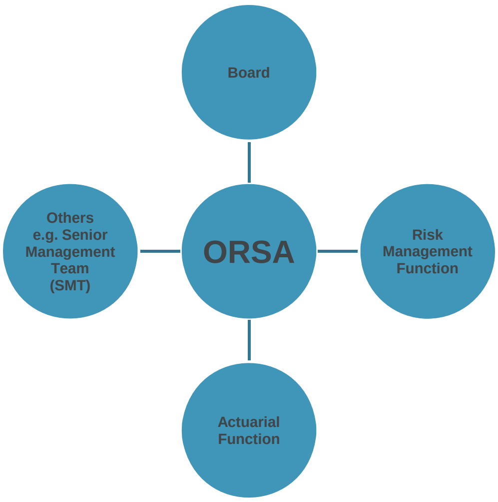
Some challenges and potential solutions

1. Getting the relevant people involved

Who is involved in the ORSA process?



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Role of the Board

- Board expected to steer how ORSA is performed and challenge results
  - Involved in the process and users of the outputs
  - Important that this happens and is evidenced
- Board involvement at start of the process
  - Approve ORSA policy
  - Input into stresses and scenarios (possibly through Risk Committee)
- Board involvement at end of the process
  - Challenge outputs
  - Regulators expect evidence of quality Board discussion on ORSA process and output
  - Evidence that Board take the output of ORSA into account in
    - Business planning and strategy
    - Setting risk appetite
    - Capital management & dividend policy
    - Product development

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Some challenges and potential solutions

2. Balance Sheet Projections

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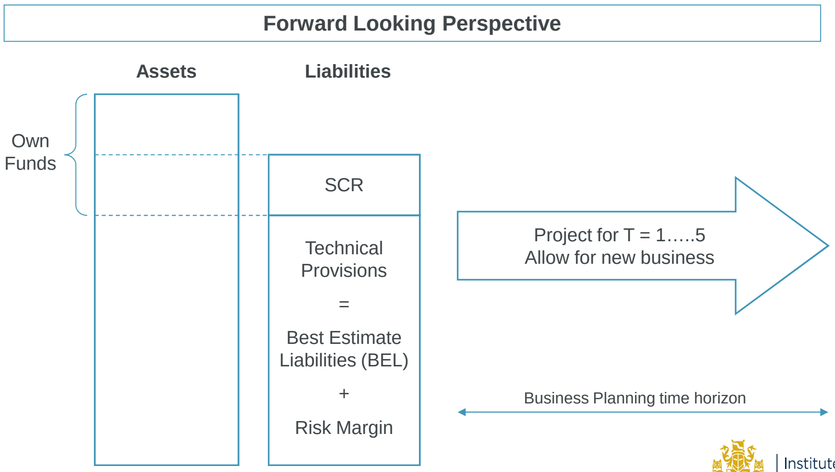
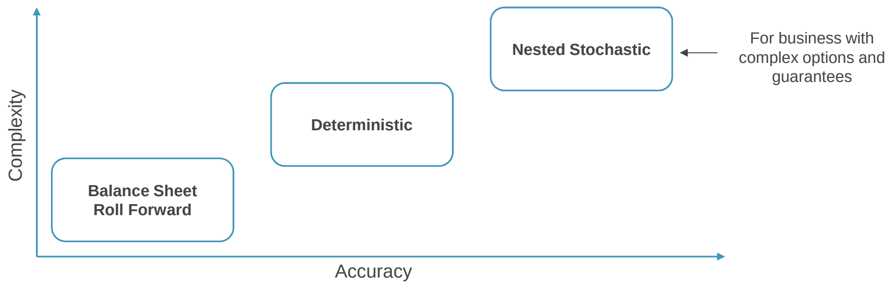
Balance Sheet Projections



Projections

- Required to project Assets, Liabilities and Capital Requirements (SCR)
  - Not a trivial task!
  - Responsibility of the Actuarial Function
- Existing capital projections models may already be available
  - e.g. Financial Condition Reports
- Approach should be proportionate to the nature scale and complexity of the business
  - Trade off between simplicity and accuracy
  - Need to be able to understand and explain output to Board

Projection methodologies



- Issues to consider:
  - IT resources and run times
  - Spurious accuracy
- IMPORTANT: Output must be understood and used by the business

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Projecting Assets & Liabilities

- Deterministic approach may be appropriate for many lines of business
- Liabilities
  - Run-off of Existing BEL and Risk Margin in line with best estimate assumptions
  - Build model points for future new business
- Assets – issues to consider
  - Granular data available on asset holdings?
  - What is the company's ALM strategy?
  - Reinvestment policy for existing assets?
  - What assets are assumed to back new business?
  - What is the company's capital and dividend policy?
  - Rebalancing of portfolio in particular scenarios?

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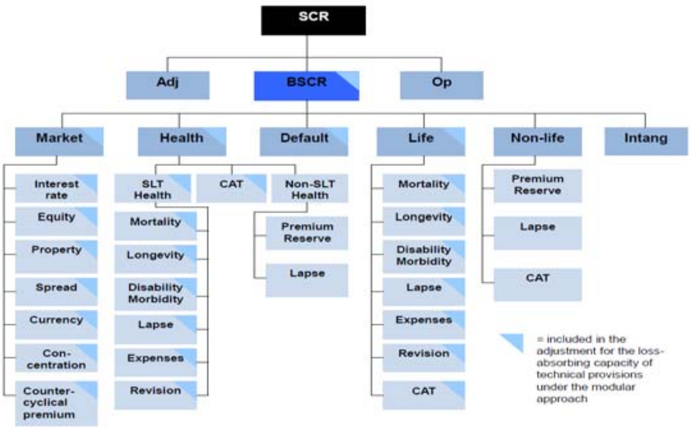
SCR – Standard Formula



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Projecting SCR

- Full recalculation for each future year very onerous
  - Significant number of market consistent valuations to calculate opening SCR
  - Projecting forward, total number of calculations mounts up very quickly
- Key risk drivers, e.g.
  - Sums at risk for insurance risks
  - Growth in equity / property / bonds for market risks
  - Funds under management for future AMCs
- Other options available
  - Trade off between accuracy and practicality

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Reconciliation to previous projection

- Reconcile opening position to that predicted from previous year's projection
  - Actual v Expected analysis should be done in advance of projection
- Benefits
  - Learn about the business
  - Identify sources of capital emerging and new business strain
  - Identify one-off changes in capital
  - Helps to influence any dividend payments
  - Update accuracy of model for future projections

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Some challenges and potential solutions

3. Stress and Scenario Testing

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Stress and Scenario Testing - Options

- Stress tests
  - Sensitivity of capital position to particular risks (e.g. an equity shock)
  - Consider risks not covered by regulatory capital (e.g. sovereign)
- Scenario analysis
  - Combinations of stresses
  - "What if" scenarios
- Reverse stress tests
  - Determine outcome e.g. own funds falls below SCR / MCR
  - Solve for stress level

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Selecting stresses and scenarios

- Selection of business scenarios should involve
  - Board and SMT
  - Risk Management
  - Actuarial Function
  - Others (e.g. sales)
- Consider wide range of scenarios
  - Macro-economic scenarios (e.g. multiple dependant market shocks)
  - Insurance risk scenarios (e.g. pandemics, lapse events)
  - Company specific scenarios
  - Historical events that have been encountered
  - Events that are difficult to quantify (e.g. operational errors)
- Important to consider dependencies, correlations and timings of multiple events
- Mitigations for each scenario should also be discussed

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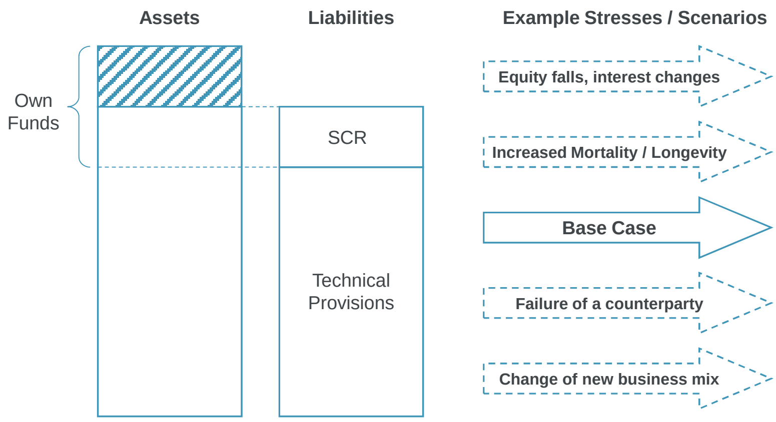
Scenarios – Overall Solvency Needs



Overall solvency needs = level of buffer required to withstand stresses

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Some challenges and potential solutions

4. Linking to business plan and strategy

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Linking to business plan and strategy

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Some challenges and potential solutions

5. Documentation

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Documentation

- Required
  - ORSA policy
  - Record of each ORSA process
  - Internal Report
  - Supervisory Report
- Challenge to produce a comprehensive report that covers all the requirements and also meets the needs of all stakeholders
  - Good overview and executive summary
  - Core of report concise - focus on key issues
  - Detail in the appendices for interested parties
  - “Courage to omit”

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Possible outline of report

- Company overview
  - Business written, market information
  - Risk appetite and capital strategy
  - Strategic plan and link to risk appetite
- Current and future solvency position
  - Base case projection on current business plan
  - Identification of key risks and results of stress testing and scenario analysis
  - Risk mitigation strategies and management actions
- Challenge and conclusions
  - Board and SMT review and challenge
  - Conclusions with respect to capital required to run business
  - Evidence of link between ORSA and strategy
- Appendices

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Some challenges and potential solutions

6. Frequency and Timing of ORSA

Frequency and Timing of ORSA

- Regular ORSA at least annually
  - No set date
  - Schedule process to feed into to business planning and strategic decisions
  - Consider availability of resources
- Non-regular ORSA following significant change in risk profile
  - Should be set out in ORSA policy
  - e.g. Acquisition of a business, new product launch etc.
- EIOPA have issued interim guidelines on Forward Looking Assessment of Own Risks (based on ORSA principles)
  - Phasing-in ORSA from 2014 in advance of full Solvency II
  - Expected to evolve over time

Risk Management versus Compliance

- The ORSA **is** about:
  - ✓ Better risk awareness
  - ✓ Understanding the overall solvency needs of the company
  - ✓ Increased alignment between risk appetite and strategy
  - ✓ More insightful decision making
  - ✓ Improved capital efficiency
- The ORSA **is not** about:
  - × Just addressing the guidelines (ticking the boxes)
  - × Creating a very complex process - output not understood by Board
  - × Designing a complex mathematical model
  - × Creating a huge report - key messages not clear

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Summary

- ORSA is now an international requirement
  - Significant consistency in requirements across territories
  - Provides similar challenges for companies globally
- Focus on what ORSA is trying to achieve and develop approach that works for the Company
  - No perfect model, will improve over time
- There are many benefits to the ORSA **if done well!**

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Questions Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

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

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