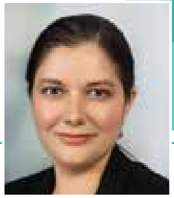

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ORSA
A continuous improvement cycle

South African insurance and reinsurance companies were expected to submit their first ever Own Risk and Solvency Assessment ("ORSA") by the end of August 2015. This was the first compulsory call for submission by the Financial Services Board ("FSB") and, for many insurers in South Africa, this was also the first mock ORSA cycle. For many, this first cycle took the format of compliance and few approached it from a value-add perspective. The next compulsory submission was due September 2016 with the third mock ORSA submission due in 2017, in line with the insurer's ORSA cycle but before the calendar year is over. This may be the last mock ORSA cycle for many, if the Solvency Assessment and Management ("SAM") legislation is enacted in the second half of 2018, as per the latest indication from the FSB.

The ORSA requirements

The FSB has taken the approach to increase the subset of ORSA requirements from one ORSA cycle to the next and to encourage insurance entities to progress towards the full set of requirements, which are outlined in the SAM Position Paper 107 ("PP107").

Submission date for First Mock ORSA: 31 August 2015	Submission date for Updated Mock ORSA: 30 September 2016	Submission date for Updated Mock ORSA: 2017 (in business cycle)	Full ORSA compliance upon SAM implementation date: H2 2018?
The objectives of this ORSA are: • Compliance to most of the 22 guidelines (PP 107 v6); • Design and implement underlying processes and produce documentation to comply with the applicable requirements; • To complete the first full ORSA cycle and use the lessons learnt to improve future cycles.	The following are additional requirements for the Mock ORSA 2016: • Document conclusions and rationale • MI (Management Information), Use and Embedding • Deviations in risk profile versus the SCR calculation • Requirement for a Group ORSA Complete the second full ORSA cycle and use the lessons learnt (and FSB feedback) to improve future cycles.		Expected compliance with all relevant Guidelines (PP 107 v6) will be required. Additional requirements for 2018 cover these areas: • Embedding of ORSA into business; • Board challenge and signing off on assumptions and methodology; • Independent reviews; • Perform out of cycle ORSA's; • Continuous compliance with TPs and SCR If insurers do not yet comply, the amount of work still to be completed is significant and complex.

This year, the FSB has not explicitly increased the scope of the mock ORSA, but has left it up to each insurer to decide whether to progress to the full set of ORSA requirements or to refine the elements contained in the last ORSA cycle.

In April 2017, in preparation for SAM implementation, the FSB published the second round of Prudential Standards covering Pillar II requirements, called Governance and Operational Standards for Insurers ("GOI"). These standards include GOI3.1 Own Risk and Solvency Assessment.

GOI 3.1 Own Risk and Solvency Assessment: At a glance

This standard is pitched at a high level. It sets out the key requirements related to the ORSA policy, performance of the ORSA, maintenance of the ORSA record, review of the ORSA process and reporting requirements. The emphasis is on the ability of the ORSA to make a clear link between the risk profile, risk management and capital management of the insurer. It also emphasises the need for wider communication of the ORSA results and the use of the ORSA in decision making.

The minimum requirements for the ORSA policy are set out. Notably, the ORSA policy must ensure a clear communication plan of the ORSA results to all relevant staff. The policy is also expected to set out the roles and responsibilities in the ORSA process to ensure that the board of directors, senior management and the risk management and actuarial control functions are actively engaged in the ORSA process.

The standard provides for the performance of at least an annual ORSA. It clearly states the need to justify the ORSA basis used (regardless of whether an economic or regulatory basis is chosen). Any deviations between the risk profile of the insurer and the assumptions underlying the solvency capital requirements must be assessed. The ORSA must make a clear link between risk and capital (level and quality of capital resources).

Embedding the ORSA in decision making is a clear focus of the standard. The link between risk management and capital management should be clear and the ORSA should show the sustainability (or lack thereof) of the business strategy across a range of risk scenarios. The Prudential Authority, once established, will look for evidence that the ORSA is embedded into the business and that management actions and capital planning are linked to the ORSA outputs.

In a SAM legislated world, the ORSA process is expected to be independently reviewed and validated by an appropriately qualified person, who is operationally independent from the ORSA process. The independent review is also expected to cover compliance with the ORSA policy.

A record of each ORSA must be kept such that it can be reviewed without unreasonable effort. The record must be complete, accurate and contain clear audit trails.

"Unless exempted by the Prudential Authority (on application), each insurer must submit an annual solo ORSA report, including the methods used in that ORSA." The submission must be within two weeks of the approval of the ORSA by the board of directors and must be accompanied by declarations signed respectively by the Chairman of the Board and the CEO.

Feedback

FSB feedback

The FSB has followed the approach of providing individual feedback to insurers on their first mock ORSA submission. Many, though not all insurers, received this feedback with sufficient time to incorporate it in the 2016 mock ORSA cycle. At the November 2016 workshops held by the FSB, the message was clear: The ORSA will be one of the key supervisory tools used by the Regulator in a SAM legislated environment.

Insurer elected feedback

Many insurers, either through their internal audit functions or through external service providers, elected to obtain independent feedback in order to fast track their ORSA progress. Full independent reviews will only become a requirement once SAM is implemented. Therefore, insurers that have elected to perform compliance style reviews have not only been pro-active but in our experience, have seen significant improvements from one ORSA cycle to the next.

Current trends and expected improvements in the next ORSA cycle

Board involvement and communication

The Board is ultimately responsible for the ORSA process and its outcomes to ensure compliance with the ORSA requirements. To date, for many insurers, the Board has not been involved throughout but rather primarily at the end of the process, in reviewing the ORSA report prior to submission. We anticipate that Boards will become more involved throughout the ORSA process. Better evidencing will be required of the challenge of assigned risk appetite statements and limits, selected stress and scenario tests and reverse stress tests, out-of-cycle ORSA trigger events and ultimate assessment and discussion of the results of the ORSA. With the ORSA focused on linking material risks and capital requirements, as well as linking into sustainability of the strategy set by the insurer, we expect the ORSA to become a standing agenda item for the Board of directors in future ORSA cycles.

ORSA basis

The ORSA allows insurers to choose the basis on which to assess risks and assign capital. Most insurers opt to use the SAM Standard Formula ("SAM SF") as their ORSA basis, with a high level comment around its appropriateness to the insurer's risk profile. More comprehensive ORSAs include a qualitative assessment of the major ORSA components and envisage more quantitative assessments in future ORSA cycles. Early indication from GOI 3.1 is that insurers should justify why the SAM SF is appropriate to the insurer's risk profile, board-approved risk appetite (and related risk limits) and business strategy.

Risk appetite and tolerance statements

Risk appetite statements and associated risk tolerance limits are still set at portfolio level for most insurers. The main focus is on capital needs and some have formulated statements and limits in respect of earnings. Such statements and limits are not yet often set in terms of non-quantifiable risks, which companies will likely develop as the ORSA process matures. The requirement is that the risk tolerance limits be cascaded down to risk types and this will be an area of future development in the next few ORSA iterations for most insurance companies.

Risk assessment

The insurance industry is in the business of taking risk and quantitative risk assessment is an area of strength for most insurers. However, insurers are still developing their processes for identifying and assessing emerging risks and for including qualitative risks within the universe of material risk assessments. For example, very few insurers' ORSAs have evidenced assessing Treating Customers Fairly (TCF) risks and the associated impact on reputation or the potential risks and mitigating actions related to cyber risk.

Stress and scenario testing and reverse stress testing

Many insurers perform stress and scenario tests and project the impact over the business planning horizon, which is usually over three to five years. The stress and scenario tests developed are generally a good reflection of the major quantitative risks faced by the insurer. However, strategic risks are not always considered. For example premium growth assumptions associated with strategy may be significant but not stressed.

Reverse stress testing is an area that requires some development. Firstly, there is no definition of what constitutes a reverse stress test. Many insurers therefore opt for testing a breach of 1 x SCR, being cautious to show the FSB that the insurer could become insolvent.

Additional options to consider could include a breach of MCR or an event which will lead to a negative SCR coverage (i.e. where the insurer does not have sufficient own funds to cover its liabilities) or both. Management actions or recovery plans, should a material risk event occur, are also expected to be an area of development in future cycles. We would expect focus on more detailed response plans so that management is clear on what actions to take, and in what order to respond, should a stressed event occur and consider how pragmatic the proposed action plans are likely to be in each instance.

Embedding and Use Test

GOI 3.1 states that: "An insurer must, at all times, be able to demonstrate to the Prudential Authority that each ORSA is aligned with the risk profile of the insurer, is widely used, is embedded in the decision making processes of the insurer, plays an important role in its system of governance, and informs strategic decisions, especially with respect to capital planning and management."

Therefore embedding of the ORSA is a requirement and enables insurers to meet the Use Test. Embedding the ORSA is not a trivial exercise and insurers will be expected to take a few iterations to fully embed the ORSA in the business. Regular communication of the ORSA results, beyond the Board and Board sub-committee levels, is key. One immediate use of the ORSA is in the dividend decision making process but other areas are expected to benefit from the ORSA as the results get more embedded into the business:

— Reinsurance
— Pricing
— Acquisitions
— New products
— Exiting existing products
— Strategy
— Investment allocations

Group vs Solo submissions

In a SAM-live environment, insurers would need to obtain approval from the Prudential Authority ("PA") to be able to submit a group ORSA, where the insurer is part of a wider group. This was not the case for the mock ORSA submissions, where approval was deemed to have been granted. Insurers that are part of a group should be pro-active and engage with the FSB to understand if there are areas which need improvement to be able to qualify for a group ORSA submission.

Conclusion

This cycle will likely be the last mock ORSA cycle prior to SAM implementation. Insurers will have to decide whether to simply refine key elements of the last ORSA cycle or to move towards full compliance with ORSA requirements. Significant progress has been made by most insurers in the last two ORSA cycles with significant leaps still being expected in future cycles. Those insurers that approach the ORSA from a business use perspective are the ones that are expected to derive maximum value from the ORSA process, much earlier than the insurers that still simply view the ORSA as another compliance exercise.