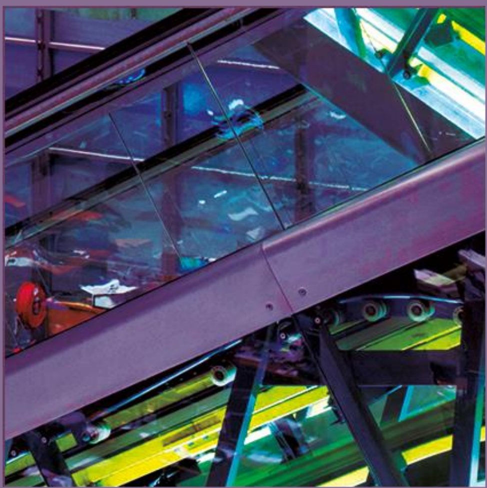

Keeping the "O" in ORSA

How Own Risk & Solvency Assessment ("ORSA") reports can best be used to promote a risk and capital culture.

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INSIGHT CONSENSUS INFLUENCE

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PREPARED BY A SUB-GROUP OF THE LMA CHIEF RISK OFFICERS (CRO) COMMITTEE

SUB-GROUP MEMBERS;

- Greg Shepherd Markel
- Penny Shaw Chaucer
- Hanna Kam Hiscox
- Andrew Hitchcox TMK
- Paul Element XL Catlin

1. Executive Summary

1.1 About this paper

The paper has been produced by the Chief Risk Officers' ("CRO") Committee of the Lloyd's Market Association ("LMA"). Its purpose is to provide the view of CROs in the London market on how Own Risk & Solvency Assessment ("ORSA") reports can best be used to promote a risk and capital culture.

1.2 Key messages

The LMA CRO Committee is very supportive of the concept of ORSA, seeing it as creating an opportunity to enhance risk management within insurers.

Initially formulated as part of Solvency II ("SII") ORSA (or a similar requirement) has been adopted by a number of other regulators.

The goal of Risk Management teams and regulators alike is to promote a "risk and capital culture" in firms, in which no strategic decision could be taken without appropriate consideration of the impact upon risk profile and capital. There is little in the form of detailed regulatory requirements within the SII Level I and Level II texts. The lack of written prescription should enable Risk Management functions to undertake the ORSA and present ORSA reports to their Boards in a manner that most facilitates forward-looking discussion of the firm's risk profile and the capital consequences of potential changes to the business.

However, there is a tension regarding the optimal level of information in annual ORSA reports.

- **Regulator/ franchisor** – our interactions with Lloyd's and the PRA suggest that they understandably see the annual ORSA report as an opportunity to gain greater knowledge of the managing agent's risk profile, risk decisions taken during the course of a year, and the effect of its forward looking strategy on its exposures and the consequent capital implications. This leads to requests to include increasing amounts of information within ORSA reports to our Boards. This can feel, in practice, highly prescriptive, such that the report no longer represents our "Own" approach to assessing risk and solvency, merely our "Own" data.

- **Board members** – our experience of reporting to our Boards is that the most effective way to achieve engagement is for reports to be brief, with information distilled into key messages. This focusses discussion at the Board meeting. As our Board members will have already reviewed considerable information on the firm's risk profile and capital implications during the course of a year, submitting large reports with information that Board members have already reviewed, will be counterproductive in enhancing discussions on risk and capital.

This paper seeks to suggest a way forward that will keep the "O" in ORSA – where CROs can draft ORSA reports that best engage their Boards, yet satisfy our regulator and franchisor with the information that they seek.

This means that, in practice, as well as theory, there should be recognition that:

- ORSA is a process, not a single risk management activity at a time in the year; and

- the level of information that will be focused upon by the Board will be a summary of key messages and issues, while that provided to the regulator will be more detailed.

ORSA presents an opportunity: but it is essential that it remains each insurer's "Own" assessment of their risk profile and capital requirements, tailored for their business and their Board.

2. Background

2.1 What is ORSA?

The SII framework directive proposal described ORSA as a tool of the risk management system that requires (re)insurance undertakings to assess their own short and long term risks and the amount of own funds necessary to cover them over the business planning time horizon.

A 2008 CEIOPS Issues Paper[1] indicated that the rationale for ORSA was to ensure that each insurer considers their own solvency needs, taking into consideration their specific risk profile. Commenting on the fact that “a standard formula is by its very nature a standardised calculation method and is not tailored to the individual risk situation of a specific undertaking”, CEIOPS said that there needs to be an assessment by the undertaking “of its own position in terms of risk and solvency”.

> “The risk-based approach requires, amongst other things, that undertakings hold an amount of own funds commensurate with the risks which they are or may be exposed to. The ORSA represents first of all the undertaking’s opinion and understanding of its risks, overall solvency needs and own funds held”.

Furthermore:

> “the matching of the own funds to the risk profile should help promote a strong culture of risk management, which in turn is a key underlying feature of the ORSA process and, more widely in soundly running the business”.

The intention of ORSA is that insurers develop a culture of assessing their own risks and the appropriate capital requirements for their business needs.

2.2 Primarily a process

The CEIOPS Issues Paper of May 2008 defined ORSA as:

> “The entirety of the processes and procedures employed to identify, assess, monitor, manage and report the short and long term risks a (re)insurance undertaking faces or may face and to determine the own funds necessary to ensure that the undertaking’s overall solvency needs are met at all times”.

Based on this definition, which refers to “the **entirety** of the processes and procedures” (our emphasis), it is clear that **all** risk management and capital assessment processes form part of ORSA. In terms of considering “what is ORSA”, it is not a single risk management task at one point in time – rather it encompasses the entirety of the risk management activities within a firm throughout the period.

Article 45 of the SII Directive requires that “the insurance and reinsurance undertaking shall inform the supervisory authorities of the results of each own risk and solvency assessment”. This indicates that a report should be produced and provided to the regulator, at a point in time. However, the CEIOPS definition makes it clear that the ORSA is primarily a process: the report evidences the outcome of the ORSA process, rather than being a separate and distinct exercise.

2.3 Wider Regulatory Adoption

ORSA is the feature of SII that regulators outside the EU have been most keen to adopt. It is already mandatory in the USA, Canada, Japan and Singapore. Switzerland, Bermuda, Australia, South Africa and Mexico require insurers to perform exercises similar to an ORSA. Regulators clearly see ORSA (or a similar requirement) as assisting:

> “to foster an effective level of ERM at all insurers, through which each insurer identifies, assesses, monitors, prioritises and reports on its material and relevant risk identified by the insurer, using techniques that are appropriate to support risk and capital decisions”[2]

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[1] CEIOPS issues paper “Own Risk and Solvency Assessment (“ORSA”) 27 May 2008

[2] Source:http://www.naic.org/cipr_topics/topic_own_risk_solvency_assessment.htm

ORSA has proved to be popular among regulators as it promotes a culture within insurers of strong risk and capital management. The lack of detailed prescription means that ORSA (or similar requirements) can be incorporated into regulatory regimes without the risk of creating inconsistency with the existing framework.

2.4 Lack of regulatory prescription

As mentioned before, it is noteworthy that ORSA is an area of SII which has not been subject to many detailed rules from EIOPA. The "O" in ORSA was taken seriously and enabled insurers to perform a bespoke assessment of their own:

1. risk profile;
2. capital requirements;
3. funds.

The NAIC has said that:

> "The "O" in ORSA represents the insurer's "Own" assessment of their current and future risks. Insurers and/or insurance groups will be required to articulate their own judgement about risk management and the adequacy of their capital position. This is meant to encourage management to anticipate the potential capital needs and to take action before it's too late. ORSA is not a one off exercise - it is a continuous evolving process and should be a component of an insurer's enterprise risk management framework. <u>Moreover, there is no mechanical way of conducting an ORSA; how to conduct the ORSA is left to each insurer to decide, and actual results and contents of an ORSA report will vary from company to company. The output will be a set of documents that demonstrate the results of management's self-assessment</u>."[3] (our emphasis)

Freedom from detailed prescription enables insurers to develop ORSA in ways most suitable for their organisation. This is a material positive feature.

[3] Source: http://www.naic.org/cipr_topics/topic_own_risk_solvency_assessment.htm

3. Where we are now

3.1 Development of ORSAs

Lloyd's required ORSA reports from all syndicates in 2011, and annually thereafter. The annual ORSA cycles to date within the Lloyd's market have facilitated much positive development.

Lloyd's has seen:

> "significant development in ORSA reports as managing agents have continued to work to ensure that they are useful documents for the Board and senior management, as well as ensuring that the content is sufficient to meet Solvency II requirements."[4]

3.2 Post SII implementation

In the build up to SII implementation Boards were mindful of the need to embrace the new requirements and implement processes in order to ensure compliance with a significantly revised regulatory regime. It was relatively easy for Risk Management functions to obtain Board time to discuss risk management related issues.

However, now that SII is "live", CROs need to demonstrate that risk management activities are adding value to the business. Risk Management functions are responding to this challenge by managing SII processes to become "Business as Usual" and using their internal models and other techniques to bring even more value to their firms.

3.3 Interaction with our franchisor and regulator re: ORSAs

Despite the lack of prescription within SII Level I and Level II guidance, as a CRO community we have observed some instances of our regulator and/ or our franchisor requiring that ORSA reports contain increasing amounts of information, some of which is effectively repetition of items already presented to the Board.

We understand the need for our regulator to be furnished with information which assists in understanding how the risk profile of the firm is developing through the implementation of strategy, and the implications of that strategy on its capital resource. However, we are concerned that this development could result in detracting Board engagement with the ORSA report.

3.4 PRA Supervisory Statement

In November 2016 the PRA issued Supervisory Statement SS19/16 "Solvency II: ORSA" ("SS19/16").

This, in part, recognised that longer reports are not necessarily better reports. It said "good ORSA reports often:

- include a clear summary;
- highlight the key outcomes of the process;
- are not too long; and
- clearly signpost supporting documentation."

This is a positive step.

However, SS19/16 later sets out a number of areas that need to be covered in the ORSA report, including:

- Business strategy
- Risk
- Capital and solvency
- Stress testing
- Internal model adequacy and confirmation that all risks identified by the firm are included in the Model.

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[4] Lloyd's ORSA Guidance notes December 2015

These areas are likely to have been considered by the Board in other contexts. For example, the Validation Report provides a detailed examination of model adequacy and risk coverage. To duplicate information on these areas in the ORSA report to the Board will be repetitious and will cause a lack of engagement.

Similarly Lloyd's' December 2015 ORSA guidance stated: "a common theme raised by managing agents concerned the length of the ORSA report and plans that they have to streamline the ORSA report to enable the Board to focus on key information." Yet the guidance also lists a number of areas where detail is required. For example it states:

"The [ORSA] report should comment on specific mitigating controls or actions taken and where there are breaches of risk appetite, details of lessons learned and what has been done to mitigate recurrence of the same breaches should be included."

This information is likely to have been reviewed and discussed by the Board and therefore will constitute repetition if included in the ORSA report to the Board.

3.4 CRO concern

While ORSA is a process, and therefore there are many points of engagement with Board members in the assessment of risk and solvency throughout the year, the ORSA report is a meaningful point at which the process is summarised and conclusions are drawn on aspects of risk and capital. It is therefore important that discussion of the ORSA report is focussed on key messages and issues.

Our concern is that Boards will very quickly lose interest in the ORSA report if it duplicates information they have already received, and contains so much detail that key messages are diluted. The ORSA report may be perceived as solely a regulatory requirement, and an opportunity for engagement regarding risk and capital issues will be lost.

3.5 Groups and ORSAs

As mentioned in 2.3 there has been widespread adoption of ORSAs by regulators outside the EU. As many managing agents are part of a wider group, often headquartered outside the EEA, the syndicate ORSA may be one of many produced across the group.

If there is a consistent approach to risk management across the group, much of the description of risk management processes will be identical at the overview level given within these reports. There will be increasing desire to produce a Group ORSA which not only explores group capital requirements but also the overall risk management strategy of the group. It is likely that Groups will want to produce fewer reports, which contain the overall group strategy and risk management approach and then entity specific information in later sections of the report. This is a necessary evolution of the ORSA report to adapt to the truly global nature of many insurance groups and their risk management functions.

4. The Way Forward

We reiterate our support for ORSA, seeing it as tool to assist in greater understanding and engagement of the Board and wider managing agency staff in a forward-looking approach to risk and capital. We also understand the desire of our regulator and our franchisor to receive a standalone document that summarises risk profile and the solvency implications of our business strategies.

As set out in 2.2 above, ORSA is a process, constituting "the entirety of the [risk management] processes". The ORSA Report, and the steps taken to produce it, are not the process: the report summarises activities and provides key messages, as evidence of the continuous ORSA process. It is important that this is recognised in the interaction between the regulator or franchisor and the managing agent.

The implication of this for the ORSA report is that during the course of the year there will be numerous activities occurring that report and mitigate risk, and manage capital. These will be documented in various reports to, and the minutes of, the Board and its committees. If the annual ORSA report to the Board contains detailed descriptions of these activities it will be perceived as repetitious and will lead to a lack of engagement.

In order to balance the different requirements of the readership of the ORSA report a distinction should be drawn between the level of detail provided to the Board and to the regulator. This is recognised in the January 2015 EIOPA ORSA guidance, which acknowledges that there can be more than one report:

> "2.20 The internal report developed by the undertaking could be the basis of the supervisory report of the ORSA. If the undertaking considers that the internal report has an appropriate level of detail also for supervisory purposes then the same report may be submitted to the supervisory authority".

One option considered was that a short, summary report could be provided to the Board, with a fuller report and\or many appendices to the franchisor/ regulator to provide the detail required.

We understand that there could be concern over there being "two reports", in case the messages and conclusions provided to Board and regulator were to differ, but this is easily negated if the report to the Board is provided to the regulator in addition to the "regulatory report", as this would identify any inconsistencies. A greater reason for not following this course is that there is significant overhead in producing two reports.

Our favoured approach is for there to be widespread acceptance that the report to the Board will be short and identify the key messages and issues, with, of course, supporting information being available. Additional information to meet the regulator and franchisor's requirements could be in appendices, which may consist of documents previously reviewed by the Board and its committees, provided there is clear signposting.

In this way we may be able to ensure that the varying requirements of Board and regulator/ franchisor are met in a way that is in keeping with that which is set out in SS19/16 and yet still allow CROs to engage with their Boards in their "own" way. However, this will require practical acceptance by PRA and Lloyd's staff in their interactions with managing agents.

In this way we can accommodate the needs of all stakeholders in ORSA.

Worldwide ORSA (or similar) requirements

As mentioned in section 2.2 a number of regulators across the world have adopted ORSA or a similar requirement. This is summarised below. The information below is largely from a report by Thomson Reuters entitled "Understanding ORSA – A Global Risk Regulatory Regime for insurers."[5] Where information is derived from other sources these are set out below:

- **USA** - large- and medium-sized US insurance groups and insurers are required to conduct an ORSA regularly, starting in 2015. The ORSA applies to any individual US insurer that writes more than $500 million of annual direct written and assumed premiums, and insurance groups that collectively write more than $1 billion of annual direct written and assumed premiums.

- **Bermuda** - The CISSA and GSSA are Bermuda's version of ORSA, designed for the unique characteristics of that market while also being consistent with the IAIS framework. Both the CISSA and the GSSA came into effect at the end of 2011.

- **Switzerland** - in line with ORSA principles, insurance companies must assess the risks to which they are exposed, including significant concentrations of risk, their total capital requirements, and the adequacy and effectiveness of risk management. Implementation Date: 1 July 2015

- **Singapore** - ORSA is part of the MAS's Enterprise Risk Management framework (Insurance Risk Based Capital – RBC2). Tier 1 insurers (with assets of SG$5 billion and above) must lodge an ORSA report annually with MAS. The first ORSA report was due by the end of 2014. For all other insurers, the first report is due on or before 31 December 2015, and every third year thereafter.
- **Australia** - APRA's new capital requirements include an Internal Capital Adequacy Assessment Process (ICAAP), which is similar to ORSA. The first ICAAP reports were published after each company's year-end date in 2013. They must be submitted to APRA annually. Revised capital requirements for insurers were implemented on 1 January 2013. These standards are broadly equivalent to Solvency II.

- **Canada** - An insurer must document its ORSA in a report to the Board at least annually. Guidance is shaped by elements of existing OSFI guidance and processes, such as A-4, DCAT and stress testing. The OSFI required all insurers to complete their first ORSA by the end of 2014.

- **South Africa -** SAM is based on Solvency II, but has been adapted in certain areas to take into account South Africa's specific conditions, risk profile and industry. The regulator says it has also considered regulations in Australia and Canada, as well as the IAIS's ICP framework. Position Paper 107, published in June 2014, sets out 22 guidelines for ORSAs. Implementation date: 1 January 2016

- **Mexico** - In Mexico the Autoevaluacion de Riesgos y Solvencia Institucionales (ARSI—the Mexican equivalent of the Own Risk and Solvency Assessment [ORSA]), will directly impact the consideration and mitigation of the risk—which, for example, can be done through reinsurance. http://www.intelligentinsurer.com/news/reinsurers-to-offer-adaptive-solutions-for-solvency-ii-in-mexico-7025 Implementation was April 2015

- **Malaysia** - In Malaysia, although there is no explicit requirement for an economic capital calculation, certain aspects (e.g., individual target capital level) are considered. The regulator has increased its focus on ORSA-type calculations by insurance companies to determine the target capital and risk appetite. http://www.ey.com/Publication/vwLUAssets/EY-risk-based-global-insurance-capital-standard/$File/EY-risk-based-global-insurance-capital-standard.pdf Implemented ICAAP requirement in 2012

- **Japan** - From 1 April 2015, all insurance companies in Japan were required to start submitting formal annual ORSA reports to the Financial Services Agency.

[5] https://risk.thomsonreuters.com/sites/default/files/GRC00738_0.pdf