Solvency II ORSA
ORSA for Solvency II Standard Formula firms

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Objective

Delegates should understand:

• The key regulatory developments on ORSA
• The quantitative and qualitative assessments that can be used to justify using the Standard Formula
• How the development in their ORSA plays an important role in that justification
• Key challenges in implementing the ORSA and the current state of UK preparations in ORSA
Agenda

• Refresh on what an ORSA is
• Update on regulatory developments
• Appropriateness of Standard Formula using ORSA
• Current state of UK preparations
• Conclusion
• Questions & Comments
Refresh on what an ORSA is
What is an “ORSA”? 

- **ORSA** = Own Risk and Solvency Assessment  
- **Purpose:** allows insurers to have a complete and holistic understanding of its business risk profiles to best inform decision making on business strategy and capital planning

“**It is an essential risk management and system tool to enable firms to express their overall solvency needs in both quantitative and qualitative terms**”
ORSA perspectives

Looking into the past and current monitoring ...

- Changes over the year
- Technical provisions
- Capital requirements

Monitoring tools ➔ Evaluate

Looking into the future ...

Project ➔ Balance sheet ➔ Future risk
- Capital requirements
- Own funds ➔ Future solvency
### Key components of the ORSA

<table>
<thead>
<tr>
<th>ORSA policy</th>
<th>ORSA process</th>
<th>ORSA report</th>
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<td>The ORSA policy defines what the business should do to perform the ORSA process. This will be used by the business to provide guidelines to perform the process.</td>
<td>The ORSA process assesses capital requirements and demonstrates how these are linked to the risk assessment and decision making processes.</td>
<td>The ORSA report ‘tells the story’ of the undertaking’s current risk and capital management practices. It demonstrates to the regulators that the undertaking has the necessary available level of capital to sustain significant negative impacts now and in the future.</td>
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Key data and model components of the ORSA

**Finance Investments**
- IFRS / local GAAP balance sheet
- Economic Balance Sheet
- Other assets and other liabilities
- Assets and investment data ("look through")
- Investment Strategy

**System of Governance**
- Risk Management Framework
- Risk Appetite Framework
- Governance and Controls
- Use of decision making
- Business Plan & Strategy
- Management assessment of risks

**Risk & Solvency Assessment**
- Projected Balance Sheets & SCRs
- Market Risks
- Insurance Underwriting Risks
- Liquidity Risk
- Operational Risk
- Group Risk
- Pension Risk
- Emerging Risks/Other Risks

**Process**
- ORSA end-to-end "iterative" process
- Continuous Compliance
- Significant deviations of risk profiles
- Roles & responsibilities
- Documentation
- Validation

**And Others**
- LACDT + DTA/DTL (Tax components)
- Reinsurance data
- Credit rating & counterparty exposure data
- Legal & organisational structure
- External benchmarking data

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*Group ORSA Balance Sheet + Report*
Regulatory updates
Update on regulatory development

“The ORSA implementation progress is less affected by Solvency II delays”

• ICAS+ – The PRA’s push is towards insurers incorporating elements of Solvency II development into their ICA models

• EIOPA Consultations – EIOPA have released four consultation papers including one on ORSA on 27 March 2013
  – Proposal for Guidelines on System of Governance
  – Proposal for Guidelines on Forward Looking assessment of the undertaking’s own risks (Based on the ORSA principles)
  – Proposal for Guidelines on submission of information to national competent authorities (NCAs)
  – Proposal for Guidelines on Pre-Application of Internal Models
EIOPA’s Guidelines proposal on ORSA

• The Guidelines proposed in this consultation on the forward looking assessment of the undertaking’s own risks covers three main aspects:
  – Assessment of overall solvency needs;
  – Assessment of whether the undertaking would comply on a continuous basis with the Solvency II regulatory capital requirements and the requirements regarding the calculation of technical provisions; and
  – Assessment of deviations from the assumptions underlying the solvency capital requirement calculation.
PRA’s key messages on ORSA
(PRA’s industry briefing on 8/9 April)

• A full ORSA is not necessarily expected of all firms in 2014. But firms are expected to **develop their ORSA starting in 2014**.

• **Interim ORSA builds on principles underlying ICAS and other prudential requirements in the PRA Handbook, however, firms should extend their preparations on the following:**
  - Own Solvency needs assessments (OSN)
  - Continuous compliance with the regulatory solvency requirements (SCR)
  - Deviations between risk profile and assumptions underlying SCR calcs
  - Compliance with SII Technical Provision requirements
ORSA – expected regulatory timeframe

• Timeframes
  – Preparation for ORSA commence from January 2014;
  – A plan must be prepared to show how the ORSA process will be fully embedded by January 2016
    - Conduct an ORSA gap analysis during 2013 and carry out an ORSA “Lite” to understand those gaps;
    - Plan for dry runs in 2014 with a near final dry run in 2015

“Scrutiny and prominence of ORSA is increasing. Regulators are expecting to see firms use the ORSA as a key decision making tool”
Quantitative & qualitative assessments of risks in ORSA
The quantitative work required in the ORSA

Firms using the Standard Formula for Pillar 1 will need to assess whether this is a suitable measure for use within the ORSA

- Are all risks covered within the Standard Formula?
- Does the SF calibration approach fit with the firm’s risk profile?
- Can benefits be gained through less constraints on ‘issues’ such as contract boundaries?
- How sensitive is the SF to changes in the firm’s risk profile?
- Is the SF aggregation approach sufficient and appropriate for how risks interact for the firm?

Review of ORSA Capital Measure
Assessment of deviations from Standard Formula
Assessment of deviations

Key components of an analysis of the difference between an undertaking’s risk profile and the assumptions underlying the Standard Formula SCR calculation:

• An analysis of the risk profile and an assessment of the reasons why the standard formula is appropriate, including a ranking of risks;

• An analysis of the sensitivity of the standard formula to changes in the risk profile, including the influence of reinsurance arrangements, diversification effects and the effects of other risk mitigation techniques;

• An assessment of the sensitivities of the SCR to the main parameters, including undertaking-specific parameters;

• An elaboration on the appropriateness of the parameters of the standard formula or of undertaking-specific parameters;

• An explanation why the nature, scale and complexity of the risks justify any simplifications used; and

• An analysis of how the results of the standard formula are used in the decision making process.

Outline of an approach

Possible Process

Initial analysis
Is ICA for the risk different to SF for the risk?

No

Qualitative analysis
Are our risks different to those of an average insurance company?

No

Quantitative analysis
Is the risk financially significant?

Yes

Detailed quantitative analysis
Does a more detailed show that the standard formula provides an adequate quantification of the risk exposure?

No

The standard formula is not appropriate for this risk in isolation

Yes

The standard formula is appropriate

Comparison between ICA and Solvency II SCR will give a good feel for the other tests

Typical qualitative questions include:
• What products do we have?
• What investment strategy do we follow?
• What is our customer base?

“Choosing to use the standard formula is an active choice”

Slavko Gvero (FSA Solvency II Implementation Manager)
Stated at speech to firms attending implementation seminars held by the Association of British Insurers, 25 May 2012

Institute and Faculty of Actuaries
ORSA: Deviations from assumptions underlying the SCR calculation

Proposal for Guidelines on Forward Looking assessment of the undertaking’s own risks (based on ORSA principles), March 2013

…national competent authorities should ensure that the undertaking assesses whether its risk profile deviates from the assumptions underlying the Solvency II Solvency Capital Requirement calculation and whether these deviations are material.

If the outcome of this qualitative and quantitative assessment is that there are significant deviations between the risk profile of the undertaking and the SCR calculation, the undertaking would be expected to consider during the preparatory period how this could be addressed. It could decide to align its risk profile with the standard formula, to apply for undertaking-specific parameters, where this is allowed, or to develop a (partial) internal model. Alternatively, the undertaking could decide to de-risk.
ORSA: Deviations from assumptions underlying the SCR calculation

Materiality of risk

Expect that for a Standard Formula company risks will cluster round the Standard Formula risk profile

Plot each risk on grid using qualitative commentary and QIS5 or ICA risk capital

Nature of risk profile

Level of riskiness of risk profile underlying Standard Formula

Less risky

More risky

Less material

More material
ORSA: Deviations from assumptions underlying the SCR calculation

Risks like this may support the case for the Standard Formula if the firm is more risky on other risks.

Partial Internal Model or USPs for Risks here

Materiality of risk

More material

Less material

Less risky

More risky

Level of riskiness of risk profile underlying Standard Formula

Nature of risk profile

More material

Less material

Align Risk Profile

De-risk
Current state of UK preparations
Latest ORSA developments
Current state of UK preparations

Progress to date

- **Training** – Board and Senior Management awareness raised to the ORSA and its component parts. The Board must be fully engaged in the process and help to drive the assessment and provide challenge.

- **Framework Development** – Firms have prepared policies, standards and report templates to help steer the ORSA

Areas for development

- **Board Challenge** – Few reports demonstrate an appropriate level of Board challenge and interaction on the results of the ORSA process. There was very limited information in reports explaining to the Board what the material weaknesses and strengths were

- **Testing and embedding** – Demonstrate the ORSA is being used as a decision making tool and is aligned to the strategic plan for the business
Latest ORSA developments
Current state of UK preparations

Progress to date

- **Report Production** – Populated ORSA reports based on readily available information. Some firms doing phased implementation – Each dry-run building on the last. The contents of the report are now clearer and this must be submitted within 2 weeks of the conclusion of the assessment. Although not specified, this could be considered as the point at which the report is agreed and signed-off by the Board.

- **Report Content** – reports are good at reflecting the end position of the capital positioning

Areas for development

- **Further dry run activities** – Further development of underlying components supporting the ORSA, e.g. projections and link to risk appetite. Also we have seen less progress on the links between components to create a holistic picture of the business

- **Reports should reflect the process** – no clear description of the ORSA process or area where decisions have been made or other ‘use’

Firms need to make sure dry-runs are driving developments rather than just making the process smoother
Beyond UK and Europe…

*Other Regulatory Jurisdictions* – Beyond Europe there has been notable interest in implementing requirements similar to ORSA.

“Scrutiny and prominence of ORSA is increasing. Regulators are expecting to see firms use the ORSA as a key decision making tool”
Conclusion
Key things to consider

• Key role the ORSA plays in justifying your SF approach
• State of your ORSA preparedness
• Status of development plan
• Your company’s response to EIOPA’s Consultation Paper / PRA messages
Next steps

• Understand where your ORSA is by having a holistic overview of key components and carrying out “gap analysis”


• Quantitative and qualitative assessments on deviations from SF basis

• Document your assessments

• Understand key challenges of implementing Standard Formula
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.
Thank you!