



**The Actuarial Profession**

making financial sense of the future

Life Conference 2012

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# Validation of the ORSA

## How can management gain comfort in the ORSA?

Tuesday 6<sup>th</sup> November 2012

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# Agenda

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- Introduction
- Regulatory requirements
- Technical validation
- Continuous validation of the ORSA
- Old Mutual views of the ORSA

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- **Introduction**
- Regulatory requirements
- Technical validation
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- Old Mutual views of the ORSA

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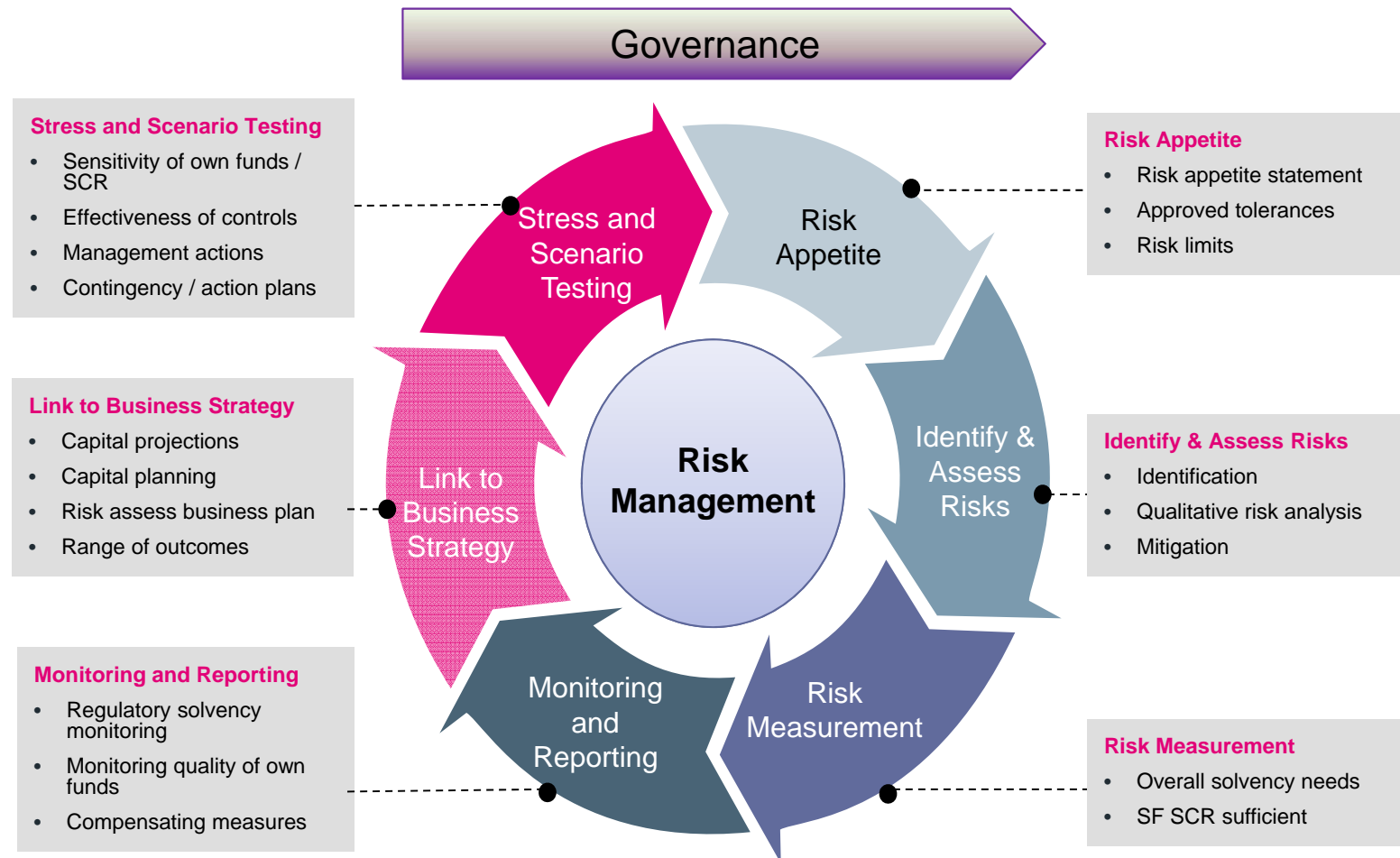
# There are three aspects of validation to consider

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- **Regulatory requirements** – what is required under Solvency II?
- **Technical validation** – certain technical elements of the ORSA will require validation
- **Continuous validation of the ORSA** – is the ORSA process fit for purpose and being used as part of decision making?

# A re-cap of the Own Risk and Solvency Assessment

## Illustrative ORSA process



# There is a requirement to use the ORSA in business decision making

Throughout the ORSA guidance, there are references to the required links between the ORSA process and the business decision making process

## General considerations

“the undertaking must ensure that...the output from the assessment is embedded into the decision making processes of the undertaking”

## Guideline 2

“The AMSB’s responsibility, taking into account the insights gained from the ORSA process, to approve the long and short term capital planning whilst considering the business and risk strategies it has decided upon for the undertaking”

## Guideline 9

“The assessment of the overall solvency is at least expected to:..  
b) Reflect the undertaking’s management practices, systems and controls;...  
d) Connect business planning to solvency needs”

## Guideline 14

“the ORSA feeds into the management of the business, in particular into the strategic decisions, operational and management processes”

## Guideline 14

“The ORSA is required to reflect the business strategy...In reverse, the ASMB needs to be aware of the implications strategic decisions have on the risk profile and regulatory requirements and overall solvency needs”

## Guideline 15

“The ORSA has to be performed on a regular basis and in any case directly following any significant change in the risk profile of the undertaking...such changes follow from internal decisions or external factors”

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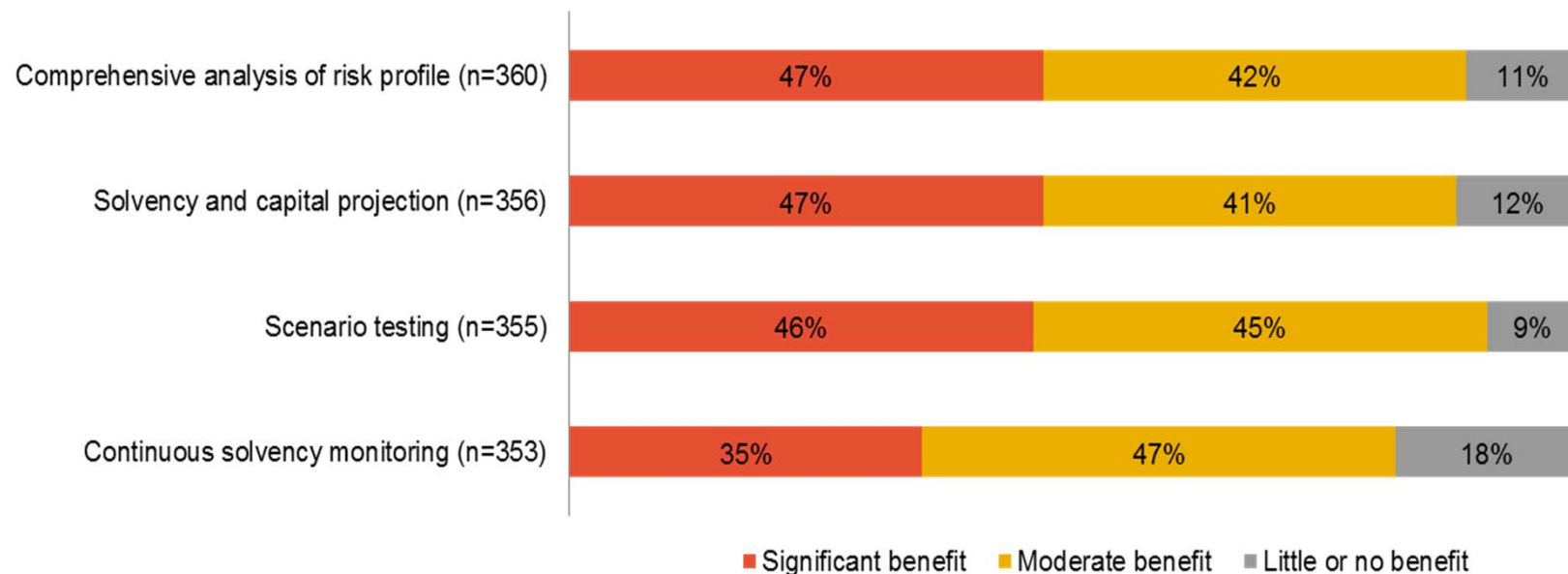
# How does the delay in Solvency II impact ORSA developments?

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- ORSA **regulatory requirements are relatively final** and are not a key area of debate
- There is a **global trend** towards ORSA assessments and increased risk management requirements
- It is a key way to **gain value** from Solvency II work carried out to date

# Many in the insurance industry world-wide are positive about the potential benefits of the ORSA

Participants in the Towers Watson ERM Survey 2012 generally view the ORSA/ICAAP as strongly beneficial to their organisations

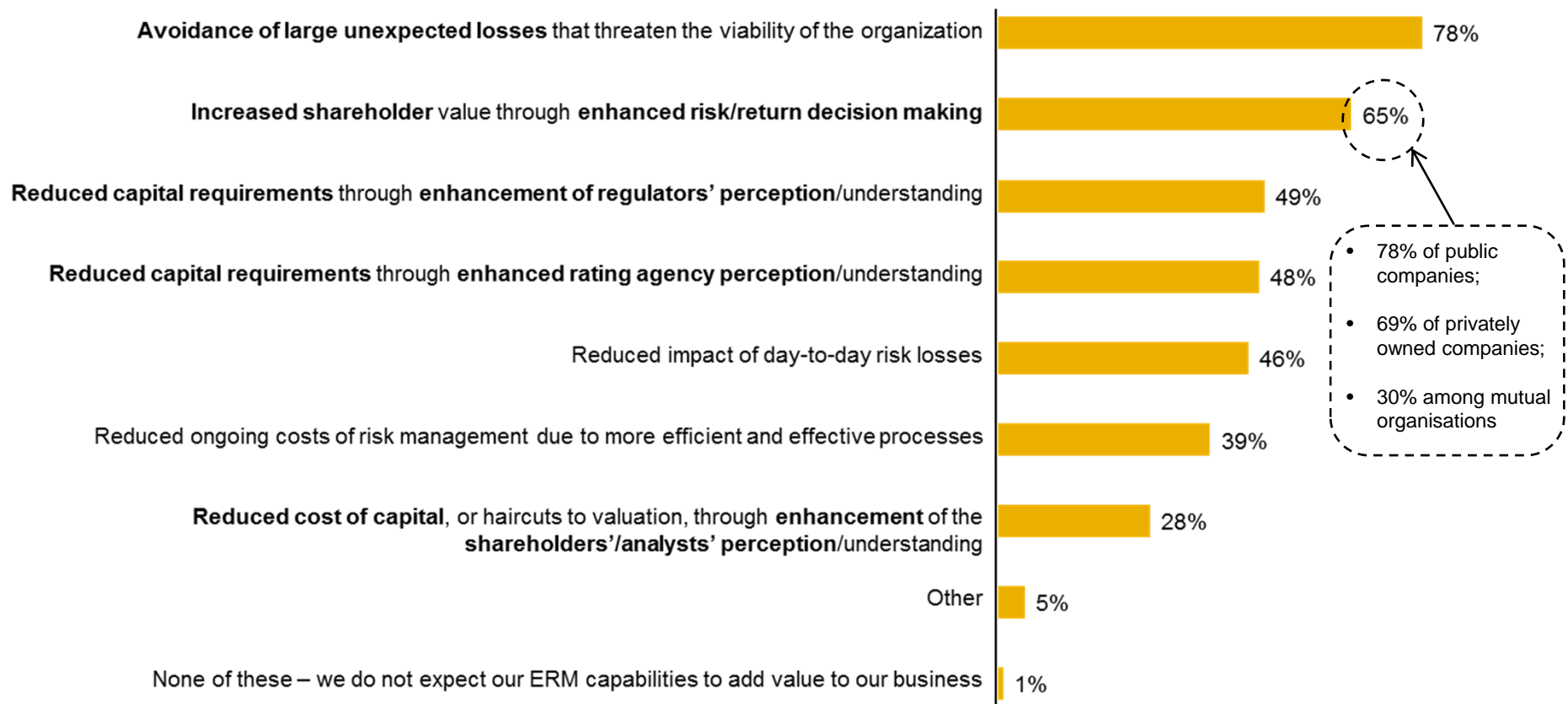


Base: Those required or intending to carry out an ORSA/ICAAP or equivalent giving a valid answer (percentages exclude 'not applicable') for **Q.37 How would you rate the potential benefit generated from each of the following areas within ORSA/ICAAP for your organization?**  
*Please select one in each row.*



# Looking at wider ERM, participants expect it to add value in different ways

The majority of participants believe ERM will add value through the avoidance of large losses and better risk/return decision making



Base: Total respondents n=539 for Q.3 How do you expect your ERM capabilities will enhance business performance? *Please select all that apply.*

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Source: Towers Watson ERM survey 2012

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# Is there a regulatory requirement for validation as part of Solvency II?

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## Yes – but the method of validation is not detailed

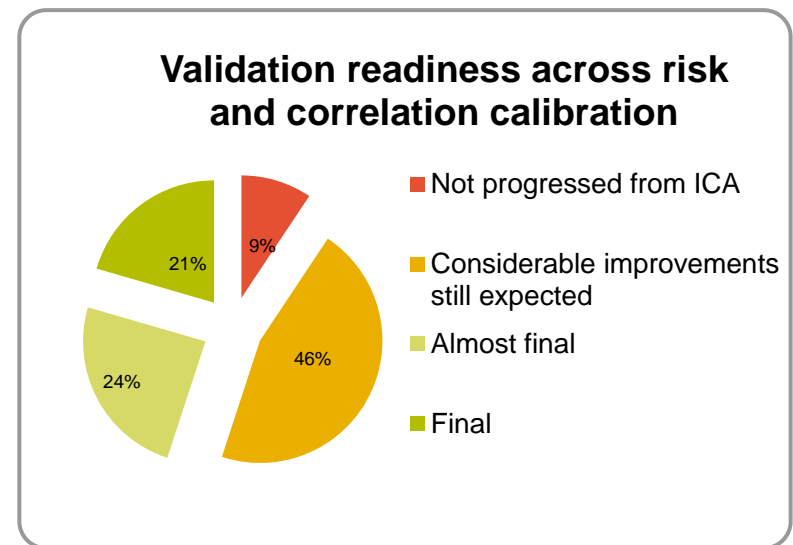
- There are no detailed ORSA validation requirements however Solvency II requires that:
  - In the documentation of each ORSA process, a description of the methods used and an explanation of how these methods can be validated.
  - There is a regular review of the calculation of technical provisions
  - The AMSB (“Administrative, management or supervisory body”) should ‘steer’ the ORSA assessment and challenge results
- Many elements of the ORSA will need validation for standard formula companies
- Independent review of the ORSA is required
  - It was removed from the Level 3 guidance on the ORSA, but in the consultation responses EIOPA said it would still be required as part of the general System of Governance requirements
  - Independent does not necessarily mean external

# What are the key technical elements of the ORSA that need validation?

Element of ORSA	For consideration
Deviation from assumptions underlying SCR calculation	Can deviations in the undertaking's risk profile be explained? Can the SCR calculation methodology be justified? Particularly important for standard formula undertakings. Has a reconciliation back to SII results been performed?
Assessment of overall solvency needs	Does the ORSA calculation of capital requirements ensure better consideration of the specific risk profile of the undertaking? Have different risk calibrations been validated?
Continuous solvency monitoring	Does the methodology used allow appropriately for material risks? Continuous compliance of technical provisions requires input from actuarial function.
Projection methodology	Is the methodology robust enough to enable management to make business planning and capital planning decisions?
Stress and scenario testing methodology	Within what boundaries can robust results be obtained from the models? Are the stress and scenario tests within these boundaries?

# The use of different risk calibrations in the ORSA

- This is most likely for standard formula companies, as internal model companies should already have validated their own risk calibration assumptions
  - Although an internal model company using a different confidence level should validate that their assumptions are appropriate at that level
- A recent Towers Watson survey across 20 participating UK Life insurers taking part in the IMAP process raised some interesting issues to take into account:
  - Calibrations showed a wider range of stresses observed across firms for a number of market and non-market risks compared to ICAs
  - Majority of firms were nearing completion of calibration, but still had work to do on completing independent validation of their analysis



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# To carry out technical validation

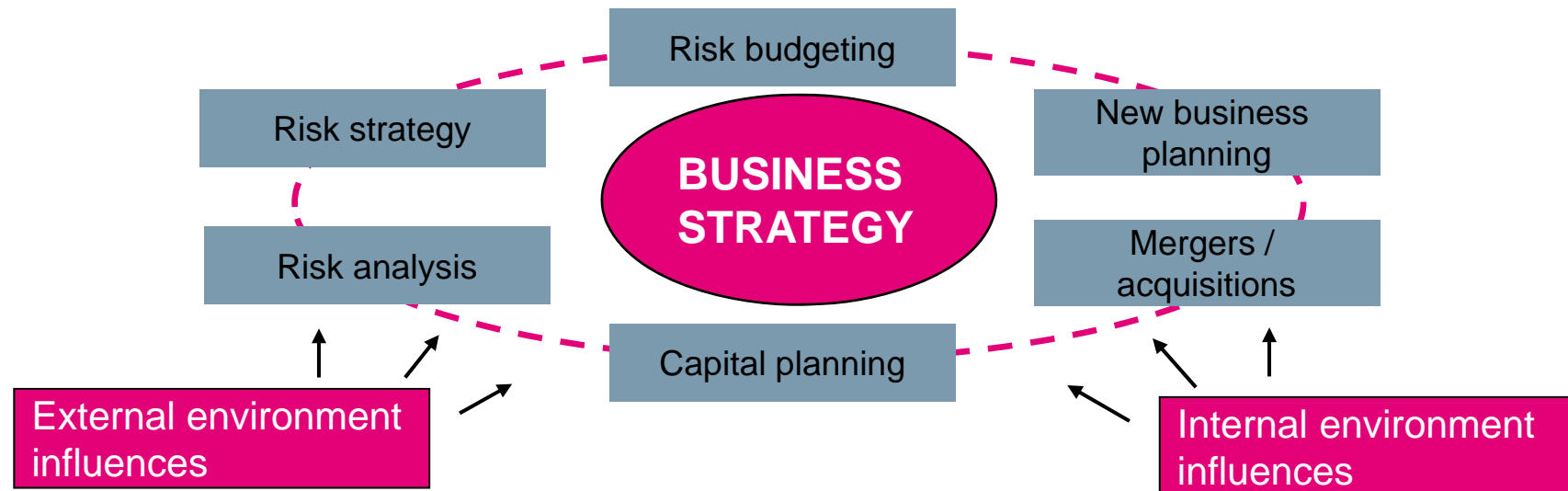
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- For each element, set out specific tests with executable steps
- Define target outcomes for each test – what is the definition of success?
- Agree frequency of validation and format in which results of validation are reported
- Don't underestimate the time taken the first time!

# Is the ORSA being used in making business decisions?

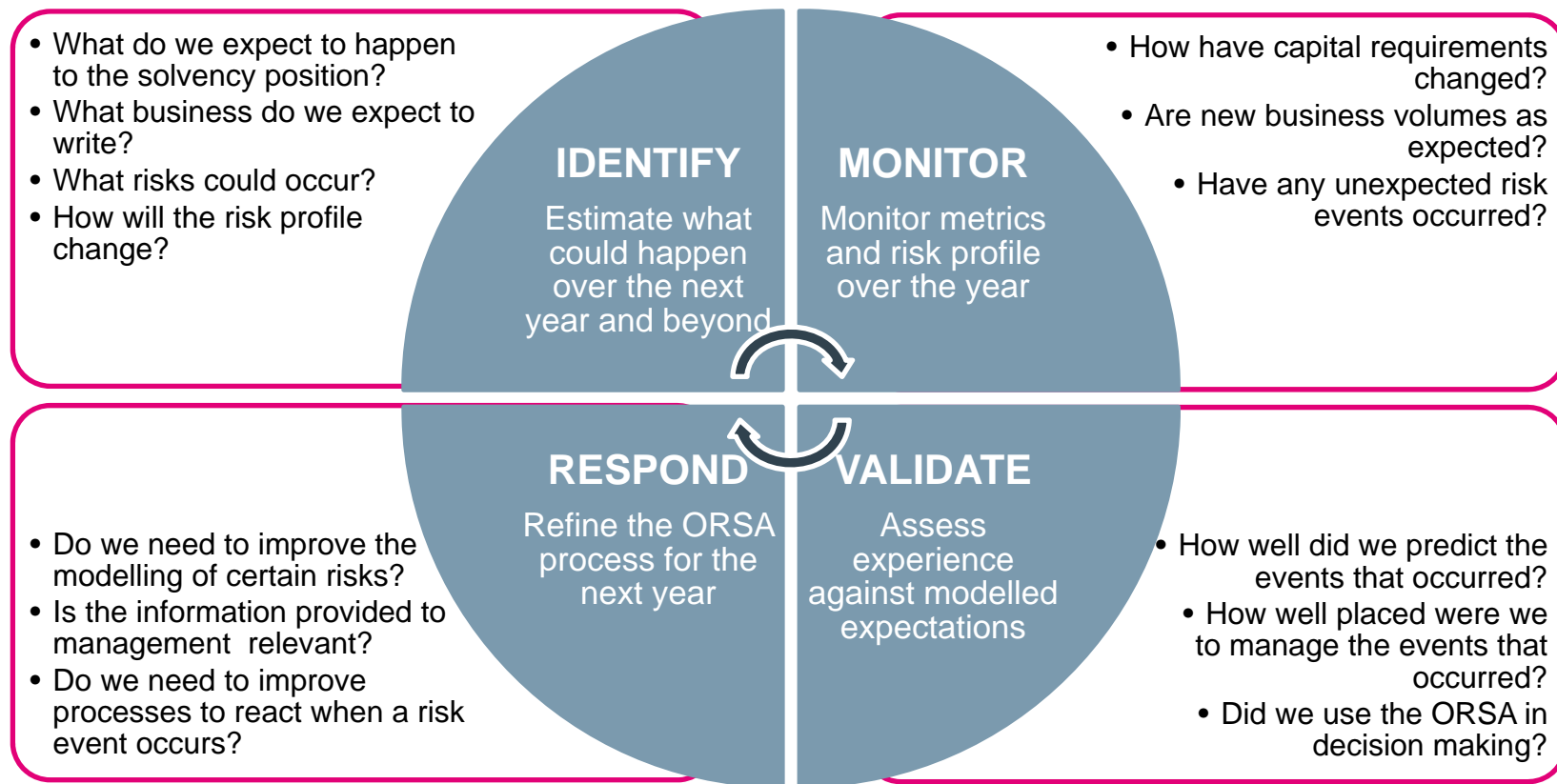
## ORSA and business strategy

- Solvency II requires management to embed the ORSA process into the business and into the decision making process
- A good ORSA process ensures that risk and capital management is taken into account in setting business strategy, and vice-versa:



# Continuous validation: Is the ORSA process fit for purpose?

Validation of the ORSA should lead to a continuous cycle of improvement





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# Example of continuous validation: Risk Appetite and Limits

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- **Identify:** when setting business strategy, management review risk appetite and set risk limits
- **Monitor:** risk exposure is monitored against limits at regular intervals. During the year a limit is breached
- **Validate:** After the event, consider if risk appetite and limit framework was suitable
  - When the limit was breached, was action taken?
  - Was action taken quickly enough?
  - Could the issue have been identified sooner?
- **Respond:** Consider improvements or changes, for example:
  - Introduction of “green, amber, red” limits
  - Pre-approval of management actions in certain circumstances
  - Re-visit risk appetite

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# To carry out continuous validation

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- Should already be an integral part of the ORSA
- But important to ensure it is a planned part of the process
- Can define key questions in advance for each element of the ORSA to assess its appropriateness
- If management is really using the ORSA process to make key decisions then they will drive improvements in the process

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- Use of the ORSA in the business
- **Old Mutual views of the ORSA**

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# Old Mutual views of the ORSA

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- Benefits
- Challenges
- Views on validation
- ORSA progress and aspirations

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# Old Mutual views of the ORSA: Introduction

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- Existing Economic Capital framework (to a 99.93% confidence level) since 2004.
- First cycle of ORSA process for BUs – ORSA process followed with reports produced and discussed at local management/Board level.
- Group ORSA in progress.

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# Old Mutual views of the ORSA: Benefits

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- Highlights the biggest risks facing the business and whether these are in line with expectations, as well as consideration of management of these risks.
- Insight into whether business units are able to follow their business strategies and business plans without breaching their risk appetite limits.
- Insight into these businesses through a “risk” lens - allows for different perspective on current situation and intended strategies.
- Forward looking assessment allowing for different scenarios and strategies.
- In most cases these BU ORSA reports have been presented and discussed at a local management/Board level, so management is well informed.

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# Old Mutual views of the ORSA: Challenges

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- Ongoing need to manage the business on both a regulatory and an internal basis. It is unlikely that the two bases will converge to allow a single basis to be used.
- Process integration and embedding. Includes reviewing report architecture (e.g. Are other reports also including ORSA type information?), and co-ordination of inputs from different areas.
- Regulatory environments are constantly changing and are becoming more complex. Challenge of using multiple bases for planning and decision making.
- Businesses are becoming increasingly reliant on technology to operate
  - increased exposure for the Group of failure of IT to supporting business needs, particularly, regarding IT supporting business growth.
- Timing of ORSA: Before business planning to influence strategy?

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# Old Mutual views of the ORSA: Views on validation

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- Technical validation: Perform quite heavy validation on the internal model and capital results for insurance entities (at both 99.5% and 99.93%).
- Continuous validation: Implicit already within the ORSA process thorough use of ORSA.
  - ORSA discussed and challenged at local management/Board level.
  - Business executives standing behind and owning reports and findings.



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# Old Mutual views of the ORSA: ORSA progress and aspirations

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- We've made good progress, but the journey continues. ORSA still operates as a standalone process – need for embedding and integrating with other processes.
- First cycle of ORSA process for BUs. All reports discussed and challenged at local management/Board level, including the Group Board Risk Committee.
- The results so far focus on risks inherent in the current economic balance sheet (i.e. what could make us go insolvent quickly!)

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# Old Mutual views of the ORSA: ORSA progress and aspirations

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- A consistent theme emerging is that the current balance sheet is adequately protected against extreme risk events.
- Risk management should therefore focus on risks which limit future growth (since the downside risks seem well covered). It is important to also consider:
  - The longer term (“slow burn”) risks which, even though are not dramatic, can still destroy significant franchise value (for example poor strategy execution).
  - Particular combinations of risk factors which are plausible yet could threaten the survival of the group.
  - Often qualitative assessments required to delve into these issues.
- These additional dimensions are explored further in the stress and scenario testing exercises.
- Group ORSA: Planned for next cycle, challenges incorporating:
  - Non-EU business. OMB and OMEM?
  - Non-insurance companies

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# Key take-aways

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- The ORSA is a good way to gain value from Solvency II work carried out to date
- Technical validation is important to give management comfort in the results
  - In particular for standard formula companies
- Validation should be an integral part of the ORSA process, leading to continual improvement and embedding in decision making processes

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# Questions or comments?

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Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

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

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