ORSA: The New Kid in Town

Understanding ORSA and Other Emerging Global Insurance Regulations
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Risk and Compliance: Ever-Moving Targets for the Insurance Industry

The insurance industry was one of the first economic sectors to be regulated – and it continues to be subject to close scrutiny by public authorities throughout the world. For the last 30 years, businesses in this industry have been bombarded with new and increasingly diverse regulations, all designed to ensure that insurers are financially stable. But in recent years, insurance has become far more complex and sophisticated. And many of the earlier regulations put in place can’t address new industry complexities.

For this reason, insurance companies around the world are facing a host of new regulations that go beyond simple compliance. For example, European insurers are consumed with implementing Solvency II, which will take effect in 2016. Many other countries, such as Bermuda, Australia, Canada, Japan, Singapore, China, Brazil and South Africa, are closely following events in Europe and seeking to implement the equivalent of Solvency II in their own regions. And in the United States, the National Association of Insurance Commissioners (NAIC) has introduced the Solvency Modernization Initiative (SMI), which is scheduled for implementation on Jan. 1, 2014.

At the heart of many of these new regulations is the requirement that insurance companies perform an Own Risk and Solvency Assessment (ORSA) – a self-assessment of their current and future risk. This white paper will discuss ORSA requirements in more detail and the concept’s impact on insurers globally.

What Is ORSA?

ORSA is a relatively new concept aimed at enhancing insurer awareness and understanding significant risks and interdependencies, as well as the impact of these risks on each company’s available capital and its own view of capital needs. An integral part of the proposed new solvency regimes globally, ORSA symbolizes a commitment by both regulators and the regulated to embrace a customized, forward-looking system of solvency regulation – one that involves a more holistic, real-time assessment of risk and its short- and medium-term impact on insurers.

One of the key requirements of ORSA is that companies conduct an annual, forward-looking assessment. The result is an ORSA report that includes all material risks to which the insurer is exposed or may be exposed to in the future (e.g., “emerging risks”) and must be managed to arrive at its appropriate risk profile and risk appetite. Risk should not be restricted just on the basis of quantitative risks (i.e., products, market risk, etc.) or measured solely as the economic loss. Rather, risk analysis should include effects on the reputation of the business as perceived by customers, media, regulators and others, as well as the business (for instance, on IT infrastructure, staff and buildings).

The goal is to not only demonstrate that the company’s current capital needs are appropriate, but also that its future capital needs will be met over a specified assessment time frame (usually three to five years). The report also allows regulators to get an enhanced view of an insurer’s ability to withstand financial stress.

It’s important to remember that ORSA is not an independent process. To deliver full value, ORSA should be developed and implemented in conjunction with each insurer’s business plan. In addition, each part of the ORSA process must be conducted in a way that allows participants to challenge the business plan and perform one extra iteration. This ensures that the capital plan actually influences the insurer’s strategic initiatives (see Figure 1).

So ORSA should not be viewed by insurers as a new, static regulatory requirement for compliance. Rather, it should be seen as an opportunity to integrate a number of existing considerations, activities, tools and outcomes to enhance how an insurance company’s board and management team makes strategic decisions.

Figure 1: How Business Plan and Capital Plan Processes Should Interact.
Keys to Enabling a Successful ORSA Process

Many industry leaders consider Solvency II and ORSA to be a “game changer” for the insurance industry, as these regulations represent an opportunity for insurance companies to demonstrate that they understand their own risks and liabilities. But for many insurers, implementing these initiatives will be a major challenge. To help ensure their success, insurers should consider the following best practices.

Capital Planning and Management Best Practices

Chief risk officers (CROs) are responsible for what is commonly referred to as the capital management and planning process, during which they define the medium- to longer-term risk strategy for their insurance organization. The scope of capital management within insurance companies extends from measuring individual component capital to aggregating capital across components and engaging in effective, long-term capital planning.

Using a capital management system to manage the data flow between different business units, CROs can perform risk and profitability planning. This process usually takes into consideration variables such as risk appetite, target market, customer segments, core products, distribution channels and expected return on investments.

The first step in the process – capital measurement and management – requires insurers to identify and model all material risks that can potentially affect their solvency or the long-term value of equity. To have an efficient capital management framework, insurers also need to coordinate the actions of their risk units with actuarial and finance. Planning and budgeting exercises that steer direction for operational actions should be coordinated with a view into risks, profitability and shareholder returns.

At the same time, they need to align their decision-making process with estimates for how much capital the organization needs to have on hand in light of commitments and identified risks. This helps business line managers perceive the constraints and opportunities that economic capital presents in the areas of risk-based pricing, customer profitability analysis, customer segmentation and portfolio optimization.

With effective capital management, insurers should be able to weather extreme internal risk events (e.g., a large operational risk event) and external scenarios (e.g., a catastrophic natural disaster) at an enterprise level. It also helps business line managers to create favorable opportunities, as they can generate an optimized risk-return profile of their product portfolios.

ORSA Framework

<table>
<thead>
<tr>
<th>Actuarial</th>
<th>IT</th>
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<tr>
<td>• Risk exposure assessment</td>
<td>• Data management framework</td>
</tr>
<tr>
<td>• Technical provision calculations</td>
<td>• Internal &amp; external reporting support</td>
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<tr>
<td>• Review of ORSA process</td>
<td>• Risk and legacy system integration</td>
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<th>Risk &amp; Compliance</th>
<th>Finance</th>
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<tr>
<td>• Supervise risk management process</td>
<td>• Financial reporting requirements</td>
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<tr>
<td>• Assess emerging risk</td>
<td>• Manage investment strategies</td>
</tr>
<tr>
<td>• Monitor compliance</td>
<td>• Develop business plans</td>
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<td>• Define risk mitigation strategies</td>
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Figure 2: ORSA Framework for Driving Alignment of Business and IT
Business-IT Alignment Best Practices

Success with ORSA also requires that insurers align the technology that they already have to better enable ORSA processes. The goal is to drive strong alignment between the business and the actuarial and risk management departments of an insurer’s technology group (see Figure 2) - for example, by integrating enabling software and processes supporting data governance, process automation, analytical risk modeling, reporting and decision management.

In addition, IT solutions used to support ORSA activities must be flexible, make it easy to test the viability of business and capital plans for new macroeconomic scenarios, and enable people to extend models to include potential new risk factors for the business. The world is constantly changing, so software should accommodate business planning models designed to handle new types of scenarios and stresses. Through scenario and stress testing of business plans, insurers gain valuable insight into how sensitive their business is to risks such as equity market crashes or a catastrophic natural disaster that hits a region heavily serviced by the business.

Development of a Risk-Based Capital Framework

Risk management activities and compliance with regulations such as Solvency II and the Solvency Modernization Initiative require a sophisticated approach to risk management, financial reporting and corporate governance. They are also heavily dependent on getting accurate, timely information from the business. So IT also needs to establish effective data management and data quality processes. This requires establishment of comprehensive standards, policies and processes for the use, development and management of data.

The Business Benefits of ORSA

Insurance executives must make a choice when developing a business case for ORSA. Some are electing to do the minimum required to ensure compliance. While this approach is less expensive in the short term, it leads to disadvantages over the long term, as it implies a higher cost of capital and results in less sophisticated risk management capabilities.

Other insurers are choosing to invest up front in enterprise-class technology and integrate risk management within their core business processes. These insurers can expect significant business benefits. For example, this technology approach enables insurance executives to gain knowledge and feed it into their decision-making processes for more efficient business strategies and operations. They can also expect to:

- **Increase return on capital.** Optimizing business strategies on the basis of the risk-capital-return trade-off leads to selection of most suitable strategies. Insurers can also better allocate capital to profitable business, which leads to better-quality growth. They can also reallocate capital and risk capacity to take advantage of emerging opportunities.
- **Reduce volatility.** Ongoing monitoring of risks - and active management of those risks - will help reduce volatility. For example, proactive management of risk exposures helps companies carefully select risks that are within the appetite of management. Insurers can also better anticipate risks using forward-looking analyses and take steps to mitigate unwanted risks. Ultimately, understanding how economic risk factors affect the balance sheet results in better risk management actions.
- **Achieve better management of risks and allocation of risk-based capital charges for lower premiums and higher sales.** Optimization of an insurer’s investment strategy results in better investment performance and higher returns to policyholders. At the same time, hedging investment and insurance risks leads to better performance.

How SAS® Can Help

SAS provides an integrated set of solutions for data management, as well as a powerful risk engine that can support the quantitative elements of ORSA and contribute to an effective capital planning process.

UK Insurer Uses Data Management to Meet Solvency II Requirements

To support rigorous Solvency II data regulations, this insurer implemented a data quality framework. This organizationwide approach to data quality established data governance processes that reduced costs and improved business decisions.
SAS is the leader in business analytics and software services. For more than 30 years, we have worked closely with more than 1,200 insurance customers to understand their needs and develop solutions that help them do more with increasingly limited resources. Having worked on more than 50 Solvency II projects worldwide, we have extensive experience with regulatory change.

With SAS, insurers can:

- Accelerate ORSA compliance projects with a robust risk analytics framework.
- Improve data quality for an accurate risk profile and better-informed decision making.
- Reduce the impact of risks and mitigate losses using advanced analytics.
- Lower the cost of ownership with a single, integrated solution.
- Ensure transparency and traceability across the entire process.

Closing Thoughts

Solvency II and other insurance regulations demand a more comprehensive approach to risk management. Insurance companies need to evaluate their business activities more closely to fit with their long-term strategic goals, risk appetite, and regulatory requirements for capital requirements - as well as efficiently manage their capital, as this is critical in the current regulatory environment.

At the same time, they need to be able to anticipate the regulatory and risk changes ahead and deal with them efficiently and proactively. Insurers who have the systems and processes that help them adapt swiftly to change will realize significant competitive advantages, including lower compliance costs, less intrusive regulatory supervision, and greater peace of mind for their board members.

Want to Learn More?

- For more information about SAS Risk Management, visit sas.com/industry/ins/risk-mgmt.html.
- To read more thought leaders’ views on risk, visit Risk and Fraud Insights at sas.com/en_us/insights/risk-fraud.
- To get a fresh perspective on analytics in insurance from industry experts, visit The Analytic Insurer blog at blogs.sas.com/content/insurance.

European Insurer Aligns Capital Management with Business Performance

A leading Italian insurer implemented SAS Risk Management for Insurance to accurately interpret and evaluate its specific risk drivers. Managing approximately 200 different data flows, the solution aggregates relevant data and provides a global evaluation of its risk exposure.