



INSURANCE SOLUTIONS

Own Risk & Solvency Assessment

ORSA

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ADVISORY

Introduction

Background

Issues Paper from 27 May 2008

„Own Risk and Solvency Assessment (ORSA)“*

Internal assessment of own risk and Solvency



Article 44** demands from (re-)insurance undertakings:



- Determination of their **overall solvency needs**
- Reporting the ORSA information to **solo and group supervisory authorities**
- ORSA information will be used in the **Supervisory Review Process (SRP)**

Matters to discuss:

- Absence of **details** and **explanations** in Article 44**, **not exhaustive**
- **Complexity** and **sophistication**?

Ambition of the European Commission:

- No requirement of an **internal model**
- Agreement with the capital requirements from the **SCR** and the **MCR**
- Not too burdensome

Introduction

Definition and aim of the ORSA

Definition

ORSA is 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.

Aims

Enhancing awareness:

- **Understand** and **asses** the risks
- **Interrelationships** between the risks
- **Internal capital needs** that follow from its risk exposure
- **Level of own funds** appropriate to its risk and internal control environment

* overall solvency need includes the assets necessary to cover the liabilities, including technical provisions, the regulatory capital requirements – SCR and MCR – as well as the internal capital needs.

Introduction

Compliance on a continuous basis

Frequency of the ORSA:

Risk profile	➔	Frequency of the „ partial-calculations* “
Volatility of the capital requirements Volatility of the own funds Level of solvency	➔	Frequency of the full calculation
Significant changes of the risk profile	➔	full calculation is required

Undertakings should justify the **adequacy of the frequency** of the calculation taking into account its **risk profile.**

*Undertaking needs to have processes in place to estimate the changes in the capital requirements and eligible own funds' level since the last full solvency calculation.

Assessment of the overall solvency needs

In according to the following criteria:



Principles and guidance for undertakings

Principles

The undertaking should have regard to the **following principles** when conducting its ORSA:

- A. The ORSA is the responsibility of the undertaking and should be regularly reviewed and approved by the undertaking's administrative or management body.
- B. The ORSA should encompass all material risks that may have an impact on the undertaking's ability to meet its obligations under insurance contracts.
- C. The ORSA should be based on adequate measurement and assessment processes and form an integral part of the management process and decision making framework of the undertaking.
- D. The ORSA should be forward-looking, taking into account the undertaking's business plans and projections.
- E. The ORSA process and outcome should be appropriately evidenced and internally documented as well as independently assessed.

Principles and guidance for undertakings

Administrative or management body (AMB)

A) The ORSA is the responsibility of the undertaking and should be regularly reviewed and approved by the undertaking's administrative or management body.

guidance

Article 44*

Proportionality

Undertakings decide how to **design** their **ORSA process**

Responsibility for the compliance remains to the administrative or management body

(also at outsourcing the ORSA)

→ compliance of article 44* and 48**

→ management decisions for risk-/capital management

Article 48**

Administrative or management body (AMB):

- Regularly **approve** and **review** of the assumptions by the AMB (including any management actions)
- **Sign-off** the results
- Responsibility for the **adequacy**
- **Active involving** the AMB in the review and challenge of the ORSA

Management actions:

- Implications of **prospective management actions**
- **Details** of any management actions
- Enacting of the management actions in times of **financial stress**

principles

Principles and guidance for undertakings

AMB – Why is ORSA important?

Promotion

- **Strong culture** of risk management
- **Soundly running** business

ORSA:

Matching of the own funds to the risk profile

Assessment of the own situation

as to risk and solvency is crucial for the implementation of a risk-based regime such as **Solvency II**.

ORSA

Opinion and understanding

by the undertaking of

- own long-/short-term risks
- global solvency need
- own funds

Effects of prospective changes in the risk situation:

- Monitoring / measure the changes?
- Solvency need?
- Capital position?
- Acquisition of additional own funds?

ORSA:

Accentuation of **future-orientation**

Principles and guidance for undertakings

Solvency 1/3

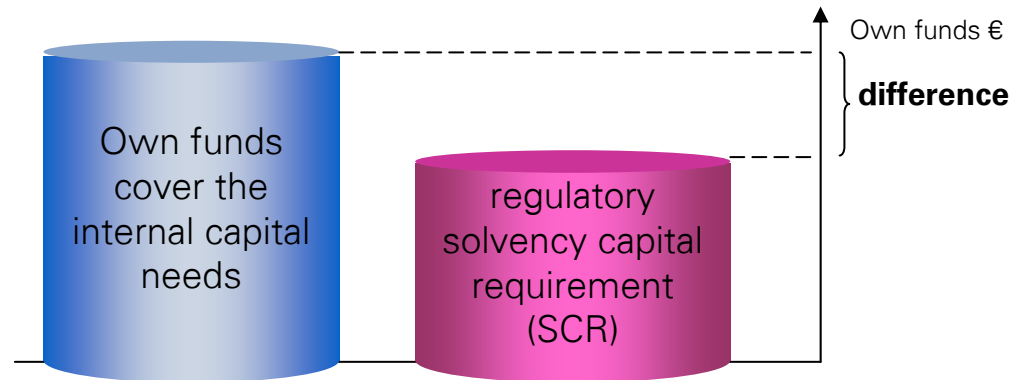
B) The ORSA should encompass all material risks that may have an impact on the undertaking's ability to meet its obligations under insurance contracts.

- Distress of a reduction of the **current level of own funds**
- Endanger the protection offered to **policyholders**
- **Separate identification** of all risks, which are not captured by the SCR / approved internal model
- **Consideration of**
 - risk mitigation techniques (incl. reinsurance)
 - diversification effects
 - loss-absorbing capacity of technical provisions and deferred taxes
 - risk appetite / level of confidence used for intern purposes
- Ongoing gathering of information about **present / future risks** on every
 - hierarchy levels
 - operational processes
 - functional areas
- Assessment of the **adequacy** of the undertaking's governance system (incl. risks arise from whose inadequacy / deficiency)
- **Assumptions** used in assessing and aggregating risks (explanation and justification of the differences to the SCR – assumptions)

Principles and guidance for undertakings

Solvency 2/3

ORSA includes an **analysis** of the possible differences of required own funds:

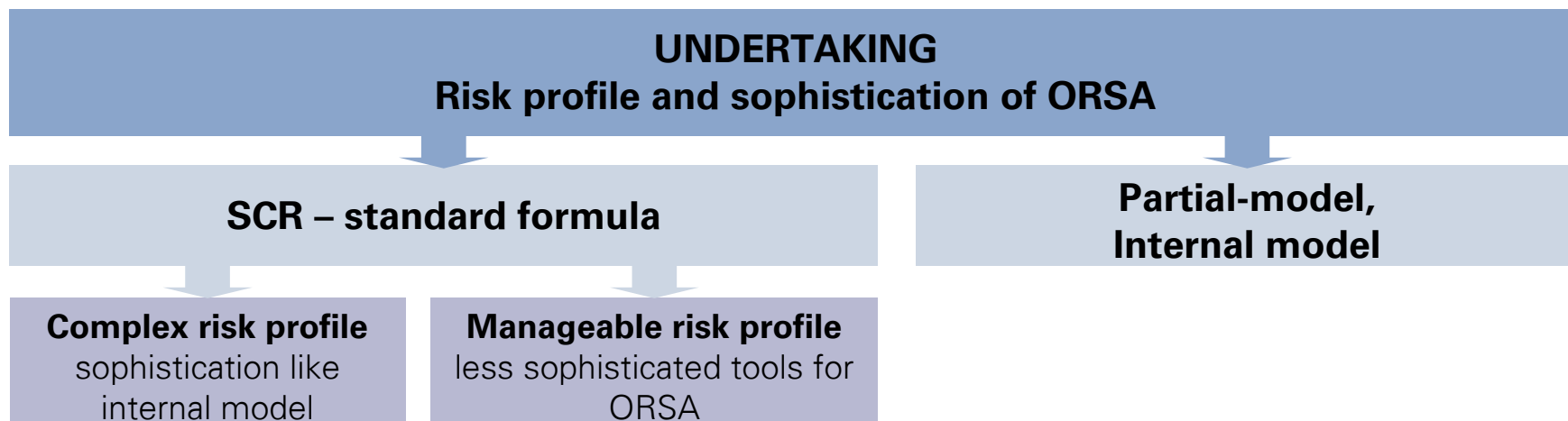


Reasons for possible differences:

- **Confidence level (i.e. own funds for rating purposes)**
- **Time horizon for business planning**
- **Risk profile:** Risks are not / not adequate covered (i.e. liquidity risk, reputational risk, strategic risk)
- Planned management actions, that influence the risk profile
- **Firm-specific risk characteristics** (niche player)
- **Concentration risk within the insurance portfolio**, relationships between risks
- Inappropriate **capital investment policy**
- **Missing effectiveness** of risk mitigation arrangements
- **Lacking of governance** in stress situations

Principles and guidance for undertakings

Solvency 3/3



- **Internal model** itself is a tool for ORSA.
- Description of the **role of the internal model** in the integrated management of Risk and capital needs
- **Ongoing adequacy** of the model to the risk profile
- ORSA should expose the **capital need** due to internal purposes **and** regulatory capital requirements

- In order to assess the deviation according to article 44 1 c)* it is necessary to perform the internal calculation on the basis of a 99.5% confidence level and a one-year time horizon.
- Under the ORSA the parameters should be used that best reflect the individual risk situation.

Principles and guidance for undertakings

Solvency – Why is ORSA important?

Compliance on a continuous basis

- Regulatory capital requirements
- Internal capital aims

SCR standard formula

- Standardised calculation methods
- Perhaps **no covering of all specific risks** the undertaking faces to
- No consideration of the risk situation of an **specific undertaking**

ORSA:

Integrated management of risks and capital

ORSA

- **firm-specific risk profile**
- **Robust processes** to assess the overall solvency need
- **Extension** to standard formula
- Measure **own funds**
- Assessment of the **adequacy of the regulatory capital requirements to the individual risk position**

Principles and guidance for undertakings

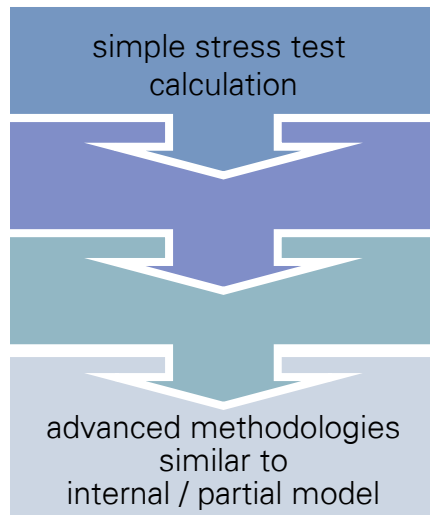
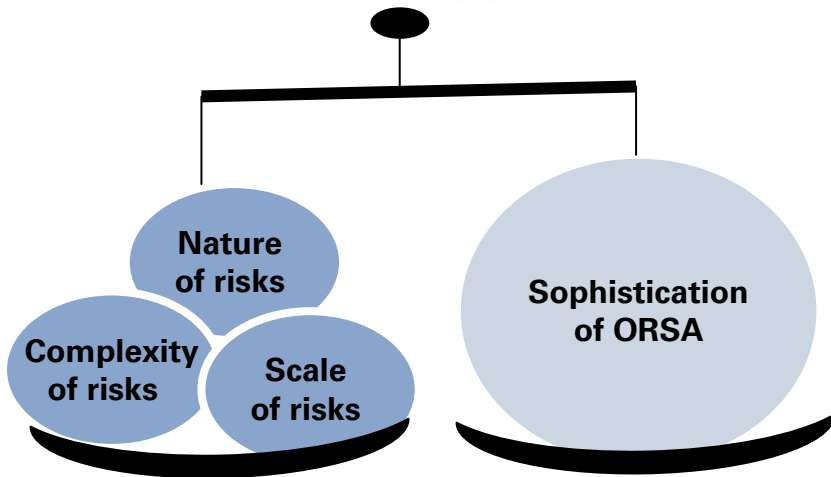
Measurement and assessment processes

C) The ORSA should be based on **adequate measurement and assessment processes** and **form an integral part of the management process and decision making framework** of the undertaking.

- Undertakings should explain and justify the following:
 - **Methodology / key assumptions**
 - **Results** (incl. sensitivity of the results to the assumptions)
 - Appropriateness of the assessment / modelling approach
 - **Data** used and systems / controls around it
- Dealing with parameter **uncertainty** and **fluctuations**
- **Reconciliation** of balance sheet items used in ORSA within entries from financial statements
- Explanation of differences between **accounting** and **economic capital measures**
- Remark the **results** of the ORSA & **insight gained** into the ORSA-process in:
 - Strategy formulation
 - Product development
 - Decision making
 - Governance
 - Own funds' allocation

Principles and guidance for undertakings

Measurement and assessment processes



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Proportionality

Content of ORSA:

- All **assets / liabilities**
- **Off-balance sheet items**
- **Management practices, systems and controls**
- **Consistent valuation basis**
(not necessary consistent to Solvency II)

- Quantitative **and** qualitative assessment of own funds (incl. **stress situations**)
- **Restriction** of own funds to own resources

Principles and guidance for undertakings

Purposes

D) The ORSA should be forward-looking, taking into account the undertaking's business plans and projections.

Reflection of both in die assessment:

Fulfil the business objections

Responsibility to policyholders

Sufficient financial resources for **planned investments / new business?**

Consideration of all, **in future very probably risks**

- Internal trigger: i.e. changes of the business plan
- External trigger: i.e. deterioration of economic conditions

Description of how ORSA **is integrated in the management of the business**, especially the extend to which ORSA is embedded in:



Principles and guidance for undertakings

Documentation

E) The ORSA process and outcome should be appropriately evidenced and internally documented as well as independently assessed.

- **Comprehensible described, simple reviewable documentation**
- Ensure the **separation of practitioners and controlling persons** in the ORSA process (on the part of the administrative or management body)

- **Authorisation:**

- internal / external **auditor**
- **skilled** internal or external function

Condition: **Independency!**



- Conclusions drawn from the independent assessment should be **reported** to the **administrative or management body** in order to enable it to act on this information if necessary.
- ORSA is part of the risk management, that means that the written fixed risk management policy should include ORSA.

Principles and guidance for undertakings

Documentation

Documentation of ORSA should minimum include:



Annex 1 - Sources

- [IP] = Issue Papers „Own Risk and Solvency Assessment” (ORSA)
CEIOPS-IGSRR-09/08, 27 May 2008
http://www.ceiops.eu/media/docman/public_files/consultations/IssuesPaperORSA.pdf
- [SOLV] = Amended Proposal for a DIRECTIVE OF THE EUROPEAN
PARLIAMENT AND OF THE COUNCIL on the taking-up and
pursuit of the business of Insurance and Reinsurance (SOLVENCY II)
(recast)
(presented by the Commission pursuant to Article 250 (2) of the EC Treaty)
Brussels, 26.2.2008, COM(2008) 119 final, 2007/0143 (COD)
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0119:FIN:EN:PDF>

Annex 2 – Article 44

1/2

Article 44

Own risk and solvency assessment

1. As part of its risk management system every insurance or reinsurance undertaking shall conduct its own risk and solvency assessment.
That assessment shall include at least the following:
 - (a) the overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the undertaking;
 - (b) the compliance, on a continuous basis, with the capital requirements, as laid down in Chapters VI, Sections 4 and 5 and with the requirements regarding technical provisions, as laid down in Chapter VI, Section 2.
 - (c) the extent to which the risk profile of the undertaking concerned deviates significantly from the assumptions underlying the Solvency Capital Requirement as laid down in Article 101 (3), calculated with the standard formula in accordance with Chapter VI, Section 4, Subsection 2 or with its partial or full internal model in accordance with Chapter VI, Section 4, Subsection 3.

Annex 2 – Article 44

2/2

2. For the purposes of point (a) of paragraph 1, the undertaking concerned shall have in place processes which enable it to properly identify and measure the risks it faces in the short and the long term and also to identify possible events or future changes in economic conditions that could have unfavourable effects on its overall financial standing. The undertaking shall demonstrate the methods used to determine its overall solvency needs.
3. In the case referred to in point (c) of paragraph 1 when an internal model is used, the assessment shall be performed together with the recalibration that transforms the internal risk numbers into the Solvency Capital Requirement risk measure and calibration.
4. The own risk and solvency assessment shall be an integral part of the business strategy and shall be taken into account on an ongoing basis in the strategic decisions of the undertaking.
5. Insurance and reinsurance undertakings shall perform the assessment referred to in paragraph 1 regularly and without any delay following any significant change in their risk profile.
6. The insurance and reinsurance undertakings shall inform the supervisory authorities of the results of each own risk and solvency assessment as part of the information reported under Article 35.