ORSA1: Exactly what is ORSA? Why does it matter?

Martijn van Wensveen, partner KPMG Netherlands

Wednesday, March 21, 2012
## Solvency II Overview – the ‘3 Pillars’

<table>
<thead>
<tr>
<th>Pillar 1</th>
<th>Pillar 2</th>
<th>Pillar 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>Quantitative capital requirements</em></td>
<td><em>Qualitative supervisory review</em></td>
<td><em>Market discipline (reporting)</em></td>
</tr>
</tbody>
</table>

- **Pillar 1**
  - Market-consistent valuation (balance sheet)
  - Own funds (avail. capital)
  - Economic risk-based capital requirements
    - minimum (MCR): fixed
    - solvency (SCR): SF/IM
  - Treatment of Groups (diversification benefits)

- **Pillar 2**
  - Internal controls and risk management
  - Required functions (governance)
  - Own Risk & Solvency Assessment (ORSA)
  - Supervisory review (entity & group level)
  - Capital add-ons

- **Pillar 3**
  - Transparency
  - Disclosure (link with IFRS)
  - Solvency and Financial Condition Report (SFCR)
    - solo
    - group

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**Compliance and Audit**

Source: KPMG Netherlands
Objectives of Solvency II

- Better protection of insurance policyholders
- Harmonization within Europe – create level playing field
- Risk-based supervision – encourage better risk management

Source: KPMG Netherlands
# Overview of Solvency II regulation

<table>
<thead>
<tr>
<th>Level 1</th>
<th>Solvency II Directive (EU-approved)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Omnibus II</td>
<td>Amendments to Solvency II Directive (post-crisis)</td>
</tr>
<tr>
<td>Level 2</td>
<td>Delegated acts (implementation measures)</td>
</tr>
<tr>
<td>Level 3</td>
<td>Implementing technical standards</td>
</tr>
<tr>
<td></td>
<td>Final guidelines (incl. non-binding technical standards)</td>
</tr>
</tbody>
</table>

Source: KPMG Netherlands
Solvency II Timeline

Date of application SII

Finalisation Solvency II Requirements

L1 Omnibus II: publication & adoption

L2 - L3 IMs: Finalization proposed text by EC

2011

2012

2013

2014

Solvency I in force

Solvency II in force

Approval Procedures in place

Impl. Plan and/or Supl. reporting

6-9 months before L1 and L2 requirements are known

Application of specific transitional measures

Sources: AEGON

= Representing uncertainty or differences in EP and Council proposals
Areas of on-going discussion

- Insurance contract boundary
- Impact on long-term guarantees
- Scope and timing of ORSA reporting
- Expected profits in future premiums (EPIFP)
- Transitional measures
- Audit requirements
- Matching / counter-cyclical premium
- Non-life catastrophe risk
- Non-life and non-SLT health calibration

Source: KPMG Netherlands
Solvency II – key aspects to keep in mind

- Ability to challenge assumptions (principle based)
- Embedding of Risk Management
- Evidencing (reporting and documentation)
- Continuous monitor and be in control
- Alignment of risk and capital with business strategy
- Forward looking (going concern)

Source: KPMG Netherlands
Solvency II Overview – Pillar 2

Pillar 1
Quantitative capital requirements
- Market-consistent valuation
- Own funds
- Economic risk based capital requirements
  - minimum (MCR)
  - solvency (SCR)
- Groups

Pillar 2
Qualitative supervisory review
- Internal controls and risk management
- Required functions
- Own Risk & Solvency Assessment (ORSA)
- Supervisory review
- Capital add-ons

Pillar 3
Market discipline
- Transparency
- Disclosure
- Solvency and Financial Condition Report (SFCR)
  - solo
  - group

Compliance and Audit

Source: KPMG Netherlands
Some risks are better addressed by determining new governance standards and not just by setting additional quantitative risk management requirements.

Source: KPMG Netherlands
## Risk types – taxonomy example from a business model perspective

<table>
<thead>
<tr>
<th>BUY/SELL RISK</th>
<th>SCR</th>
<th>Risk Management tools include</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inherent in insurance products</td>
<td>✓</td>
<td>Hold capital (reserves)</td>
</tr>
<tr>
<td></td>
<td>✓</td>
<td>Monitor realisation vs expectation</td>
</tr>
<tr>
<td></td>
<td>✓</td>
<td>Monitor exposure, apply limits</td>
</tr>
<tr>
<td></td>
<td>✓</td>
<td>Sound pricing</td>
</tr>
<tr>
<td><strong>Mortality &amp; longevity</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>Non-life</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>Equity / interest rate</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>Liquidity</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>TAKE RISK</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Add to balance sheet</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>Credit risk</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>Equity (investments)</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>Real Estate</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>ACCEPT &amp; MITIGATE RISK</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Result of operation</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>Operational risk</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>Strategic risk</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>Reputation risk</strong></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td><strong>Compliance risk</strong></td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>

Source: KPMG Netherlands
Risk Management Qualitative & Quantitative

Strategic Risks:
- Mergers, Acquisitions & Disposals
- Brands
- Housing
- Audit
- Corporate Social Responsibility
- Environment
- Customers
- Communication

Financial Risks:
- Capital management
- Market risk
- Derivatives
- Credit risk
- Reinsurance (4x)
- Product (pricing)
- Underwriting
- Liquidity & concentration risk
- Claims

Operational Risks:
- Fraud
- Integrity
- Human resources
- IT & Infrastructure
- Bus. Protection
- Projects & Programs
- Bus. Processes
- Third Parties (outsourcing & procurement)
- Distribution
- Archive

Regulatory Risks:
- Legal
- Compliance
- Tax

Reporting Risks:
- Financial Reporting
- Financial Management: mandates
- Provisions & Reserves (Life and General Insurance)

Quantitative
Risk Register & Risk Assessment
Stress Test
Scenario Modeling
Data Quality
Stochastic Modeling
Correlations
Diversifications
Interdependencies

Qualitative
Prioritisation & Mitigation
Controls & procedures
Governance & Oversight
Training & Competence Regime
Reporting, Loss Data
Record Keeping
Roles & Responsibilities

Source: KPMG Netherlands
Risk Management needs to cover all aspects of the business cycle

Source: KPMG Netherlands
Capital management and risk appetite

- **Assets**
  - Own funds
  - Other liabilities
  - Technical provisions

- **Own funds**
  - SCR
  - MCR

- **Surplus capital**
  - Target ratio
  - Early warning ratio

- **Available capital** = own funds

- **Current Risk Capital** = SCR

Source: KPMG Netherlands
Solvency II Overview – ORSA

Pillar 1
Quantitative capital requirements
- Market-consistent valuation (models)
- Own funds
- Economic risk based capital requirements
  - minimum (MCR)
  - solvency (SCR)
- Groups

Pillar 2
Qualitative supervisory review
- Internal controls and risk management
- Required functions
  - Own Risk & Solvency Assessment (ORSA)
- Supervisory review
- Capital add-ons

Pillar 3
Market discipline
- Transparency
- Disclosure
- Solvency and Financial Condition Report (SFCR)
  - solo
  - group

Compliance and Audit

Source: KPMG Netherlands
Strategic objectives

- Are our strategic business objectives consistently translated into clear Risk Appetite statements?
- What are our metrics for steering our business?

Past and current performance

- Have we been compliant with the technical provisions and solvency requirements?
- Does our Internal Model represent our risk profile?
- What are our main risk categories?
- Have we covered all our material risks?
- Have our risk-mitigating actions been effective?

Future outlook

- Will we have enough capital to support our future business plans?
- How robust is our current strategy towards adverse conditions?
- What are the emerging risks that could affect us?

Documentation

- Can we evidence our risk process and the outcome?

Source: KPMG Netherlands
The basic ORSA process

In practice the process takes place on different levels in the organization and at differing frequencies

Source: KPMG Netherlands
Thank you for your attention
(and may the ORSA force be with you!)

Martijn van Wensveen
Partner, KPMG Netherlands
Global Head of Financial Management, KPMG Management Consulting
Phone: +31-20-6564015
Mobile: +31-6-51493448
Email: vanwensveen.martijn@kpmg.nl