Maximising the value of your ORSA

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Presenter: Keith Lindsay, Towers Watson

Agenda

- Introduction
- Initiatives in Europe to introduce the ORSA ahead of other requirements
- Key challenges insurers have faced
- Emerging best practice
- Summary and questions

Introduction

Definition of the ORSA

- FSB ORSA and Use Test Task Group:
  - "The entirety of the processes and procedures employed to identify, assess, monitor, manage, and report the short and long term risks an insurance undertaking (and insurance groups) faces or may face and to determine the own funds necessary to ensure that insurers (and groups) overall solvency needs are met at all times and are sufficient to achieve its business strategy"
- CEA guidance:
  - Although the ORSA is based on risk calculations it should focus on the process and address the qualitative aspects of risk management
  - The ORSA's forward-looking 'what if' process will help undertakings better understand their risk exposures and how these might evolve and interact over the medium term, beyond Pillar 1 calculations
  - It should be a key tool used to foster a risk management culture … and should be linked to other planning activities such as business planning, product design, longer term capital management etc.
  - It will help undertakings anticipate, and quickly react to, adverse changes in their operating environment
  - The processes companies shall have in place for their ORSA are at least as important as the final result… but it should not necessarily be overly complex

Aims of the ORSA

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FSA

"The ORSA is aimed at being a real asset to the running of a firm and, as such, each firm needs to think about what the ORSA means to them. It is not a compliance exercise, but a process that gives real insight into the risks facing a firm."

eiopa EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY

"The ORSA aims at enhancing awareness of the interrelationships between the risks an undertaking is currently exposed to, or may face in the long term, and the internal capital needs that follow from this risk exposure."

TOWERS WATSON

"Solvency II compliance and adding longer-term business value from managing risk: the two objectives do not have to be mutually exclusive."

Key ORSA requirements

- Performed at least annually
- Disclosed privately to the regulator in the Regular Supervisory Report
- Summary of ORSA process in Solvency and Financial Condition Report
- Documentation
  - ORSA policy
  - ORSA process
  - ORSA report
- Management body of the organisation needs to take an active role in the ORSA process and sign off the results

Initiatives in Europe to introduce the ORSA ahead of other requirements

Progress with ORSA to date

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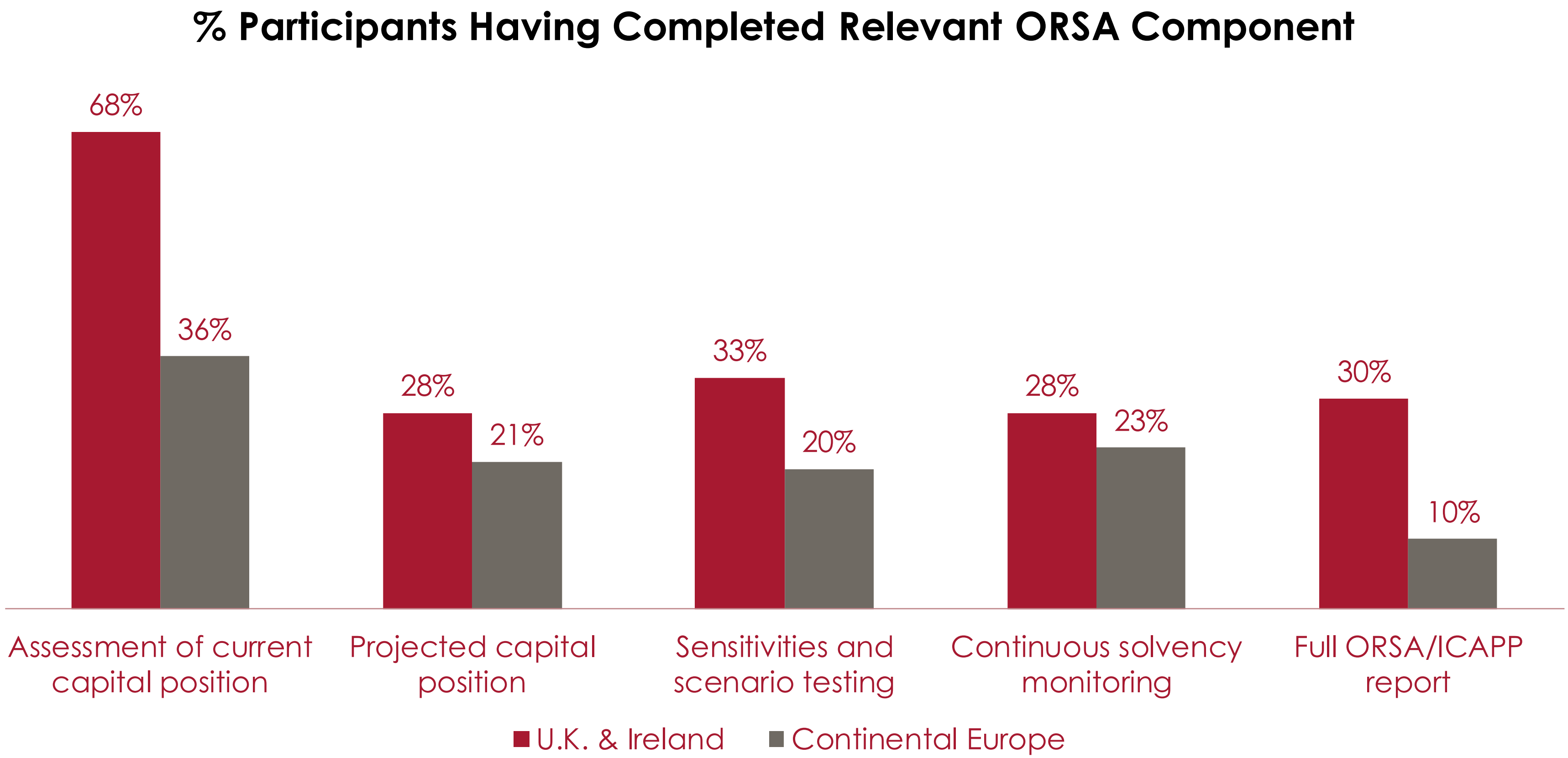

- How would you describe your organization’s progress with the ORSA/ICAAP to date?*

*2012 Towers Watson ERM Survey.

Observations on progress in the U.K.

- The existing ICAS regime has served as a useful foundation on which to build ORSA processes
- In addition, many internal model firms have made good progress
  - Lloyd's agents have already submitted draft ORSAs to the regulator
- Non-internal model firms have further development to do
- Overall, less progress has been made with some of the more difficult technical areas, in particular capital projections
- General slowing down after the announcement regarding the delay to Solvency II implementation, but this has picked up again since the interim measures were announced
  - However, this time, it is becoming the responsibility of BAU teams rather than a Solvency II project team
- It is seen as a way to gain value from Solvency II work to date

Progress in other countries

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- In many other European countries, the focus was heavily on Pillar 1 following the Eurozone fallout
  - There was little Pillar 2 activity carried out
  - In many countries, no equivalent of the ICA, so didn't have a useful starting point
- However, in 2012, many regulators started to change their focus
  - ORSA dry run in the Netherlands took place
  - French regulator planned an "ORSA blanc" exercise in 2014, with certain firms taking part in a smaller pre-exercise in 2013
  - Irish regulator planned for companies to submit ORSA reports before the Solvency II implementation date
- Regulators' plans are changing as a result of the EIOPA consultation
- The focus of firms is now shifting to the ORSA and Systems of Governance requirements

Progress in completing ORSA components

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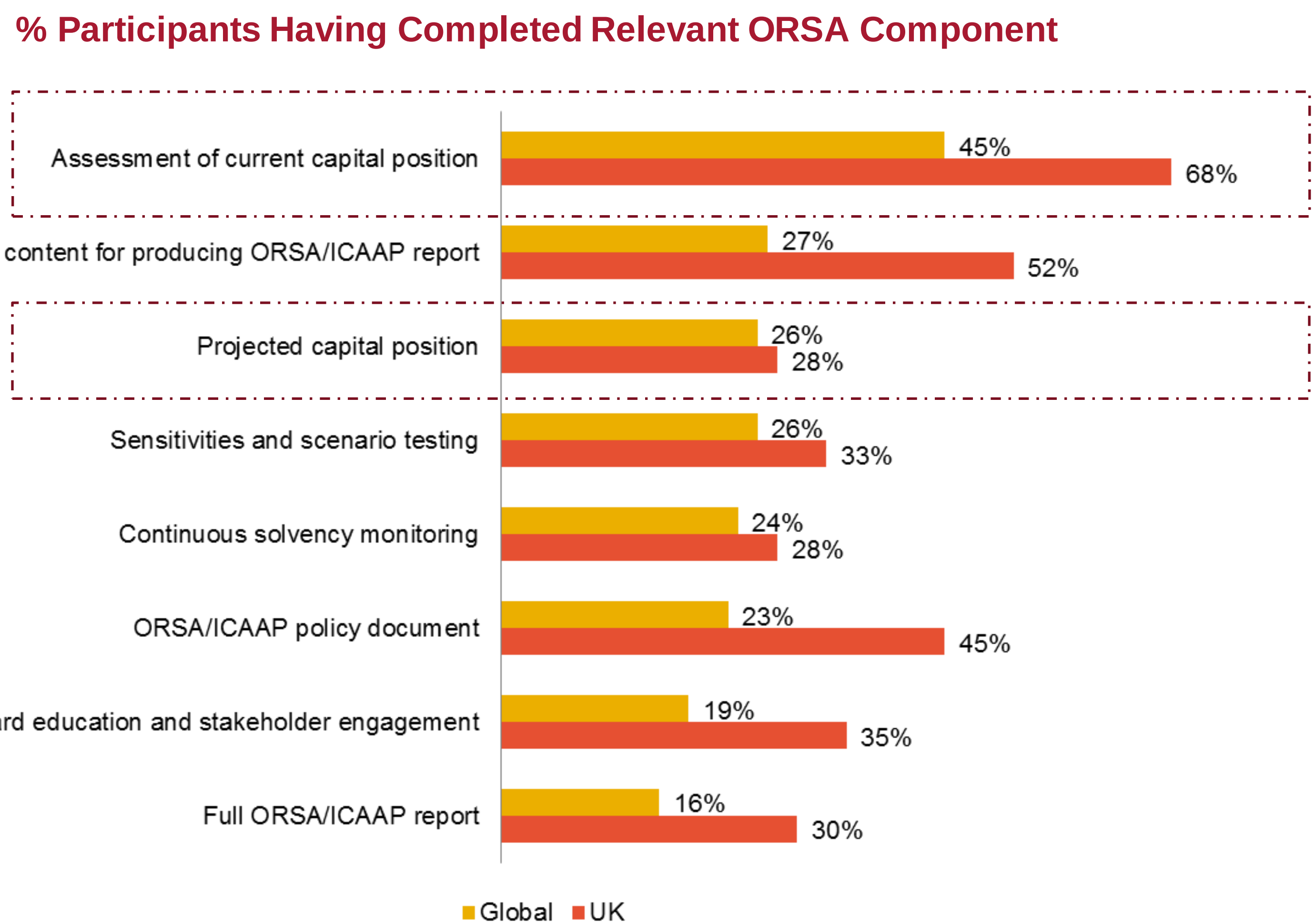

How would you describe your organisation's progress with the ORSA/ICAAP to date?

Source: Towers Watson's 2012 Global ERM Survey

Euro regulators' attitudes to early adoption of P2/ORSA

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- The CBI has confirmed it will comply with the latest FLAOR guidelines
- Expects all firms to be making steady progress with implementation and considering end 2014 review for larger firms

- ACP yet to confirm whether it intends to comply. Emphasis has been placed on the uncertainty of Solvency II timeline
- Dry run ORSA/FLAOR exercise planned for 2014

- Yet to confirm whether it intends to comply with the latest guidelines
- Has been holding internal and external working group meetings to discuss the key issues and challenges that the latest guidelines may present to UK firms
- Expectation is a glidepath for implementation, starting 1 Jan 2014 and ending 31 Dec 2015

- No formal response to date so not yet clear whether BaFin will fully comply
- However, has highlighted the importance of the interim measures and its intention to take these seriously

- The DNB has announced that EIOPA preparatory guidelines will be in force on 1 Jan 2014
- Plans to integrate elements into the current Solvency I framework

Key challenges insurers have faced

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Key challenges insurers have faced

1	Engaging the business
2	Developing effective processes for undertaking the ORSA
3	Linking the ORSA to the strategic planning process
4	Preparing effective reports that inform management actions
5	Making the risk appetite operational
6	Embedding risk management

Engaging the business

Wide engagement of stakeholders

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Board/executive	Setting overall business strategy and risk appetite
	Engaging with stress tests
	Sign-off of ORSA deliverables
Risk management function	Producing ORSA report
	Developing risk reporting templates (with others)
	Managing scenario testing and reverse stress testing
Actuarial function/Finance	Developing risk measurement tools
	Investigating risk-reward optimisation
	Stress & scenario analysis / financial projections
Strategy and planning	Business planning
	Capital structure
	Input on strategic direction
External organisations/Internal Audit	Challenge, benchmarking and independent review
	Ensuring appropriate control framework
	Quality assurance

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Engaging the business

Emerging Best Practice

1. Drafting an ORSA policy and process to help executive team and relevant staff understand what is involved
2. Allocating specific tasks to specific individuals and discussing requirements with them
3. Developing an ORSA Report template and obtaining feedback on structure and contents
4. Undertaking a ‘dry-run’ ORSA to assess level of work involved and how to undertake this efficiently
5. Documenting the dry-run ORSA and discussing structure and contents with Board and senior management
6. Actively seeking feedback from participants on what could be done more efficiently or differently

Developing effective processes for undertaking the ORSA

Overview of ORSA process

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Review risks on risk register → Identify new and emerging risks → Quantify risks → Calculate capital requirements → Undertake stress/scenario tests

Compare to risk appetite → Project capital and solvency requirements → Prepare ORSA Report → Obtain independent review → Submit for Board review

Developing effective ORSA processes

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Emerging Best Practice		
	1	Utilising existing 'business as usual' processes where possible
	2	Timing the ORSA process to integrate with the firm's strategy development and business planning cycle
	3	Timing (quarterly?) risk reviews to be a feed into the annual ORSA
	4	Critically assessing the effectiveness of each ORSA dry run and identifying refinements for next one
	5	Documenting the refined processes as instruction manuals for staff tasked with undertaking the next one

Linking the ORSA to the strategic planning process

Linking to business strategy

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Board

The Board need to be aware of the impact that strategic decisions have on the company's risk profile, regulatory capital requirements and overall solvency needs, and take this into account when deciding which strategies to pursue

Regulator

The regulator will expect to see evidence of this consideration in Board and Committee minutes

- Any regularly developed business plan needs to be reflected in the ORSA
- The undertaking should take the results of the ORSA and the insights gained in the process into account at least for the system of governance, including:
  - Long-term capital management
  - Business planning
  - Product development and design
- The company also needs to take into account external factors such as changes in economic conditions, regulation or the insurance market when undertaking the ORSA

Linking to business strategy

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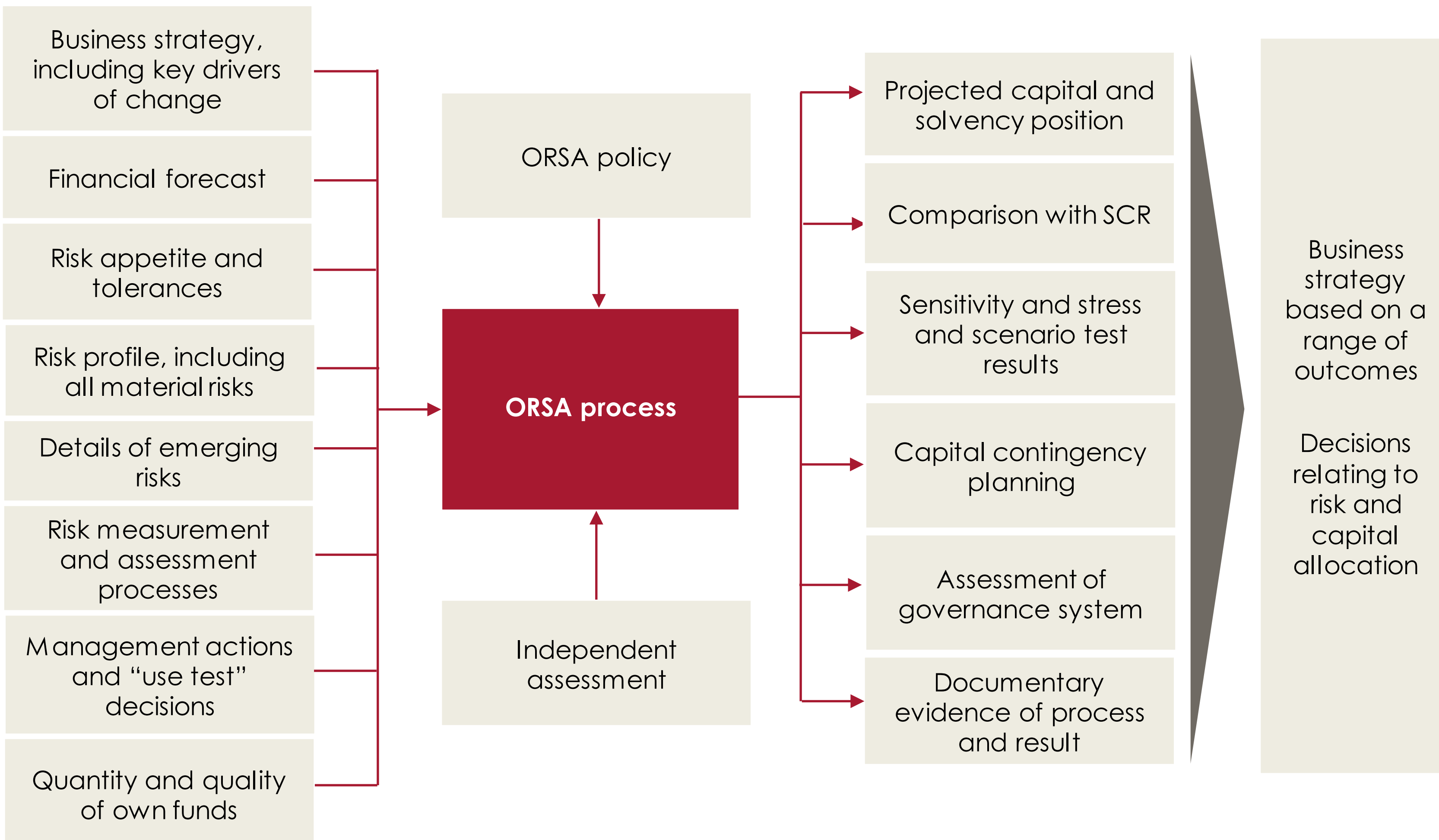

Linking to business strategy

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Emerging Best Practice

1. Most companies are aiming to perform their annual ORSA process as part of, or around the same time as, the business planning process
2. Many firms (all sizes) are educating their Board on ORSA in order to start the embedding process
3. Some more ambitious firms are considering introducing ORSA dashboards (i.e., expanding risk dashboards to include performance and capital measures)
4. Some firms are looking to introduce new performance measures (such as cost of capital for each product group rather than a combined total)
5. Some firms are reviewing their pricing bases, either to modify existing allowance for risk and cost of capital or to enhance existing bases
6. Not many smaller and medium sized firms have developed their capital projection models yet

Preparing effective reports that inform management actions

ORSA Report

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- Management document outlining results and conclusions of the ORSA
- Should be a critical reference point and integral in forming business strategy
- Owned by the Board

1	Executive summary
2	Introduction
3	Description of the risk management system and risk profile
4	Current capital position and developments over the year
5	Capital planning and projected capital needs
6	Governance structure
7	How the ORSA will be used
8	Findings from Independent Review
9	Proposed refinements

Preparing effective reports

Emerging Best Practice		
	1	Relevant to different audiences – Executive Summary, main report sections brief and succinct, further detail in appendices or other documents
	2	Easy to understand and absorb – use common terminology, tables or graphs supported by narrative information, single editor to ensure common tone
	3	Action required highlighted – narrative explanation making explicit what decisions the findings should influence, "Action now required" clearly signposted
	4	Keep internal ORSA report and ORSA supervisory report identical
	5	Consider quarterly ORSA reports – possibly linked to specific decisions the Board needs to take

Making risk appetite operational

Typical risk appetite framework

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Board of Directors

Risk strategy	Strategic expression of overall philosophy towards risk-taking, so that from the Board down there is alignment regarding the risk elements of the business strategy
Risk appetite statement	Sets out the high-level types and amount of risk the business is willing to take to achieve its business objectives

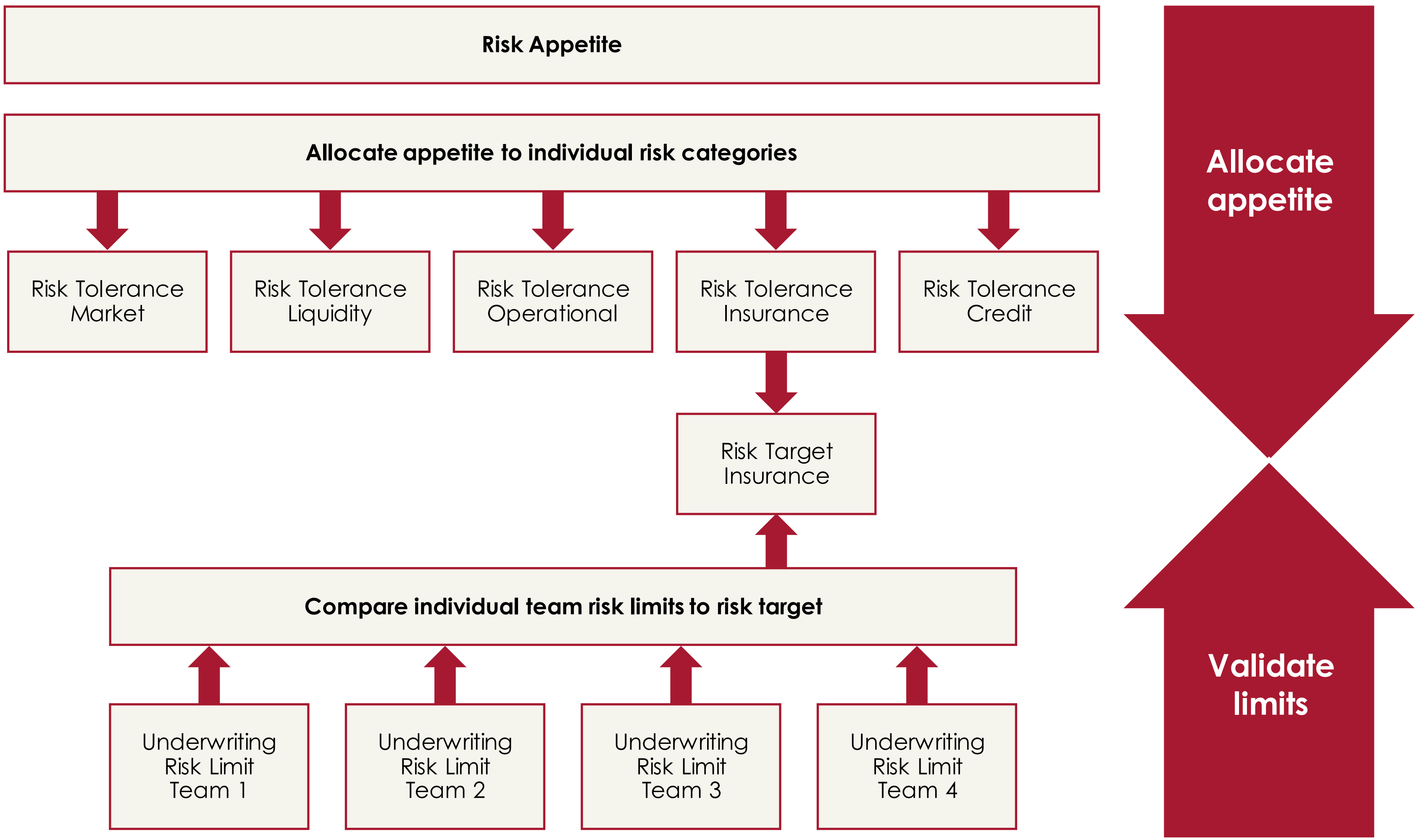
Management & Risk Function

Risk tolerance statements	Typically the maximum and/or minimum level of risk the business will accept within each risk category Qualitative and quantitative boundaries on the organisation's strategy

Risk targets	The ideal level of risk required within each risk category to achieve corporate objectives Articulating risk as opportunity, taking certain risks deliberately in the expectation of creating value	**Risk budgets**	Top-down allocation of overall risk capacity to risk categories, business units, products, and risk sources Consistent with strategy, tolerances, and opportunities

Risk limit	**Risk limit**	**Risk limit**	Granular operational controls on specific risks Expressed in metrics that are relevant to, and understandable to, operational staff, and convenient to monitor

Cascading appetite and tolerance to limits



Key finding #5: Defining risk appetite and monitoring against it are key short-term priorities

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- The top two short-term priorities for ERM development are risk appetite (40% of participants) and risk monitoring and reporting (39%), as in 2010
- The focus for development is now on refining risk appetite and operationalizing it
  - While 74% of respondents have now defined their risk appetite, 43% have yet to demonstrate its consistency with their risk limit structure
  - Of those who have defined their risk appetite, more than three-quarters recognize the need to develop it further
  - Supporting risk policies and risk monitoring processes also feature strongly in plans
- Companies have made significant progress since 2010
  - The proportion who have documented risk appetite/tolerance statements has increased from 59% in 2010 to 74% in 2012
  - Referencing of risk appetite within key business processes has also increased since 2010 in areas such as strategic planning/capital allocation (up from 55% to 71%)

	% Planning further work
Documented risk appetite/tolerance statements	81%
Processes for internal risk monitoring	80%
Risk policies and procedures to support risk appetite	75%
Developing a framework to demonstrate consistency of risk limits with risk appetite	70%

Making risk appetite operational

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Emerging Best Practice		
	1	Clear linkage between business strategy and plan, risk strategy, and risk appetite statement(s)
	2	Specification of risk tolerances – by risk category or other allocation that best meets the organisation's objectives
	3	Targets created for appropriate core risks to provide framework for risk optimisation
	4	Translation of risk tolerances into clearly defined risk limits, understood by operational staff
	5	Management information that is sufficiently granular, timely and accurate to identify actual and prospective breaches of limits
	6	An effective escalation and remediation process

Embedding risk management

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Embedding risk management

Maximising effectiveness		Embedded risk culture		
		Well integrated lines of defence	Proportionate risk governance system	
Making it work in practice	Responsibilities and accountabilities clearly allocated	Risk management framework	Effective MI & communication	Effective decision making
What needs to be in place	Clearly defined organisational structure	Key function policies and ToR	Risk policies and processes	Internal control system

Summary and questions

Summary: what is an ORSA? (1 of 2)

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An ORSA is NOT …	Instead an ORSA is …
Just a regulatory report, template or form to complete, a tick box exercise	Something owned and determined by the firm: the "own" is key!
One size fits all	Fit for purpose and proportionate
Prescribed in detailed regulation	Prescriptive on outcomes, not process
A purely quantitative assessment	Both qualitative and quantitative
A point-in-time activity	A continuous process
A compliance-driven mathematical exercise	A risk management process — should impact/benefit the whole organisation
Based on a prescribed set of risks	Based on all material and relevant risks, including emerging risks
Based on a one-year time frame	Based over business planning horizon

Summary: what is an ORSA? (2 of 2)

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An ORSA is NOT …	Instead an ORSA is …
Based only on 99.5% VaR measure	Based on own risk profile and risk appetite
Purely a solo entity exercise	An exercise that considers group interactions (contagion risk, intra group transactions, capital fungibility)
A regulatory capital requirement different from Pillar 1 SCR and MCR	Required to show continuous compliance with regulatory capital and technical provisions
A requirement to develop an internal model	Required to include an assessment of deviations between a firm's risk profile and the assumptions underlying the Pillar 1 SCR calculation
Purely an EU/Solvency II requirement	Increasingly part of international insurance supervision

Potential business benefits of the ORSA

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✓	A risk appetite that is used and understood
✓	Positive risk culture
✓	An assessment of the risk profile and a review of the appropriateness of the SCR
✓	An understanding of the key risk drivers
✓	A system to monitor the regulatory solvency position
✓	Wider thinking about risk, including both contingency planning and potential risk opportunities
✓	Forward-looking identification, monitoring and reporting of risk
✓	An assessment of future capital needs

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Questions

Comments

Contact details

- Keith Lindsay
  - Towers Watson, 71 High Holborn, London WC1V 6TP
  - +44 (0) 20 71703011; +44 (0) 7771708281
  - keith.lindsay@towerswatson.com