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2012 Conference: “Connecting Theory With Practice”

22nd Annual CAA Conference

Sheraton, Nassau, Bahamas

November 14 - 16, 2012



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ORSA and the ERM framework – An Individual Company Perspective

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November 15, 2012

ORSA and ERM – Individual Co. Perspective

- Caveats
 - This presentation represents the views of the presenter. I am not here to represent the official views of any of the organizations I am affiliated with.

Outline

- What is ORSA?
- Risk Assessment
- Solvency Assessment
- NAIC ORSA – individual company perspective
- Solvency II ORSA – individual company perspective

What is ORSA?

- A. Town in Sweden
- B. Another name for ORCA
- C. Own Risk and Solvency Assessment
- D. “game changer” for regulators
- E. All of the above



What is ORSA?

- A. Town in Sweden
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ANSWER: (besides E)

a natural part of Enterprise Risk Management (ERM)

Own Risk Assessment (& management)

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

Own Risk Assessment

- Know Yourself
 - Business Model
 - Risk Tolerance/Appetite
 - Can vary by risk
 - Resources/strengths/weaknesses
 - **CULTURE!!!!**

Own Risk Assessment

- Know Your Environment
 - Past – reason for current structure?
 - Present
 - Possible future?

Own 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		

Own Risk Management

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

Investment risks – take then mitigate

P&C insurance risks – mitigate then take

Own Risk Management

- 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

Own Solvency Assessment

- Regulator – focused on Solvency
 - 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.

Own Solvency Assessment

- Economic Capital Models
 - “All models are wrong, but some are useful”
 - Models are tools - tools guide us, don’t decide for us.
 - “Plight of the Fortune Tellers” – Riccardo Rebonato

Own Solvency Assessment

- Economic Capital Models – part 2
 - Learn a lot from building (biggest benefit?)
 - Output is more directional than precise
 - Stress test, Reverse stress test
 - They don't tell you which metric to use
 - They don't tell you which time horizon to use
 - Know when not to use (sniff test)

Own Solvency Assessment

- Economic Capital Models – part 3 – What they can't handle
 - New risks, new correlations, untested correlations
 - Correlations at the tail is guesswork
 - Can't see, observe, calibrate
 - Copula – nice in theory, but parameterization is a guess

Own Solvency Assessment

- Economic Capital Models – part 4 – What they can't handle
 - Examples:
 - Flood maps outdated due to levees, dams
 - “All things correlated at the tail” not true for assets vs. claim liabilities.
 - Fault lines not previously known
 - Impact of new paradigm (e.g., subprime mortgage crisis)

Own 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

Own Solvency Assessment

- Examples of Long-term risk issues – part 1
 - Asbestos – If we knew in 1980 what would be paid over next 30 years, then many insurers would have been declared insolvent in 1980.
 - But most companies weren't.
 - Result was the consequence of numerous court decisions and economic interactions that took place over decades.
 - How many times should you get “heads” in 10 coin flips?
 - Is that estimate wrong if you then get 10 “heads”?

Own Solvency Assessment

- Examples of Long-term risk issues – part 2
 - Real Estate Market
 - Donald Trump was technically bankrupt at one point, based on market/fair value.
 - But he doesn't look bankrupt now.
 - Was fair value the right measure of solvency, when no one forced him to liquidate in a down market?

NAIC ORSA Manual – co. perspective

- Don't expect all states to require the “high level summary report”
- Why?



NAIC ORSA Manual – co. perspective



ORSA and ERM – Individual Co. Perspective

NAIC ORSA Manual – co. perspective

- Three sections to the NAIC Guidance Manual
 - Description of Risk Management Framework
 - Assessment of Risk Exposures
 - Group Risk Capital and Prospective Solvency Assessment

NAIC ORSA Manual – co. perspective

1. Description of Risk Management Framework

- “High level summary” of
 - 5 items (Risk culture & governance, Risk identification and prioritization process, Risk appetite/tolerances and limits, Risk management and controls, Risk reporting and communication)
- Isn't this already learned as part of the on-site exam?
WHAT'S NEW?
- Best done by referencing a standing document, reporting only on what's changed.



NAIC ORSA Manual – co. perspective

2. Assessment of Risk Exposures

- Quantitative and qualitative assessment in normal and stressed environments for each material risk identified in section 1 (in a “high level summary”)
- Manual includes more of the same details in the “high level summary” requirements.
- Sounded good originally, but when you try to do it ...
- Probably best done with an update of key items and focus on hot items/new items.

NAIC ORSA Manual – co. perspective

3. Group Risk Capital and Prospective Solvency Assessment

- “ORSA Summary Report should document how the company combines the qualitative elements of its risk management policy and the quantitative measures of risk exposure in determining the level of financial resources it needs to manage its current business and over a longer term business cycle, such as the next 2-5 years” - in a “high level summary”?
- High level summary vs. Documentation?
- Probably best to meet in-person on hot issues.

NAIC ORSA Manual – co. perspective



ORSA and ERM – Individual Co. Perspective

Solvency II Guidance – co. perspective

Much longer and more prescriptive than NAIC guidance

- Requires comparing “Own” way of viewing capital to the SCR requirement
- Need to justify why a different approach is used, if different from SCR approach
- Strong bias towards SCR approach
- Who’s “Risk and Solvency Assessment” is this?

Concluding Remarks

- ORSA and ERM are great ideas, BUT
- Only useful if really your “own”.
- Great pressure from regulators to dictate the result
 - Wish list items, but what will they do with it?
- Recommend really doing an Own RSA, and having a regular chat with your regulators/supervisors.
- Otherwise – just another expensive compliance exercise.