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**P&C Insurer perspective on ORSA –
US, Canada and the UK**

April 2, 2014
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Outline


1. Terminology
2. What is ORSA?
3. Unencumbered ORSA
Risk Assessment
Solvency Assessment
4. Encumbered ORSA?
5. Questions



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Terminology for this presentation

- “SII” - Solvency II
- “Regulators” – supervisor or regulator
(even though I see these as different in practice)
- “Board” – oversight (“supervisory”) board
(see wikipedia discussion of “Two-tier system” for Boards of Directors)
- “Internal Models” – Models run for your own use
(Not just “internal models” under Solvency II for SCR calculation.)




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What is ORSA?

Own Risk Assessment, and
Own Solvency Assessment

These are two separate processes.




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What is ORSA? (risk assessment)

- Part of an ERM process
- Own Risk Assessment, usually defined to include:
 - Risk identification
 - Risk prioritization, based on knowing:
 - Risk appetite
 - Risk tolerance
 - Risk limits,all leading to
- Risk actions (not technically "assessment")

Not all of this involves numbers!!!

Two most important signs of a strong insurer:
Strong management
Strong earnings



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What is ORSA? (management)

Strong Management - Not a numbers exercise

For example – How much capital do you hold for the risk of:

- A weak CEO
- Risk that employees are unethical


Some risks you manage/mitigate, rather than hold capital against.



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What is ORSA? (solvency assessment)


- Solvency Assessment
 - Does involve a numbers exercise
 - Solvency relative to all relevant stakeholders
 - Regulators
 - Customers
 - Creditors
 - Owners, employees
 - Not just a single number
 - Required to be "forward looking"



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The Unencumbered ORSA


- Start with what makes sense for the business, regardless of compliance issues
- One size does not fit all
 - What makes sense will depend on size, scope, complexity.
 - Process & structure for a small company will be very different than that for large company.
- Reminder - ORSA is just a part of ERM



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The Unencumbered ORSA – Risk Assessment

- Know Yourself
- Know Your Environment
- Risk Identification
- Risk Sizing
- Risk Decision
- Risk Monitoring




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The Unencumbered ORSA – Risk Assessment

Know Yourself

- Business Model
- Risk Tolerance/Appetite
 - Can vary by risk
- Resources/strengths/weaknesses
- Data!! - know your customers, products!
- CULTURE!!!!




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The Unencumbered ORSA – Risk Assessment

Know Your Environment

- Past – reason for current structure?
- Present
- Possible future?




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The Unencumbered ORSA – Risk Assessment

- Risk Identification
- Risk Sizing
 - Don't have to precisely measure to manage
- Risk grid
 - Impact of risk
 - Likelihood of risk
- Focus on the high/high risks

		Risk Impact	
		Low	High
Risk likelihood	High		
	Low		




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The Unencumbered ORSA – Risk Assessment

- Risk Decision
 - Avoid
 - Take
 - Take – mitigate
 - Take – transfer

Investment risks – take then mitigate
P&C insurance risks – mitigate then take




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The Unencumbered ORSA – Risk Assessment

Risk Monitoring - MAJOR

- Cannot be static. Risks come and go.
- Must be part of culture
- Cross-discipline, cross-business line exercise
- **Involves everyone**, not just CRO or ERM staff
- Includes looking for emerging risks
- Feedback loop
- **Include reporting to the top level**



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The Unencumbered ORSA – Solvency Assessment

Regulator – focused on Solvency

- Policyholder focus - Pay last claim with last dying breath

Management/Owner – focused on Survival

- Survive, don't die – last person(s) standing
- Save the franchise value.
- For industry problems – *“don't have to outrun the bear”*.



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The Unencumbered ORSA – Solvency Assessment

Ways to assess solvency

- Stress testing, scenario testing
- Rules of thumb
- External models/formulas (can't be ignored)
 - Rating agencies, SCR, RBC
- Internal Models

Use what makes sense for you

Recommend multiple approaches



The Unencumbered ORSA – Solvency Assessment

A few words on internal models

- "All models are wrong, but some are useful"
Over-simplification, Paradigm shifts, new risks, black swans, etc.
- Models are tools - tools guide us, don't decide for us.
- "Plight of the Fortune Tellers" – Riccardo Rebonato



The Unencumbered ORSA – Solvency Assessment

Short-term versus Long-term risks

- Short term – know and feel the impact fast
- Long term
 - May take a while to know the impact
 - May take a while to feel the impact
 - Not clear when the impact occurs
 - *Chained to the roulette wheel*



The Unencumbered ORSA – Solvency Assessment

Examples of Long-term risk issues

1. Asbestos
In retrospect, many strong insurers today were "insolvent" in 1980, but they aren't now (and weren't then?)
2. Global Financial Crisis
Mark to market (temporary) insolvencies
3. How many times should you get "heads" in 10 coin flips?
If I got "heads" 10 times, what was a correct time zero estimate?

How do you handle a risk that takes years to emerge?
Allow for additional business before the bad news emerges?



The Encumbered ORSA

Now that you have something of value for the business,
Look at the regulatory requirements.

Leverage what you give your Board

- But a different audience requires a different report
- Outsider needs more context than an insider
 - Board – may deal with it in many pieces
 - Regulator – wants it all in one place

Look at the written rules
Pay attention to the unwritten rules
Oral feedback from the regulator may be the real rules.



The Encumbered ORSA

- US ORSA
- Written summary report to lead supervisor
 - Guidance manual for the report
 - limited use of "should", common use of "may"
 - Group report required
 - Suggests stress/scenario testing


- Canada
- Written report to Board (but regulator can look at)
 - Guidance manual for the process
 - More use of "should" for the process, little mention of report
 - Group report not required
 - Need an ORSA for a Canadian branch
 - Requires stress/scenario testing



The Encumbered ORSA

Solvency II (UK)

- Written summary report to supervisor
- Guidance manual focuses on the process
 - Heavy use of "should"
- Group view required
- Need an ORSA for a Lloyds syndicate
- National supervisor decides if stress/scenario testing required
- Many other "shoulds", for example:
 - Justify using valuation other than SII
 - Must use ORSA insights in product development & design
 - "Actuarial function" required to be used in forward looking evaluation of technical provisions




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The Encumbered ORSA

Forward looking view

- Consistent with business plan
- Number of years required may be local requirement
- "3 to 5 years" seems common
- Long handle hockey stick versus short handle hockey stick?

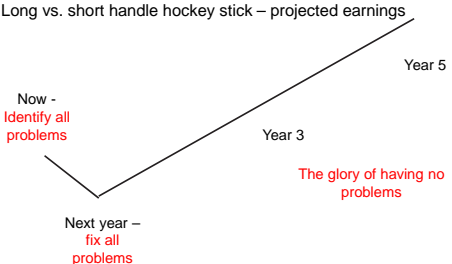
- Perspective on this is probably very different for life vs. non-life
 - Life – financial market volatility
 - 10 year mortality updates
 - Non-life – weather, tort, societal shifts
 - Annual updates to risk (if not more frequent)
- 5 year business plan in 2006?, 1999?



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The Encumbered ORSA

Long vs. short handle hockey stick – projected earnings




Now - Identify all problems

Next year - fix all problems

Year 3

Year 5

The glory of having no problems



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Questions?



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