AFIR-ERM
Finance, Investment & ERM

Profiting from the ORSA Process

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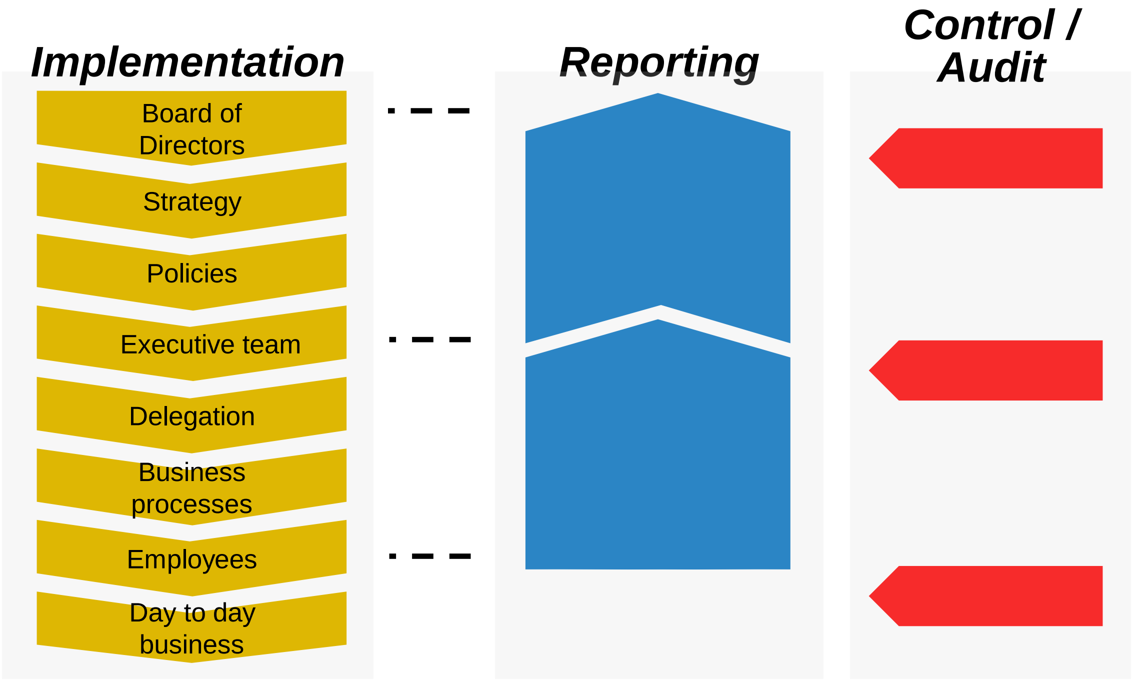
Agenda

- Own Risk and Solvency Assessment (ORSA)
- IAA and other support material
- Profiting from the ORSA process

Own Risk and Solvency Assessment (ORSA)

Own Risk and Solvency Assessment (ORSA)

- Firm needs:
  - Adequate capital
  - Employees ‘fit’ to carry out its business activities
  - A process for achieving a complete and holistic risk understanding of the business
- An ideal ORSA connects full risk picture with governance and internal control system



Source: adapted from Bernardino, G. (2011)

ORSA

- **Aims** to ensure that insurers identify and assess all risks that they are (or could be) exposed to, maintain sufficient capital to face these risks, and develop and better use risk management techniques in monitoring and managing these risks
- **Is** a process for an overall and holistic risk understanding, viewed from the management and/or supervisory body
- **Provides** a comprehensive picture of the firm's risks
- **Gives** the supervisor insight into the level of quality of the management's and Board's risk understanding
- **Links** the risk picture with the firm's risk management system and internal control system
- **Captures** risks before they are quantifiable
- **Is** a process that should include unquantifiable knowledge about risks (so should not focus just on risks that are quantifiable)

ORSA

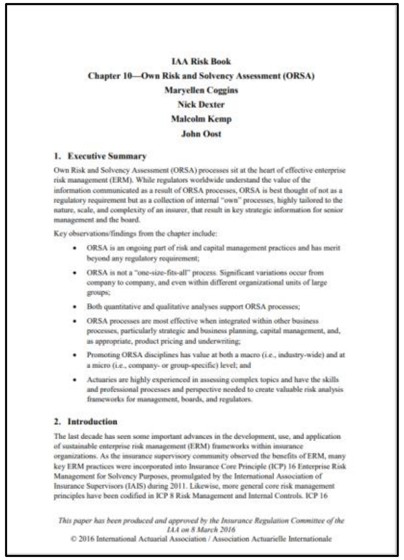
- **Is not**
  - A (new) rules-based solvency calculation
  - A *pre-defined* process. The firm needs to develop its own (efficient) self-assessment process
  - (Under Solvency II) A process (key function) which as a starting point can be outsourced
  - A process with one concrete number as its output
- Has many similarities with Individual Capital Adequacy Assessment Programme (ICAAP) and equivalents applicable to other parts of the financial services industry, e.g. banks
  - ORSA called ICAAP in Australia
  - Note: banks also now subject to ILAAP (covering liquidity)

IAA and other support material

IAA and other support material

- International Actuarial Association (IAA), IAA Member Associations and other actuarial communities like AFIR/ERM have developed support material for actuaries assisting with ORSAs. E.g.
  - IAA Risk Book (Chapter 10) *Own Risk and Solvency Assessment (ORSA)*
  - International Standards of Actuarial Practice on *Enterprise Risk Management Programs* (ISAP 6) and *Insurer Enterprise Risk Models* (ISAP 5)
  - Other IAA papers and documents such as *Deriving Value from ORSA: Board Perspective* and *International ORSA Regulatory Requirements Chart*
- Actuarial Association of Europe (AAE) focuses on Solvency II ORSA
  - European Standard of Actuarial Practice (ESAP 3) *Actuarial practice in relation to the ORSA process under Solvency II*
  - EAN 1: *European Actuarial Note on ESAP 3 and ORSA*

Texts draw on regulatory guidance



IAA Risk Book

Chapter 10—Own Risk and Solvency Assessment (ORSA)

Maryellen Coggins

Nick Dexter

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1. Executive Summary

Own Risk and Solvency Assessment (ORSA) processes sit at the heart of effective enterprise risk management (ERM). While regulators worldwide understand the value of the information communicated as a result of ORSA processes, ORSA is best thought of not as a regulatory requirement but as a collection of internal "own" processes, highly tailored to the nature, scale, and complexity of an insurer, that result in key strategic information for senior management and the board.

Key observations/findings from the chapter include:

- ORSA is an ongoing part of risk and capital management practices and has merit beyond any regulatory requirement;
- ORSA is not a "one-size-fits-all" process. Significant variations occur from company to company, and even within different organizational units of large groups;
- Both quantitative and qualitative analyses support ORSA processes;
- ORSA processes are most effective when integrated within other business processes, particularly strategic and business planning, capital management, and, as appropriate, product pricing and underwriting;
- Promoting ORSA disciplines has value at both a macro (i.e., industry-wide) and at a micro (i.e., company- or group-specific) level; and
- Actuaries are highly experienced in assessing complex topics and have the skills and professional processes and perspective needed to create valuable risk analysis frameworks for management, boards, and regulators.

2. Introduction

The last decade has seen some important advances in the development, use, and application of sustainable enterprise risk management (ERM) frameworks within insurance organizations. As the insurance supervisory community observed the benefits of ERM, many key ERM practices were incorporated into Insurance Core Principle (ICP) 16 Enterprise Risk Management for Solvency Purposes, promulgated by the International Association of Insurance Supervisors (IAIS) during 2011. Likewise, more general core risk management principles have been codified in ICP 8 Risk Management and Internal Controls. ICP 16

This paper has been produced and approved by the Insurance Regulation Committee of the IAA on 8 March 2016

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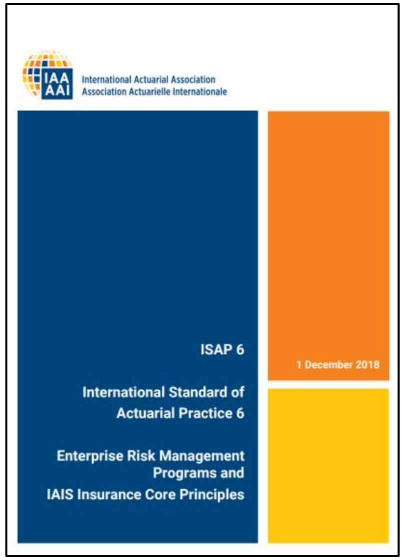

International Actuarial Association
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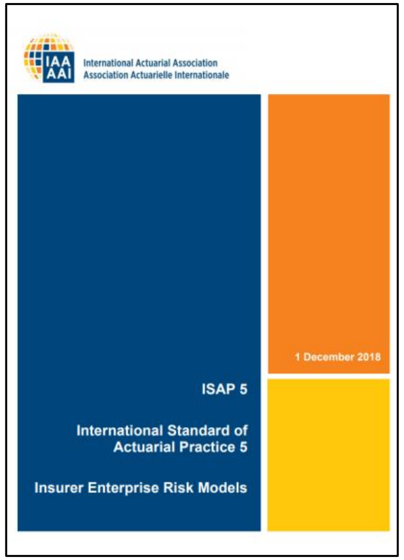
ISAP 6

International Standard of Actuarial Practice 6

Enterprise Risk Management Programs and IAIS Insurance Core Principles

1 December 2018



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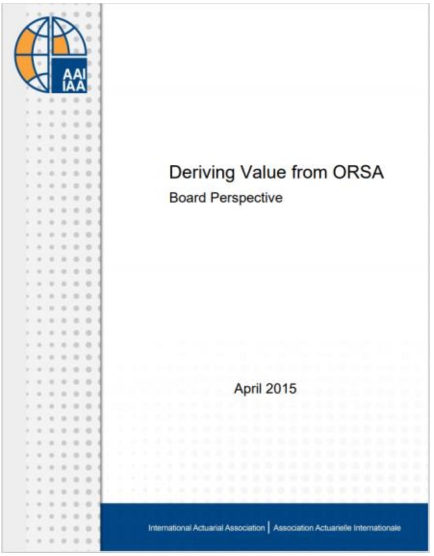
ISAP 5

International Standard of Actuarial Practice 5

Insurer Enterprise Risk Models

1 December 2018

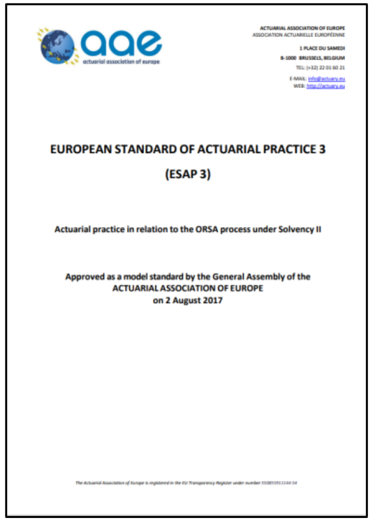


Deriving Value from ORSA

Board Perspective

April 2015

International Actuarial Association | Association Actuarielle Internationale



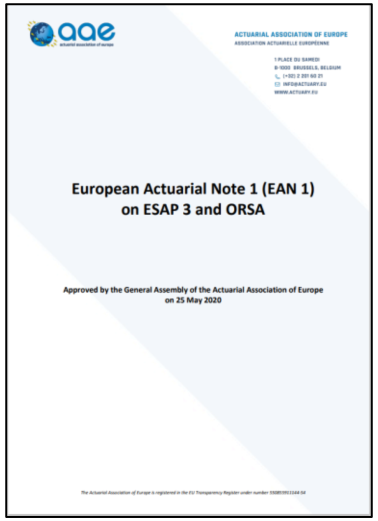
ACTUARIAL ASSOCIATION OF EUROPE
ASSOCIATION ACTUARIELLE EUROPÉENNE

EUROPEAN STANDARD OF ACTUARIAL PRACTICE 3

(ESAP 3)

Actuarial practice in relation to the ORSA process under Solvency II

Approved as a model standard by the General Assembly of the ACTUARIAL ASSOCIATION OF EUROPE on 2 August 2017



ACTUARIAL ASSOCIATION OF EUROPE
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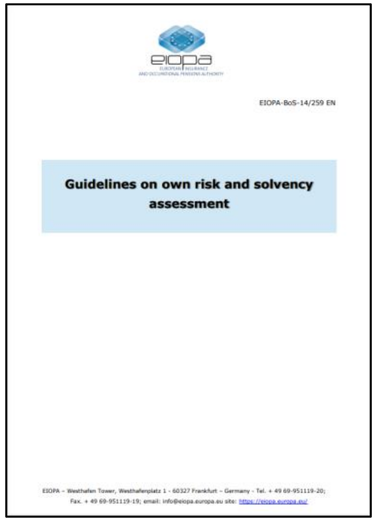
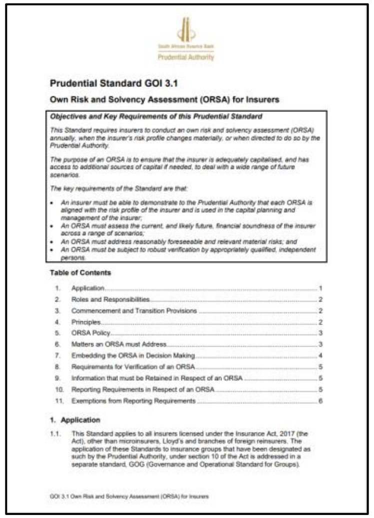
European Actuarial Note 1 (EAN 1) on ESAP 3 and ORSA

Approved by the General Assembly of the Actuarial Association of Europe on 25 May 2020



EIOPA-BoS-14/259 EN

Guidelines on own risk and solvency assessment



Prudential Authority

Prudential Standard GOI 3.1

Own Risk and Solvency Assessment (ORSA) for Insurers

Objectives and Key Requirements of this Prudential Standard

This Standard requires insurers to conduct an own risk and solvency assessment (ORSA) annually, when the insurer's risk profile changes materially, or when directed to do so by the Prudential Authority.

The purpose of an ORSA is to ensure that the insurer is adequately capitalised, and has access to additional sources of capital if needed, to deal with a wide range of future scenarios.

The key requirements of the Standard are that:

- *An insurer must be able to demonstrate to the Prudential Authority that each ORSA is aligned with the risk profile of the insurer and is used in the capital planning and management of the insurer;*
- *An ORSA must assess the current, and likely future, financial soundness of the insurer across a range of scenarios;*
- *An ORSA must address reasonably foreseeable and relevant material risks; and*
- *An ORSA must be subject to robust verification by appropriately qualified, independent persons.*

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1. Application

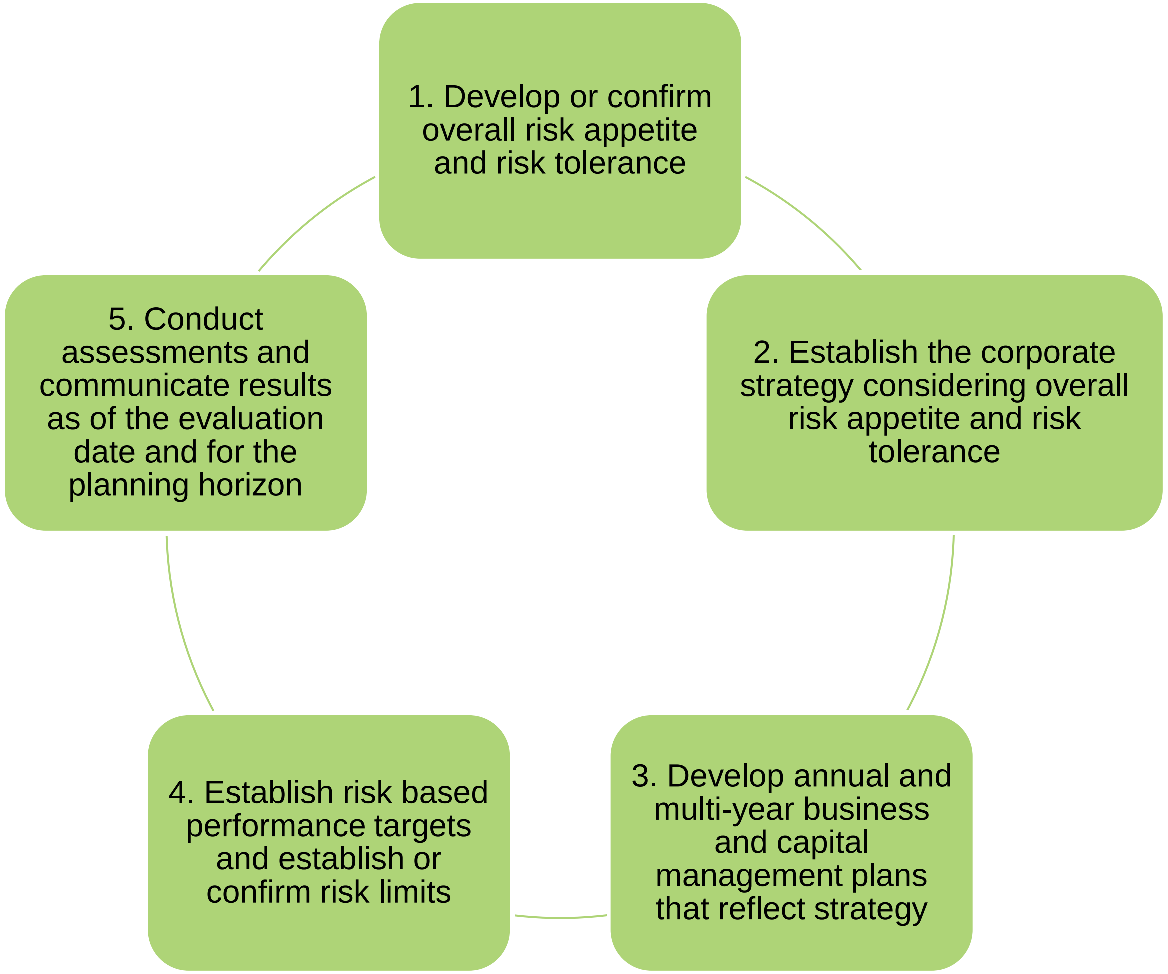
1.1. This Standard applies to all insurers licensed under the Insurance Act, 2017 (the Act), other than microinsurers, Lloyd's and branches of foreign reinsurers. The application of these Standards to insurance groups that have been designated as such by the Prudential Authority, under section 10 of the Act is addressed in a separate standard, GOG (Governance and Operational Standard for Groups).

GOI 3.1 Own Risk and Solvency Assessment (ORSA) for Insurers

Sources and copyrights, see individual links

“Own” perspectives

- Steps include:
  - Identify and prioritise key risks (gross and net, current and emerging)
  - Assess risks and capital adequacy (stress and scenario testing, “own” quantification of required capital, risk aggregation)
  - Communicate and report
  - Assess process itself (e.g. key expert judgements, potential weaknesses, scope for improvements)



Source: adapted from IAA Risk Book (Chapter 10)

“Regulator” perspectives

- A focus on:
  - Assessment of overall solvency needs (own *and* relevant regulatory capital requirements)
  - Forward-looking, i.e. include medium and longer term perspectives and projections
  - Incorporate company’s risk appetite, tolerance and limits
  - “Use test” – include results in business activities and decision-making
  - Group-wide ORSAs: need to include group-specific considerations, such as liquidity and fungibility of capital
  - Documentation
- EIOPA ORSA Guidelines also e.g. cover
  - Role of Board, reconciliation of ORSA balance sheet with regulatory capital balance sheet, continuous compliance with e.g. regulatory capital requirements, appropriateness of Pillar 1 SCR computation, frequency, internal communication, supervisory reporting
- May include harder to handle risks such as climate change and liquidity risk

“Actuarial” perspectives

- Much of an ORSA can be viewed as an example of Financial Condition Testing (FCT). FCT may also be mandated by professional standards
  - E.g. In Canada, Appointed Actuary required by Canadian actuarial standards to prepare annually for the Board a Dynamic Capital Adequacy Testing (DCAT) report
  - Although there is potential overlap with ORSA (which each insurer is also required to provide to regulator), regulator continues to value both reports and both perspectives
- Actuarial function may be formally required to contribute to ORSA, even if ORSA coordinated by risk management function
  - Exact involvement benefits from clear specification, to avoid duplication, but as ORSA is an own assessment, different companies may allocate roles differently

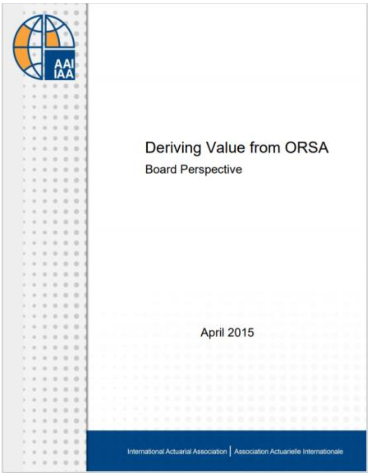
Profiting from the ORSA process

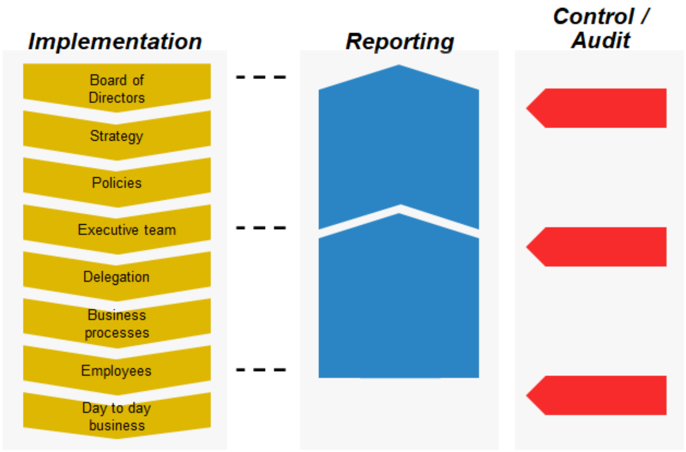
Profiting from the ORSA process

- Challenging to maximise the perceived value-added from actuarial involvement
- Still probably a tendency in many firms to view ORSA as a regulatory overhead
- Some suggestions:
  - Focus on the actuarial ‘customer’ (typically the Board?)
  - Place due emphasis on upside vs. downside
  - Leverage existing processes or, better still, inform and improve these processes

Focus on the actuarial ‘customer’

- There is value in documentation and analysis of current and future positions under different scenarios
  - Deepens Board understanding and assists Board members and senior management with supervisory interaction
  - Helps build/maintain risk awareness throughout the company
  - Structures the identification and prioritisation of risks
  - Offers chance to think outside box, do what-ifs, and assess what management is doing and thinking
  - Opportunity to highlight limitations and caveats
- And a need to ‘sell’ this value





Source (a) IAA (2015). Deriving Value from ORSA: Board Perspective, (b) Bernardino, G. (2011)

Place due emphasis on upside vs. downside

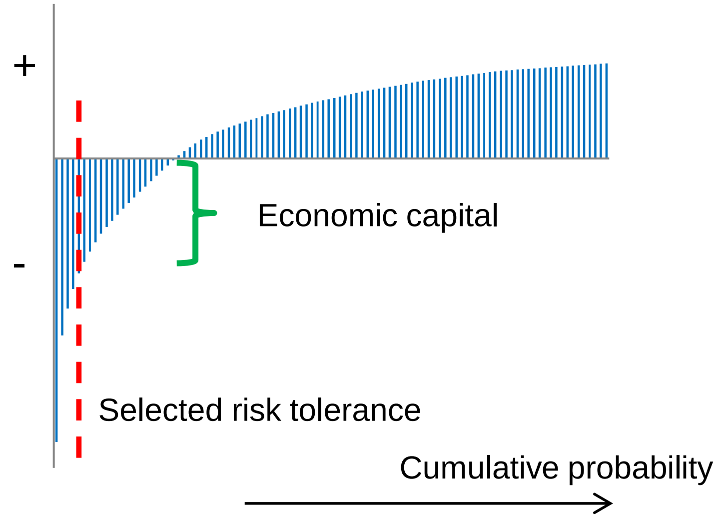
- Actuaries and risk managers talk a lot about "3 lines of defence". Important for roles to be defined and demarcated
  - Risk management has typically become more Line 2 over my working life
- But the best risk managers still need to contribute to debates about where best to target business resources (staff, capital, intellectual property, customer relationships …)
  - Straying into return versus risk, upside versus downside

RISK MANAGEMENT	
Line 1? Decision takers?	**Line 2?** Risk Challengers?

Leverage and improve existing processes

- Projections underpin most regulatory capital calculations as well as ORSA calculations, internal models, proxy models, …
  - What synergies are available?
  - What insights can be interpreted through different lenses?
  - Are there process steps that are duplicated and if so how can they best be eliminated?
  - Can approaches used for ORSA inform and enhance other processes?

E.g. Might define economic capital for ORSA purposes by simulating present values of future profits in some way



Summary

- Own Risk and Solvency Assessment (ORSA)
  - An ideal ORSA connects full risk picture with governance and internal control system
- IAA and other support material
  - E.g. IAA Risk Book Chapter on ORSA
  - And other IAA material, AAE texts (for Solvency II), material produced by other (actuarial) professional bodies and relevant regulatory guidance
- Profiting from the ORSA process
  - Deepen understanding, know and serve your (actuarial) customer, place due emphasis on risk vs reward, leverage and enhance what is done elsewhere

Thank you

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