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ORSA Experience: a consultant's view

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This brief article details my observations as a senior consultant for a leading actuarial consultancy across the Middle East and South Asia. I have three years of experience working for insurance clients in the Middle East, Pakistan and Sri Lanka. It should be noted that in many countries where I have experience, Solvency 2 and ORSA are not regulatory requirements (so far I have only seen it in Qatar).

ORSA has been helpful in shifting the focus from results orientated to process orientated approach in companies where it has been implemented. A process oriented approach allows us to separate efforts from results, which are not positively correlated most of the time. External and complex factors, as well as some random factors with their interconnections, continue to dominate the space between efforts and results. Despite our best efforts, many external risks, like financial contagion to natural catastrophes, can potentially bring ruin in results of companies.

ORSA might be perceived as more technical then it actually is, due to communication gaps and barriers between the different stakeholders involved. To provide a more common ground for mutual understanding, we actuaries have to emphasize that ORSA is not just a problem to be solved—it is a process to be lived. That is why we should continuously try to nurture a mindset in which balancing of risk and rewards is fused in the very fabric of management decision making. We do recognize that better than many sophisticated terminologies, are simplified explanations that bring about clarification. At the same time, we appreciate that there is more reason in data than many of our opinions. One plus one is not generally two when taken across aggregate of huge datasets.

One of the most contentious debates is over the level of complexity to be adopted in the technical and business sides of operations. Technical specialists advocate higher sophistication whereas management usually prefers modeling that is understandable to them. In the context of ORSA, this can be brought to the surface via various issues. Formulaic approaches apply a well-established rule of thumb, or simple factors, to assess capital adequacy which are deterministic, whereas stochastic approaches favor increasing complexity and massive computing and modeling power.

Both sides have their own merits. Each side is just expressing a different perspective of a difficult problem. Factor based methods introduce a powerful simplicity in the calculations required, rendering it easier to narrow the communication gap between the management and the technical specialists. However, many products function non-linearly which is not so neat and simple, and stochastic modeling can uncover such non-linear impacts better.

Another way this conflict can be brought to the surface is management's emphasis on business realities being different from what the consultant advises—as they are isolated from market ground realities. In their pure extreme forms, management spectrum is as dangerous as the clichéd consultant spectrum.

Nassim Nicholas Taleb makes an excellent observation when he notes that the stakeholders do not have "skin in the game"—meaning their observation is divorced from action, leading to understatement of the true risks involved. This is exemplified in its pure and extreme form by the gap between the insurance company management and the consultants. Management is involved in ORSA usually for credit rating or for regulatory sake. Hence, it is seen mostly as a burden by them. On the other hand, consultants are far away from the action and the ground realities and hence focus on mathematical integrity and beauty while sitting on a stochastic time bomb, due to lack of appreciation of the true risks involved.

But in the more realistic grey areas, management and consultants can and do try to minimize communication gaps and complement each other, as management can bring in much needed business awareness and the consultants can merge it with their data orientation to reveal the bigger picture holistically.

Risk culture is foremost for any ORSA exercise because the financial and insurance sector is not solely run by quantitative numbers, but by the underlying human psychology as well. It is up to the risk culture to not antagonize in binary opposites, but reach the middle ground to converge communication and mentalities between different stakeholders.

Reaching this middle ground is worthwhile, considering the challenges for ORSA implementation that I have seen as a consultant:

- **Making ORSA mandatory is a double edge sword.** This is the biggest challenge I have seen in my experience. A company does not bother to do it, so some regulators—like those in Qatar—make it mandatory. But with making it mandatory, it comes to be seen as a regulatory burden rather than exercise in learning more about the business and the risks it faces.
- **ORSA does not come on its own.** When there is a focus on ERM or capital modeling, then as part of those initiatives,

ORSA starts getting attention, too. So if we want to make ORSA more commonplace—especially in countries where there are no regulations for ORSA—we should propagate ERM further.

- **Breaking down silos.** Silos are not perceived as a disadvantage by a company's management and are deliberately made so that no one function or department has the whole data and to prohibit the holistic data and its massive power going into another's hands through any form. We should acknowledge that we are aware of this criticism and that is why holistic data is only given to few top posts in the risk hierarchy with adequate safeguards and controls in place.
- **It is extremely difficult to break traditional hierarchies.** In traditional hierarchies, there is no risk department or Chief Risk Officer (CRO) at a director post. Trying to convince management of the need for a risk department or CRO means garnering a lot of lip service from management. The management does want to appear progressive and modern-but power sharing at the board level with a CRO is another matter altogether. That's why there is no senior CRO post at the senior management or director level and hence this lack of risk leadership means that not just ORSA—but other risk initiatives like ERM, capital modeling, catastrophe modeling, etc.—also suffer. My personal favorite suggestion is to focus on the shale oil and that we need to do stress testing as GCC is suffering from lower permanent oil prices due to shale oil at enormous magnitudes. Once an insurance company is convinced of stress testing, they become lenient and less hard to sell regarding approval for ORSA reporting. Life insurance marketing tactic works quite effectively here that once the customer agrees to do a small favor for the sales agent, they will also likely do bigger favors.
- **ORSA reporting without integration.** It is very easy to hire a consultant and make him draft an ORSA report after few days of interviews with the company's management, but it is extremely difficult for leading managers of the company to fully understand the ORSA reports and make it business-as-usual to integrate the findings and attitude obtained from reports in their daily working routine. As a result, once a year, a consultant makes ORSA report and after showing it to credit rating agencies or regulators, it is put in the cold storage for another year.

ERM programs are facing similar difficulties across the world: effective buy-in from management, compliance exercise vs. company owned management tool, balance between simplistic risk measurement and impenetrable stochastic models, fuzziness of risk culture and so on. These difficulties are heightened in the Middle and South Asia where ORSA is rarely a regulatory requirement. Thus ERM programs are facing headwind that could be detrimental to the quality of the decision making process at the company from this part of the world. ■

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