ORSAs

Evolving themes in the ORSA process for Life (re)insurers

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The key role that the Own Risk and Solvency Assessment (ORSA) plays in the overall enterprise risk management of life (re)insurers has been highlighted very clearly in the past year as (re)insurers have grappled with the direct and indirect impacts of COVID-19 on their businesses. Over the past five years, since the introduction of Solvency II, the focus areas and process around ORSAs have continued to evolve and we share with you some general insights on evolving themes and development areas observed, in relation to the ORSA process.

More focussed reporting to Boards

As ORSAs have become more embedded in (re)insurers, developments have been observed in the form that the reporting is starting to take, with some (re)insurers considering much more focussed reporting to Boards and their Board Risk Committees, sometimes through shorter reports, with static information now being included in appendices or ancillary documentation that forms part of the ORSA record. Reporting to the Board has evolved for some (re)insurers with an emphasis on useability of the ORSA reports in highlighting the important risks, how these have changed over the year and the stresses/ scenarios carried out as part of the process. More concise Executive Summaries which highlight clearly areas for Board discussion, as well as firm conclusions, have been crucial in promoting active discussion and decision making at Board level.

Timing of the ORSA process

Some (re)insurers have adopted a process of spreading ORSA reporting across the calendar year, based on a structured timetable agreed at the start of each ORSA cycle. Many important elements are assessed at different points of the year, which has meant continuous ORSA agenda topics at Board/ Board Risk Committee level, with the main objective of the final ORSA report to bring the entire process together. Ensuring the timing of the ORSA processes facilitates effective use in decision making and in business and capital planning has been a critical area of focus for some (re)insurers.

Embedding of the ORSA into the ongoing business cycle

Formally linking the ORSA processes to the business plan/ strategy of a (re)insurer is a critical area of attention for many (re)insurers, and also of regulatory scrutiny, with an expectation that a formalised risk assessment is carried out in parallel with agreeing the business plan/ strategy of the (re)insurer. However, it is worth noting that some (re) insurers are not referencing their latest business plan in their ORSA reporting!

Increasingly, (re)insurers are integrating key elements of the ORSA processes into strategic decision making through specific risk assessments undertaken as part of the decision making process which are presented to the Board, including a relevant sub-set of the ORSA stress/ scenario testing carried out to support the assessment.

COVID-19

The COVID-19 pandemic has presented both a challenge and an opportunity to (re)insurers to assess the resilience of the ORSA processes in such stressed circumstances, particularly in the early days during March/ April 2020. At the earlier stages, the attention was mainly on underwriting related aspects (e.g. mortality, lapses, expenses), operational aspects of working from home and market related and capital impacts. Insurers are now grappling with other, perhaps more strategic issues (e.g. impacts in the medium/ longer term on business and working model, distribution approach and increased regulatory expectations on operational resilience) on their business plans.

Further themes that have emerged over the year include assessing the robustness of the continuous compliance process, focussing on regular assessment and reporting of relevant risk metrics, and reassessment of ORSA policies around when an adhoc ORSA should be produced, the specific risks to be considered in that event and assessing these more thematically if the situation arises.

Emerging Risk Assessment

As demonstrated recently by the COVID-19 pandemic, the risks (re)insurers now face are unpredictable, contagious and globally connected, which means that assessing the risk exposures is challenging. COVID-19 has certainly focussed attention on how quickly risk can transition from being an emerging risk to an emerged risk. Some (re)insurers are exploring dynamic risk assessment which ensures a more holistic assessment of risk which considers velocity and inter-connectivity of risks as well as threat and likelihood. Increasingly, Boards and the senior management are much more engaged in the identification of risks (including emerging risks) and it has become common for (re)insurers to organise specific workshops to discuss stress and scenario selection for ORSA purposes and also emerging risks separately. Areas of development for some (re)insurers are to assess emerging risk as a stand-alone process and to clearly demonstrate the relevance of the emerging risks identified to the (re) insurer in question.

Climate Risk

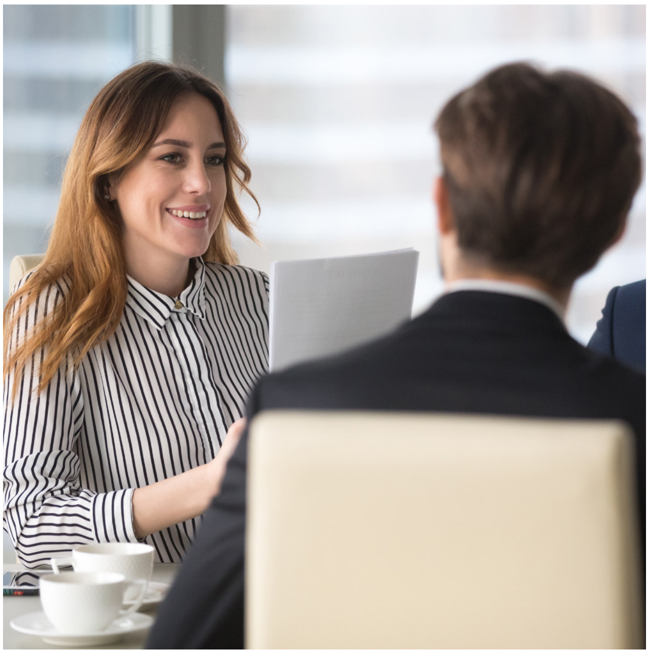
Climate risk has not been considered by most Irish based life (re)insurers in any great detail so far. UK life (re)insurers appear further ahead in this regard with the Prudential Regulation Authority (PRA) issuing publications since 2019 on enhancing approaches to managing financial risks from climate change and inclusion of climate risk in industry wide stress testing. Even in the UK, other than for a small minority of life (re)insurers, climate risk stresses/ scenarios do not feature in the ORSA process, although an assessment of asset related exposures and integrating Environmental, Social and Corporate Governance (ESG) into investment strategies is becoming more of an area of consideration. Tentative steps have been taken by some UK life (re)insurers in setting up specific programs whose task it is to commence assessment of climate risk. We expect attention to ramp up in this area in the short term with a more holistic European regulatory response in terms of stress testing preferable in this regard.

Recovery Plans

While the Central Bank of Ireland has published Recovery Plan guidelines in April 2021[1], many (re)insurers have been trying to pre-empt what the expectations might be in relation to Recovery Plans, with an emphasis on categorisation of recovery plan options into Business as Usual (BAU) options, financing type options (including reinsurance) and franchise destructive type actions (i.e. closing to new business, selling components of the business etc.)[2]. An area of interest, particularly across UK (re)insurers, has been to include an assessment of the challenges of implementing the governance process in a fast moving crisis using any experience of having to convene Board meetings quickly to validate the approach. For some more advanced (re)insurers (particularly UK based) running "war games" to practically test the feasibility of recovery plans has been an area of consideration! These games have helped with the identification of practical constraints that have led to re-assessment of aspects of recovery plans.

Risk Appetite Framework

More dynamic reporting (including use of advanced visualisation tools) has become an important objective for some (re)insurers in the regular reporting of risks to Boards to assess whether defined limits/ tolerances are breached within the ORSA timeframe for each of the stresses/ scenarios. While there is continued attention on limit frameworks/ tolerances within which the business can manage, there is increasing focus on strategic, emerging and reputational risks, though these present challenges in the identification of best approaches to be deployed in monitoring these risks. An area for potential development for some (re)insurers is to show a clearer alignment of the risk appetite framework to the triggers for performing an ad-hoc ORSA.



Stress Testing

The number, range and complexity of stress and scenario testing carried out as part of the ORSA tends to vary quite a bit across (re)insurers. Most tend to be point-in-time stress and scenario tests, rather than a stress or scenario developing at a future point in time or arising gradually over the ORSA time period. Some (re)insurers have become quite targeted in terms of the stresses and scenarios run year-on-year, i.e. not running all stresses each year from a practical perspective, if the impacts are unlikely to be materially different to the previous year. Specific quantitative strategic scenarios within the ORSA have been an area of consideration for some (re)insurers.

Focus has increased in recent years in assessing the management actions that may be used in each of the stress and scenario testing and the feasibility and speed at which these may be undertaken.

Reverse stress testing is still an area of quite varied practice, particularly on the approach to specifically quantifying the level of stress that would break the business model. Generally, reverse stress testing is quite focussed on financial risks. However, recently there has been an increasing trend in the number of operational reverse stress tests being performed, which links to the increased regulatory scrutiny on operational resilience, third parties/outsourcing and so forth.

Operational Risk

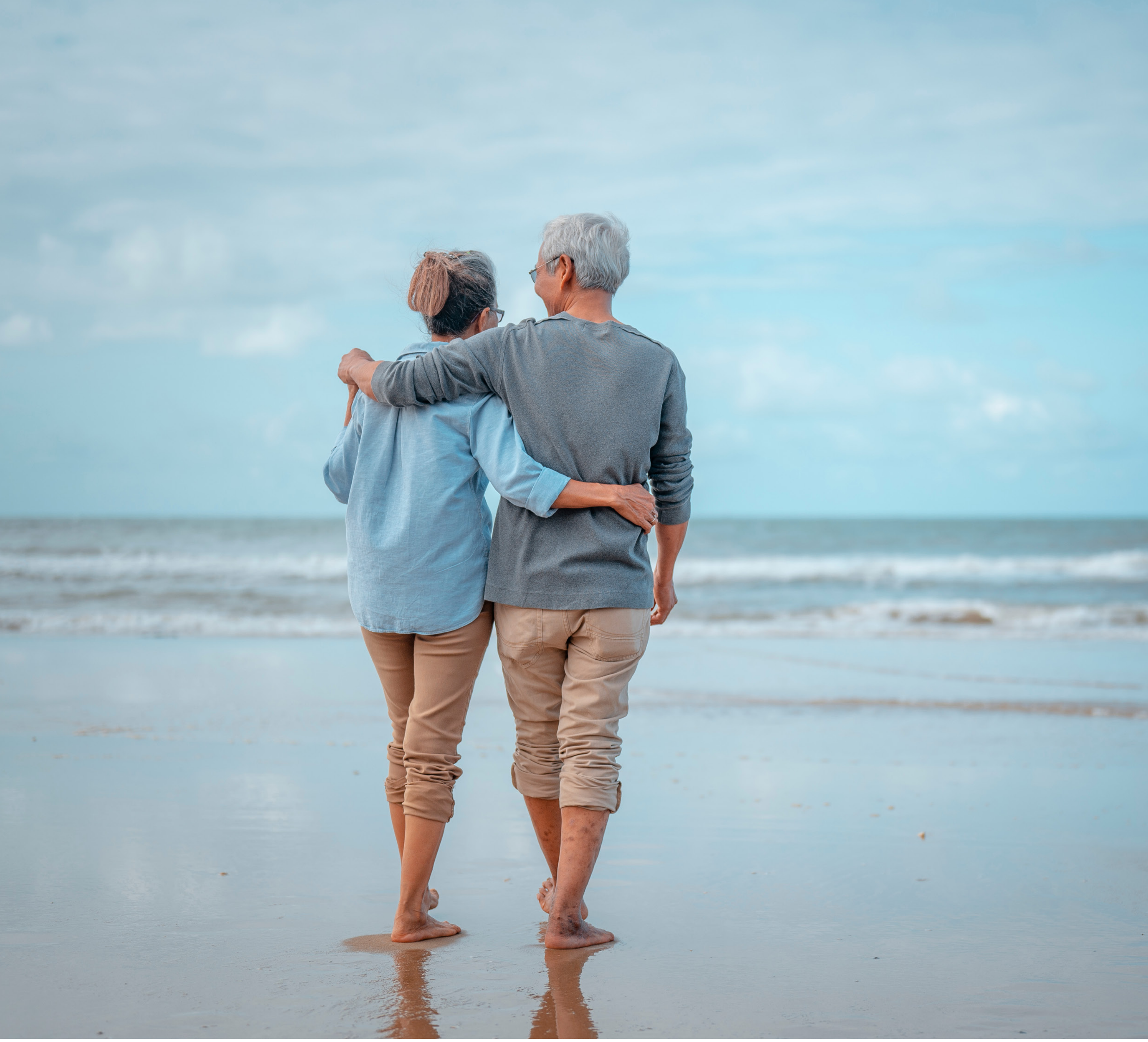
Most (re)insurers have included a range of operational risk stresses within the ORSA stress and scenario testing. However, the approach to the assessment of an operational risk capital charge for the purposes of Own Solvency Needs Assessment tends to vary quite significantly between (re)insurers, including specific stress/ scenario testing carried out using internal models, hybrid models (which look at actual loss data and also additional operational risk scenario testing), qualitative assessments of operational risks with Key Reporting Indicators (KRIs) on systems, processes, products and people environment. Some (re)insurers have a scorecard format to identify areas with increasing levels of risk. Generally there has been a shift – across banking and insurance industries – to place less reliance on complex stochastic models and place greater reliance on consideration of simplified approaches alongside internal and external data. The aim is to strike a balance between placing reliance on models and taking a broader perspective on where operational risk actually exists for (re)insurers (leveraging insight from business experts).

Own Solvency Needs Assessment

To date, some (re)insurers, and particularly Standard Formula capital (re)insurers, have made limited adjustments between Pillar 1 and Pillar 2 assessments of capital. Some regulators across Europe have broadly

[1] Recovery Plan Guidelines for (Re)Insurers (centralbank.ie)

[2] Recovery planning for (re)insurers



allowed insurers across Europe to develop a truly "own view". Some of the more leading Standard Formula companies have carried out quite detailed assessments and have endeavoured to assess capital needs in a 1 in X year event, which can be challenging to calibrate, and using the results to help provide a steer on strategic target limits.

Strengthening the governance framework

A further priority area for many (re)insurers has been on strengthening of the governance framework around the ORSA, which includes:

- Formally demonstrating additional review and challenge of ORSA results within Actuarial and Risk teams;
- Streamlining the stress and scenario projection process to minimise operational risk associated with out-of-model adjustments;
- Documentation of the technical basis for the stress testing – assumptions, methods, calibration of stresses similar to a year-end assumptions basis document.

Furthermore, good practice tends to be for a formal "handover" document between the team that runs the capital projections and the Risk Function, demonstrating the control framework and sign-off process in relation to the projections.

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