Own Solvency Needs
Gavin Hughes, Towers Watson
Agenda

• Background
• Key considerations
• Potential implications
• Conclusion

Background
Background — Own Solvency Needs

\[
\text{OSN} = T = 0 \text{ Capital need} + \text{Allowance for future capital needs}
\]

- Article 45 1(a) and L3 CP Guideline 12 (and others)
- Firm's own view of its capital needs
- Taking into account future solvency needs
- Applies to both SF and IM firms
- Allowing for own risk profile, risk appetite and the business plan
- Requires input from across the business
- Expressed in quantitative terms
- Supplemented by a qualitative description of material risks
- Subject material risks to a wide range of stresses
U.K. insurers have progressed well with economic capital assessment, but not projections

% Participants Having Completed Relevant ORSA Component

- Assessment of current capital position: 27% (Global), 26% (UK)
- Roadmap/outline of content for producing ORSA/ICAAP report: 52% (Global), 45% (UK)
- Projected capital position: 26% (Global), 28% (UK)
- Sensitivities and scenario testing: 26% (Global), 33% (UK)
- Continuous solvency monitoring: 28% (Global), 28% (UK)
- ORSA/ICAAP policy document: 45% (Global), 45% (UK)
- Board education and stakeholder engagement: 35% (Global), 35% (UK)
- Full ORSA/ICAAP report: 30% (Global), 30% (UK)


Why do an OSN?

- Emerging regulatory requirement
- Link to business strategy, risk appetite and business plan
- “Articulate” the assumptions underlying the business model
  - Understand the differences with the assumptions underlying the “regulatory” model
- Basis to help inform management decisions
  - Understand impact of management actions
Key considerations

Considerations — General

- How important is this — how will the assessment be used?
- How to project own funds and risk capital
- How onerous is it to maintain and regulary update projection model?
- Balance the needs for flexibility, transparency, understanding, accuracy and practicality
- Granularity of results
- Term of projections
- How the assessment can be used to improve risk and capital management

Holding more capital is not necessarily the answer!
The importance of the Own Solvency Needs Assessment will vary considerably for different insurers

<table>
<thead>
<tr>
<th>Important</th>
<th>Less Important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard formula firm</td>
<td>Internal model firm</td>
</tr>
<tr>
<td>Competitive pricing important</td>
<td>Closed to new business</td>
</tr>
<tr>
<td>Business plan is capital-consuming</td>
<td>Existing business throwing off sufficient capital</td>
</tr>
<tr>
<td>External view of capital important</td>
<td>Mutual insurers</td>
</tr>
<tr>
<td>Risk profile non-static</td>
<td>Risk profile stable</td>
</tr>
</tbody>
</table>

Projecting the excess assets position

- Expected value of excess assets
- 20% confidence level
- 80% confidence level
### T = 0: capital needs

**General**
- Different valuation and recognition bases for OSN
- Quantitative assessment of impact
- Consider the sensitivity of the risk profile

<table>
<thead>
<tr>
<th>Standard Formula</th>
<th>Internal Model or PIM</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Justify use of SF as baseline</td>
<td>• Consistent with SCR?</td>
</tr>
<tr>
<td>• SF assumptions paper</td>
<td>• Trigger change in IM?</td>
</tr>
<tr>
<td>• Known deficiencies of SF</td>
<td>• Risks outside of PIM</td>
</tr>
<tr>
<td>• PRA data collection exercises</td>
<td>• Different to IM SCR for Pillar 1?</td>
</tr>
</tbody>
</table>

### Allowance for future capital needs

**What might lead to additional capital requirements?**
- New business plans and planned acquisitions
- How sensitive is the risk profile to change?
  - Emerging risks
  - Changing operating environment
- Adverse events, stresses and scenarios

**Factors affecting how much capital to hold**
- Quality and loss absorbency of capital
- Availability and ease of risk transfer
- Allowance for future management actions
- Plans for distribution of surplus capital / dividends
- Options for raising capital and associated costs
- Sensitivity of the projection assumptions
Potential implications

Regulatory outcomes for a SF firm

Own assessment requires more capital than Pillar 1
- Self-imposed CAO
- Regulator CAO?
- Change risk profile
- Apply for USPs, PIM or IM

Own assessment requires less capital than Pillar 1
- Business case for PIM?
- Constrained by Pillar 1 or strategy / internal decision making
Regulatory outcomes for an IM / PIM firm

Own assessment requires more capital than Pillar 1

Unlikely? Need to understand the cause of the difference – regulatory or management view? CAO?

Revisit the IM

Own assessment requires less capital than Pillar 1

Business case for PIM?

Constrained by Pillar 1 or strategy / internal decision making

Wider business implications for firms

• Questioning of the assumptions underlying the business model
  – identification of strategic advantages

• Better linkage of risk appetite, strategy and business plan
  – Strategic lead rather than model lead

• Better understand the evolution of the capital position
  – Greater confidence in financial plans
  – Better understanding of management actions

• Improved capital efficiency
Conclusions

• Capital management is the twin brother of risk management

• There is a requirement for an OSN assessment but important to think upfront how it will be used and communicated
  – Link to strategy and business plan

• It will likely require development work for most.
  – Understand the difference between “regulatory” and “economic” view
  – Future capital position and impact of management levers
  – Not just about the models

• Capital is not everything!
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.