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HOW TO REVIEW AN ORSA

Co-Sponsoring Organizations:

A Literal Guide to ORSA Oversight

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When it comes to appropriate board oversight of the Own Risk and Solvency Assessment (ORSA) process, there is a great deal of uncertainty and confusion around what is to be expected. While it is clear that boards of directors have accountability for ensuring an organization has an adequate enterprise risk management structure in place and that appropriate capital models are used for decision making, how this is to be completed has been left to individual organizations to determine. This has created angst in the minds of many directors, and even some regulators have expressed uncertainty around how the initial rounds of the ORSA implementation will progress. In such situations, it is often best to go back to basics to determine the true intent of the efforts and the most effective means of evaluating the established processes. For the ORSA process, this means taking a literal look at each of the words that make up the commonly used acronym.

Own

While there is little concrete guidance provided to date from regulators with respect to ORSA expectations, one thing that has been clear from the start is the desire for this process to be unique for each individual organization. Each insurance operation needs to look at its "own" circumstances and evaluate how various risks could impact the achievement of their overall goals and how those risks might jeopardize the ongoing capital position of the organization.

By looking at each organization individually, each ORSA will provide a unique snapshot of the risks faced and the potential impacts if those risks materialize. Much like a fingerprint or a snowflake, each ORSA will be somewhat different from any other. While this provides some beneficial flexibility in tailoring the ORSA process and resulting report to be useful for an organization, it also means an easy checklist of what is to be included is not feasible. There is no template to follow which will work for all organizations. In evaluating the appropriateness of an ORSA for an organization, it will be vital to assess whether that ORSA addresses the key areas of potential impact to that organization. The Board is uniquely positioned to provide independent evaluation of the areas of primary concern and focus to the organization based upon strategic discussions with the executive team. The Board will also need to determine for themselves the level of detail and the precision of the models they require to gain comfort on the risk positions faced.

Risk

In evaluating an organization's relative capital and performance strength, taking into account the risks that the organization faces is vital. Risk in these terms should be interpreted as the volatility of potential outcomes, be they broad economic and financial trends or company specific incidents, which could prevent the organization from attaining its goals. Even more importantly, it requires an identification of circumstances where the ongoing ability of the organization to continue operations could be put in peril.

While it is often stated that risk and opportunity are two-sides of the same coin, in the ORSA process the focus is primarily on the side representing downside risk. The organization must identify and articulate the circumstances and events which provide the biggest potential to derail the organization's plans and to potentially challenge the ongoing viability of operations. With respect to the ORSA report itself, the focus even within this risk context should be on financial risk implications. There can be a number of human resource, strategic, marketplace, and/or reputation impacts that have important long-range impacts, but for the ORSA process as currently contemplated, it is really primarily the financial manifestations of these risk events that matter. Everything needs to be considered in a mature Enterprise Risk Management (ERM) context, and this is a piece of the ORSA review

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required. The focus, however, will remain on the financial aspects, at least for the initial rollout of the process.

In assessing the alignment of the ORSA process for their organization, it will be important for the Board to examine risk at two levels. First, what are the areas of volatility that have the most potential impact on the organization and its financials? This is the identification of the risk set that needs to be considered, and once an initial set has been established, it is important to scrub that set to ensure nothing material has been missed. Once the risk set is agreed, the second stage is to develop the most plausible set of scenarios within which a given risk is likely to emerge. By creating these scenarios, the magnitude of risk impacts can be calibrated to the likely severity of the scenarios outlined. In addition, the scenario review can assist in establishing the likely correlation between several risks by identifying the likely common impacts of the contemplated risk scenario. If both the underlying risk set and the representative scenarios are comprehensively established, a solid risk environment is in place upon which the remainder of the ORSA effort can be completed. The Board needs to feel comfortable that this bedrock is firmly in place as the foundation upon which the final evaluations will be built.

Solvency

As noted above, the primary focus for the ORSA process as currently contemplated should be on the downside volatility for an insurance operation. The concept of solvency reinforces this focus, as it deals with the long-term viability of an organization as an independent, going concern. Solvency is the most basic requirement for any enterprise, particularly one in a highly regulated industry such as insurance, as the independence of the organization and the ongoing opportunity for the Board (rather than a regulator) to lead the efforts are based upon this requirement. Breaching solvency is also one of the most extreme situations to be considered, as there should be a number of early warning signs for an enterprise well before it approaches a solvency crisis in all but the most calamitous shock scenarios.

The solvency concept can help frame the scope of analysis required by the Board, as it helps establish the level of contingency planning needed within the ORSA itself. Taken to an extreme, any risk analysis runs the risk of spiraling out of meaningful usefulness by contemplating embedded contingency actions within embedded contingency actions. For ORSA, the solvency concept means examining whether the enterprise can survive a risk event and retain a positive capital position given its initial surplus level and its business plans. It does not need to consider what actions may be required following that event to adjust future business plans to attain long-range goals. It does not need to evaluate options to capitalize on opportunities the risk events may create. The Board simply needs to determine if the enterprise is adequately capitalized at present to survive a risk event or if changes to current business plans or the raising of additional capital is needed now to provide for such a contingency. The longer-term reactions are for a different day.

Assessment

Finally, the outcome of the ORSA process needs to be a definite assessment of the current capital position of the organization based upon its balance sheet strength; its projected business and strategic plans; the key exposures and risks faced, as well as the mitigation plans established to address those risks; and the overall readiness and ability of the Board itself and its senior executives to deal with stressed environments if and when they emerge. If the ORSA does not provide a solid conclusion on the capital position of the organization as well as the most troublesome risks that it will face from a solvency perspective, the Board needs to request refinements to the report.

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On the other hand, if the ORSA provides Management with the forum to convey confidence in the ongoing viability of the enterprise in a variety of risk scenarios, the Board should feel comfortable that the process has delivered on its primary goal. This assessment will of course need continual monitoring and periodic updating as circumstances change, but with a solid foundation of models and scenarios considered, the follow-on efforts should prove much easier for both Management and the Board to pursue.

Conclusion

The ORSA process is a challenging, but vital, piece of the overall ERM program for insurance operations. It provides the most concrete link between the Board and Management with respect to the ERM process, and it is likely the tool most commonly used by an organization to convey its risk management acumen to its regulators. As such, it will be crucial for both the Board and Management to have comfort on the completeness, appropriateness and adequacy of the ORSA report. The best, and simplest, way to gain that comfort is to focus on the literal components of what is requested. If these four key words have been addressed, the Board can feel good that they have done their part to ensure the organization can survive and prosper in the volatile times ahead.

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