



Forward Looking Assessment of Own Risk

Helping you to prepare for the new regime

A presentation to the Integrated Assurance Network

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TOWERS WATSON 

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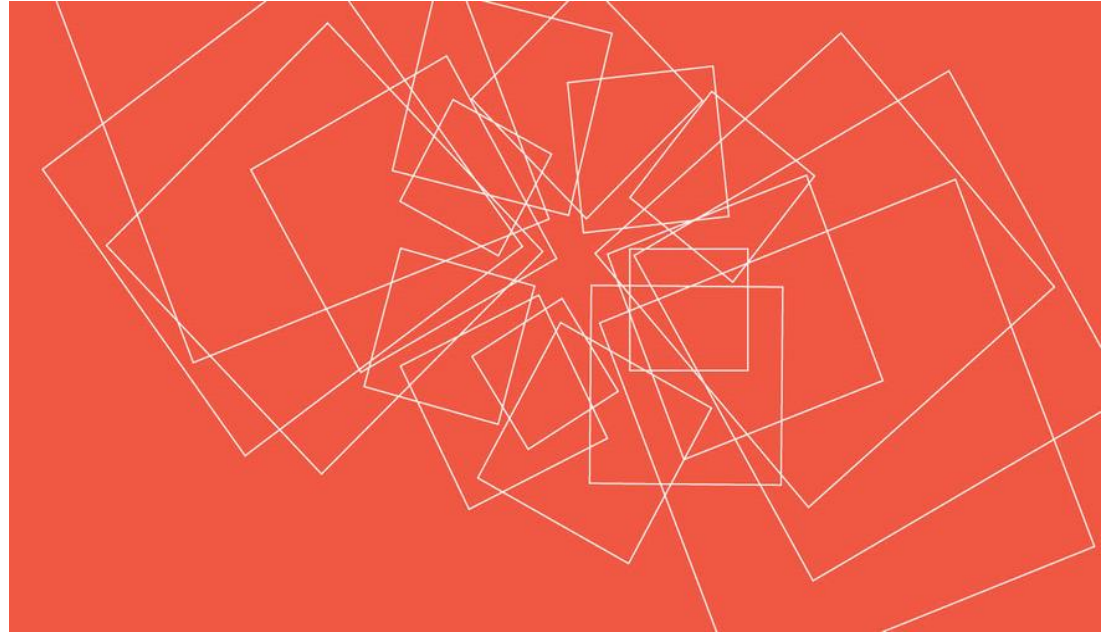
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4. How Towers Watson can help

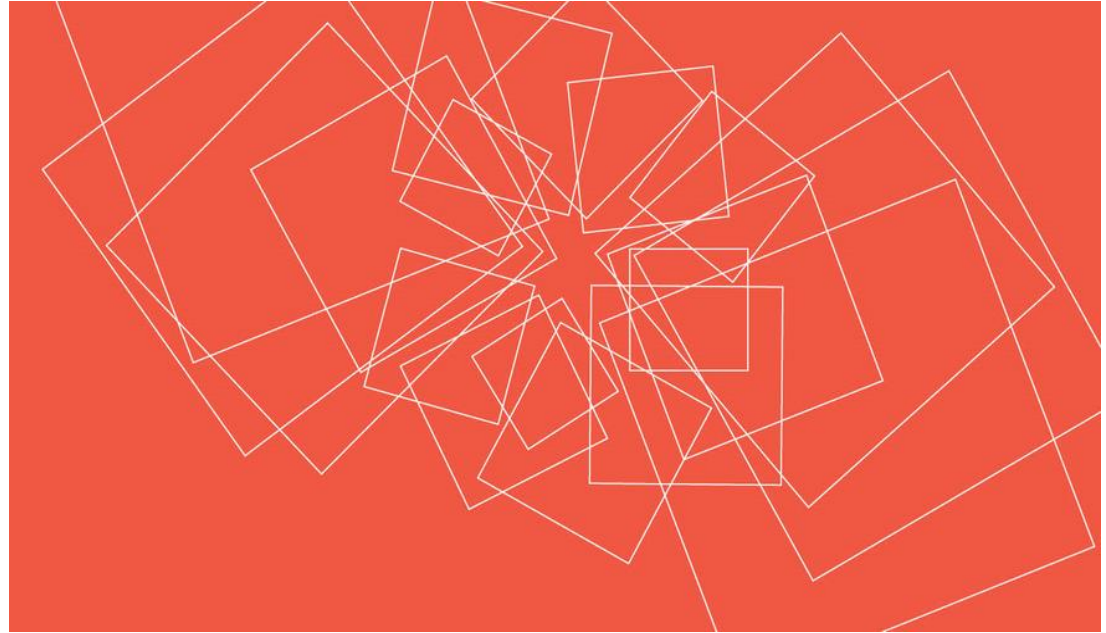
1. Introduction



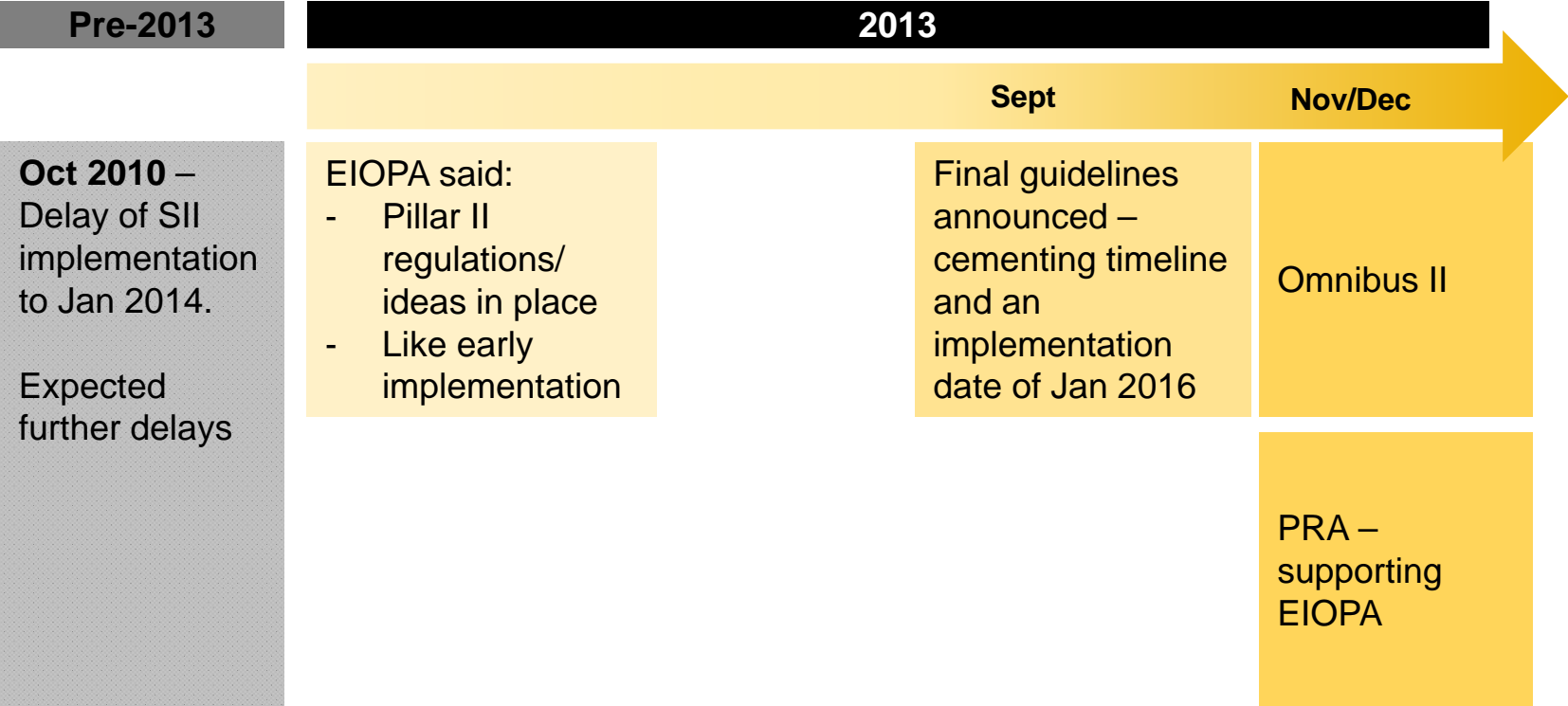
Introduction

- This presentation provides a high level overview of the Forward Looking Assessment of Own Risks (“FLAOR”, previously known as “ORSA”) requirements
- It highlights the impending requirements following the announcement of the Solvency II interim guidance in September 2013, and the announcement of the Omnibus II directive in November 2013, as well as the full implementation requirements that will be necessary from 1 January 2016
- Contact details are provided at the end of this pack

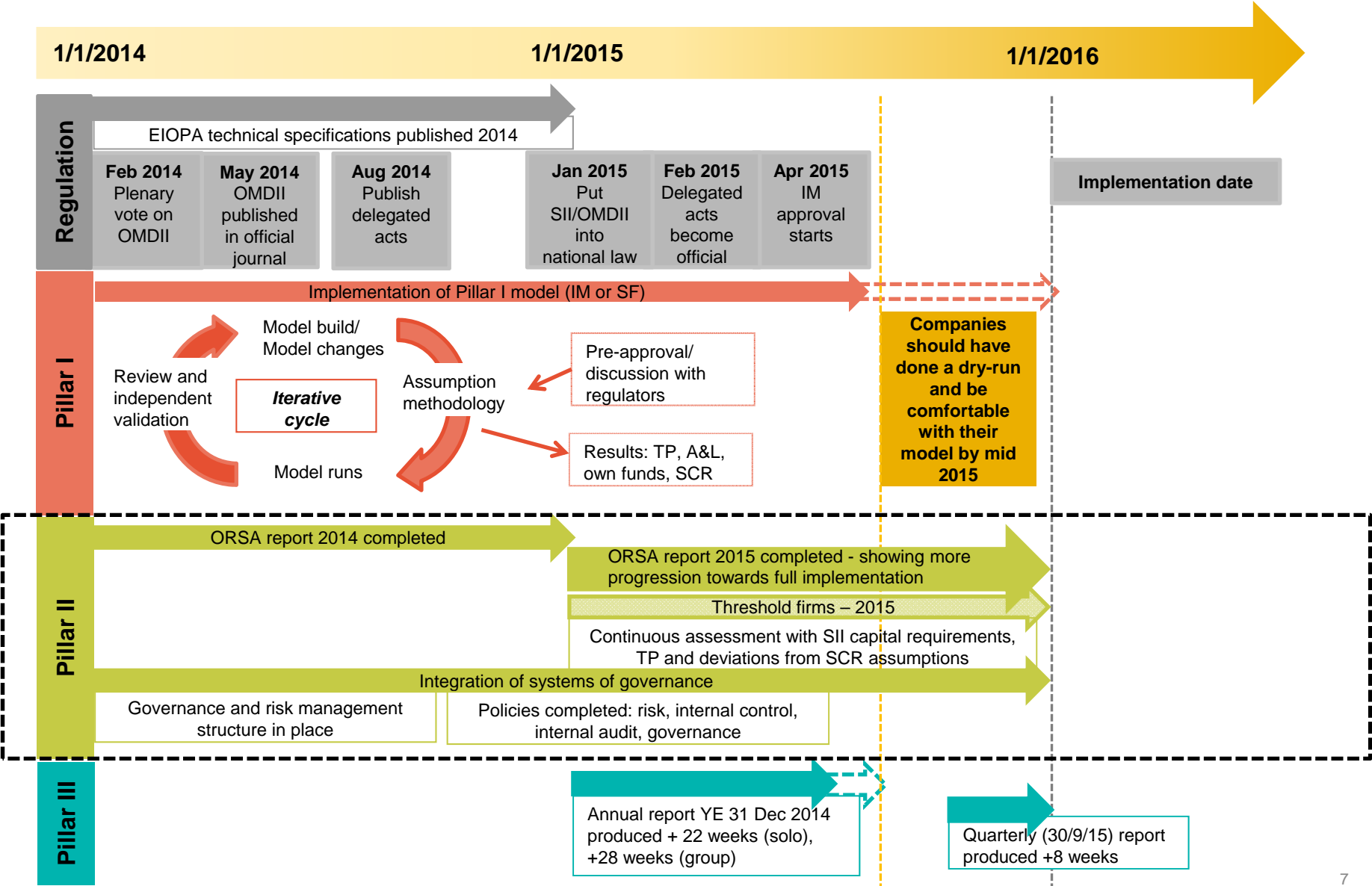
2. Background



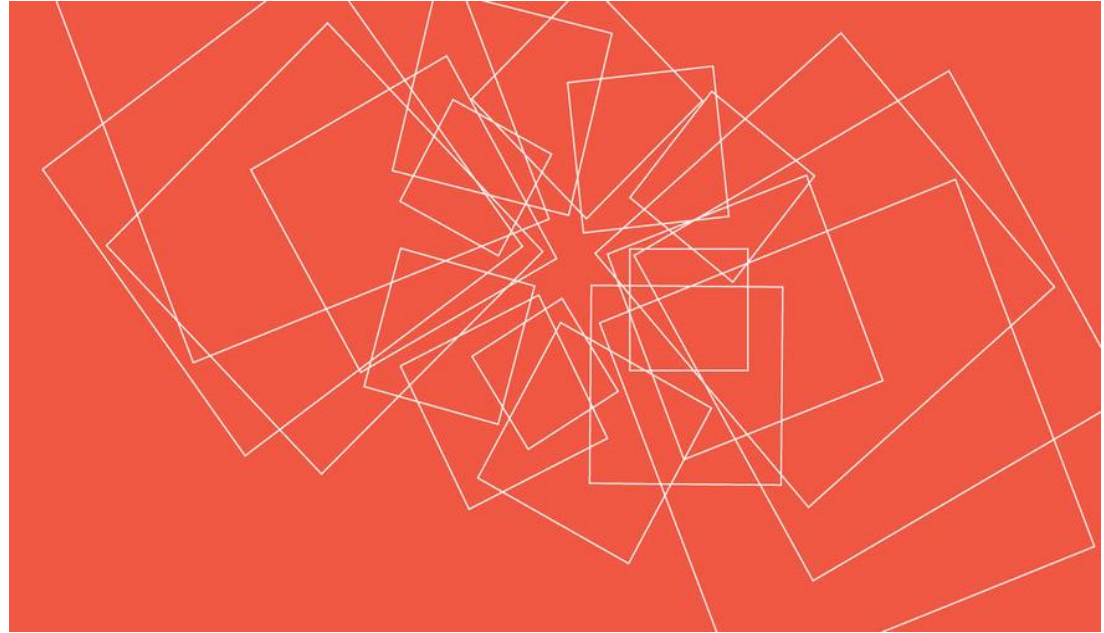
Background to Solvency II



Solvency II roadmap to 2016



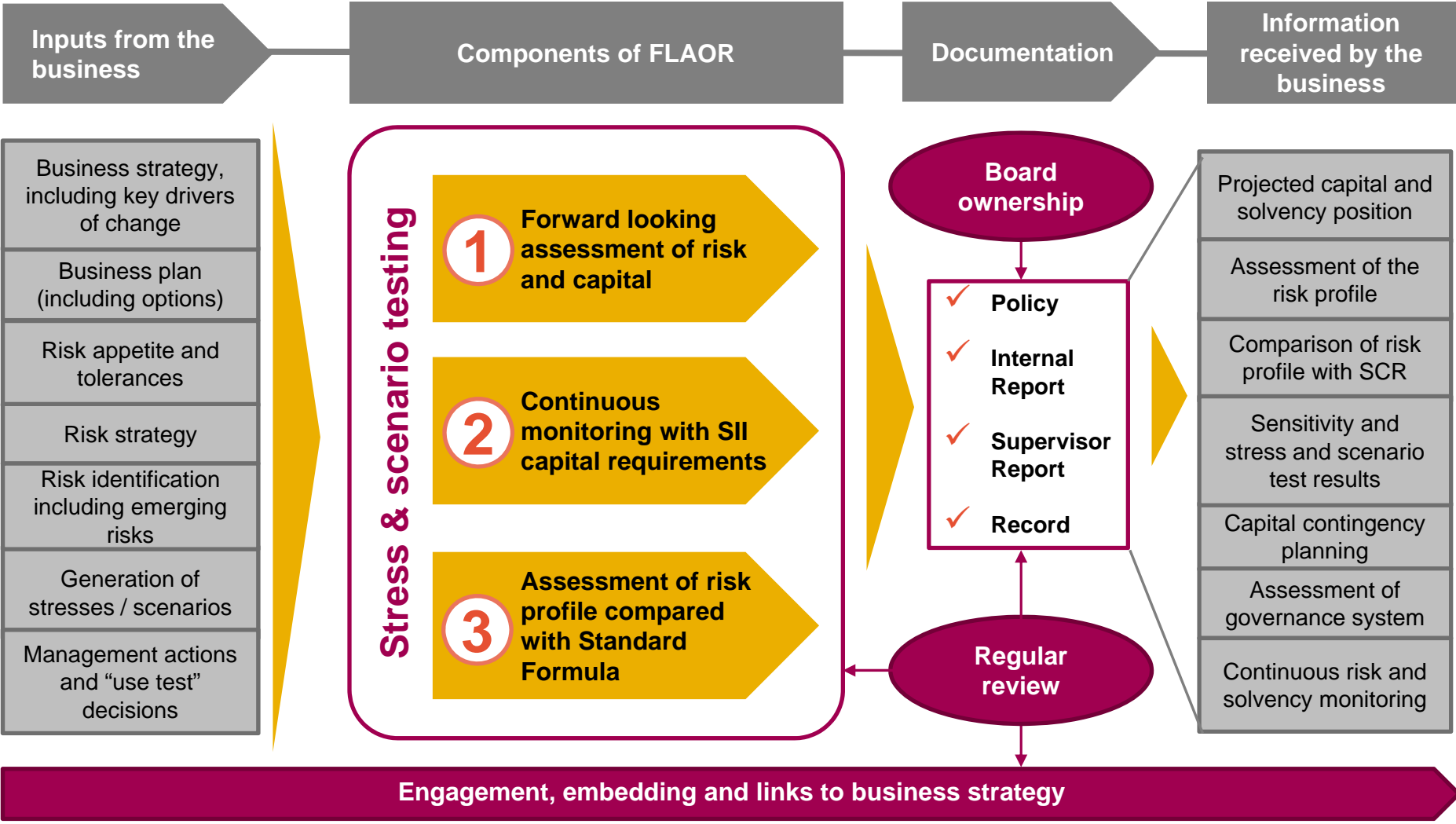
3. Overview of requirements



FLAOR includes three main requirements

All companies	80% of the market + assets under management > €12bn	
1	2	3
<ul style="list-style-type: none"> • Forward-looking assessment of own risks and capital <ul style="list-style-type: none"> • Assessment of overall solvency needs including forward-looking assessment of capital needs 	<ul style="list-style-type: none"> • Assessment of continuous compliance with Solvency II capital requirements and the requirements on technical provisions 	<ul style="list-style-type: none"> • Assessment of how the company's risk profile compares to the assumptions underlying the Solvency II standard formula <div data-bbox="1453 922 1951 1078" style="border: 2px solid purple; padding: 5px; text-align: center;"> <p>Internal model firms are exempt from this requirement</p> </div>
As of 2014		
As of 2015		

FLAOR depends upon wider ERM processes and engagement from the business, but delivers valuable information in return



Forward looking assessment of risk and capital

①

A forward looking assessment of the risk profile, and the capital and other means needed to address these risks

Own Solvency
Needs

=

T = 0
Economic Capital +
other current risk
management
arrangements

+

Allowance for future
capital needs + other
future risk management
arrangements

- Firm's own view of its necessary capital and risk management requirements
- Taking into account future solvency needs
 - Allowing for changes in risk profile
 - Allowing for business plans
- Applies to both standard formula (SF) and internal model (IM) firms
- Requires input from across the business
- Capital needs expressed in quantitative terms
- Supplemented by a qualitative description of material risks
- Subject material risks to a wide range of stresses

Assessment of continuous compliance with Solvency II capital requirements

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- Need to demonstrate “continuous compliance” with SII Pillar 1 requirements of the business planning horizon – both Solvency Capital Requirement (SCR) and technical provisions
- This will require processes for monitoring the regulatory solvency position at the current time, and also methods for projecting the regulatory solvency position forward on different scenarios

The analysis needs to consider:

- Potential future material changes in the risk profile
- Impact of future shocks on own funds
- Quantity and quality of its own funds over the period
- The composition of own funds across tiers during the period
- The capital management plan / policy
- Issuance, redemption or repayment of capital instruments
- Distributions of income or capital
- Ability to raise capital

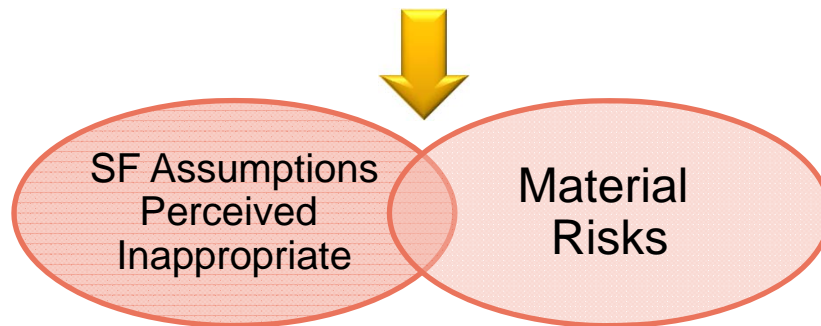


Assessment of how the risk profile compares to the assumptions underlying the standard formula

3

Need to assess “the significance with which the risk profile of the undertaking concerned deviates from the assumptions underlying the Solvency Capital Requirement”

Focus areas



The review process will be unique to each firm – the depth and areas of review will depend on your business, your definition of materiality and proportionality and other factors such as whether an internal model already exists.

Once SII is implemented, the regulator could potentially apply a capital add-on:

“Draft level 2 - Article 268 CA 3

Add-ons in relation to deviations from SCR assumptions – risk profile deviations are regarded as significant if the SCR reflecting the actual risk profile is more than 15% higher than the standard formula SCR. Below this level the supervisory authority can conclude that the deviation is significant or not, depending on the reasons for it.”

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Stress, scenario and reverse stress testing

Forward looking assessment

- Subject the identified risks to a sufficiently wide range of stress tests / scenario analyses to provide an adequate basis for the assessment of the OSN
- Consider loss absorbing capacity under different scenarios
- Consideration of future scenarios including different scenarios for the business plan (i.e. consider changes to the risk profile over time), which are likely to be additional to those used for the internal model

Continuous monitoring

- Regularly carry out stress tests, reverse stress-tests, as well as scenario analyses as part of the business and capital planning processes
- Use experience from stress tests and scenario analyses to determine whether changes in external factors could impact the undertaking's risk profile significantly

Risk profile assessment

Need to include:

- An analysis of the sensitivity of the standard formula to changes in the risk profile, including the influence of reinsurance arrangements, diversification effects and the effects of other risk mitigation techniques
- An assessment of the sensitivities of the SCR to the main parameters

Documentation

- Insurers are required to include in the Policy document information on how stress tests and sensitivity analyses are to be performed, and how often they are to be performed

Documentation requirements

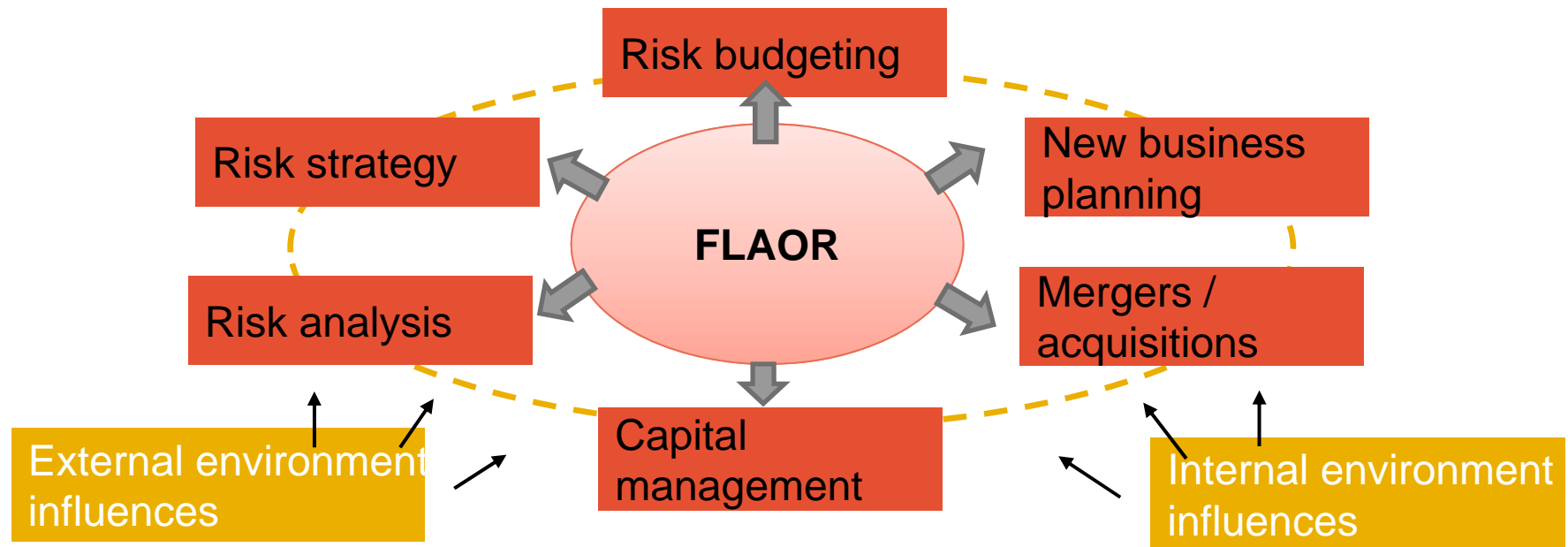
“The information communicated to the AMSB has to be sufficiently detailed to enable it to use it in its strategic decision-making process and the information communicated to relevant staff has to be sufficiently detailed to enable those staff to take any necessary follow-up actions.”
(Guideline 9 supporting text)

- FLAOR needs to be performed at least annually or on occurrence of trigger event
- Documentation required
 - ✓ **FLAOR Policy**
 - ✓ **FLAOR Record**
 - ✓ **FLAOR Internal Report**
 - ✓ **FLAOR Supervisory Report (if different to internal)**
- Longer term the FLAOR will also feed into the Regular Supervisory Report (RSR) and the Solvency and Financial Condition Report (SFCR)
- Some firms may also choose to document the FLAOR process in more detail than is covered in the Policy
- Management body of the organisation needs to take an active role in the process, including approval of the Policy and signing off the Report
- In addition, as part of the system of governance firms will need to undertake an independent review of the FLAOR (this can be internal or external)

Embedding and linking to business strategy

National competent authorities should ensure that the undertaking takes into account the results of the forward looking assessment of the undertaking's own risks and the insights gained during the process of this assessment in at least:

- a) its capital management;
- b) its business planning; and
- c) its product development and design.



“ In deciding on the business strategy, the undertaking has to take into account the output from the forward looking assessment of the undertaking's own risks
Guideline 17 – Supporting text ”

Regular review



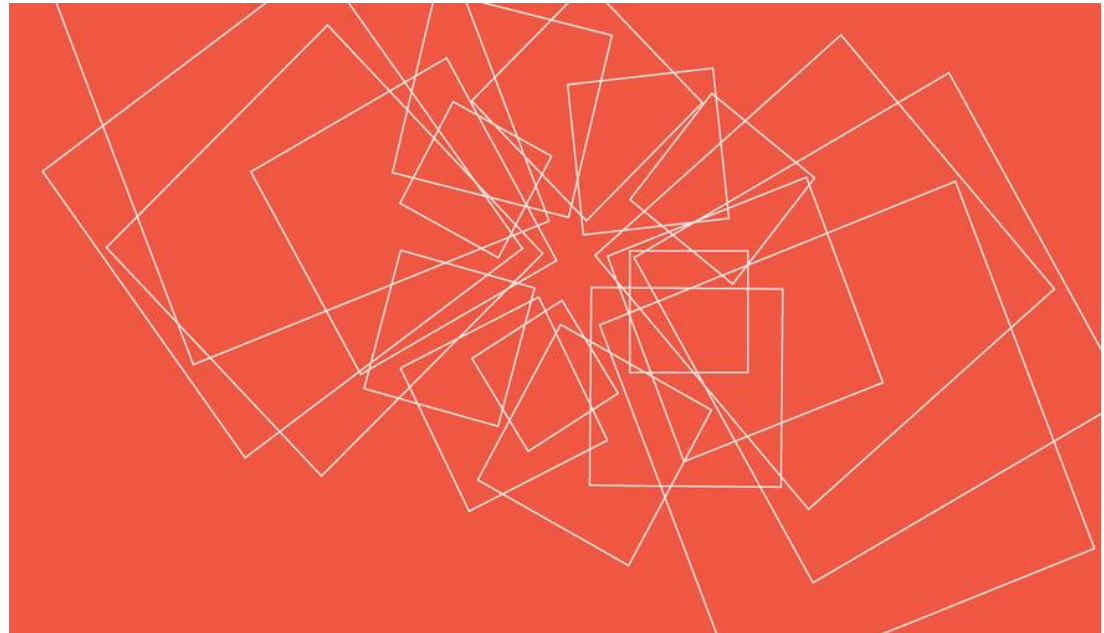
“The system of governance shall be subject to regular internal review”

Article 41, Level 1 Solvency II text

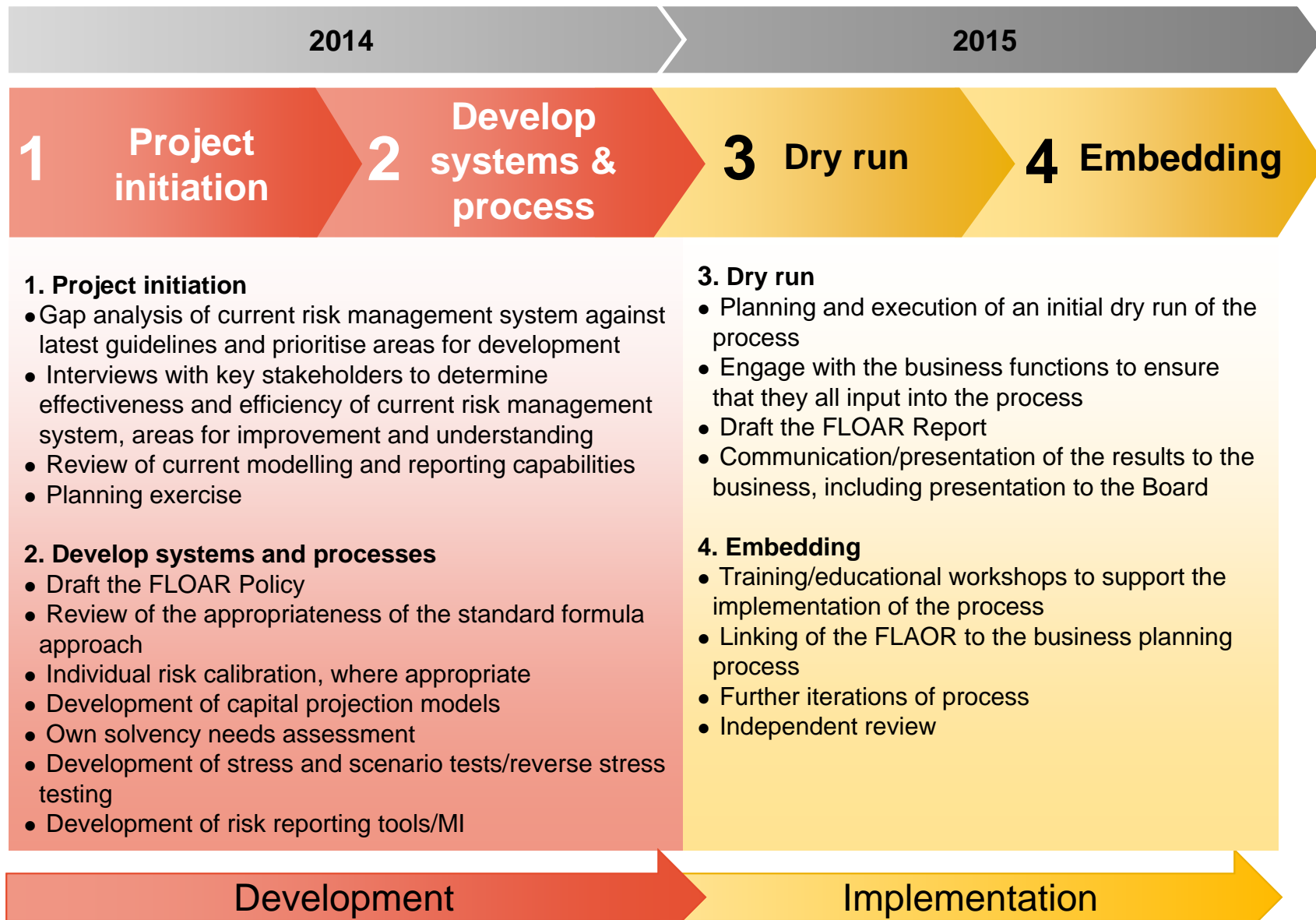


- Despite there being no explicit reference in the FLAOR supporting text, as part of the consultation process, EIOPA has confirmed that firms will need to conduct an independent review as part of the system of governance
- Guideline 8 of the supporting text on System of Governance states that there must be a regular internal review of the system of governance
- Internal audit is responsible for evaluating the functions, effectiveness and efficiency of the internal control system and all other elements of the system of governance. So the review undertaken by the internal audit function can provide input to this internal review of FLAOR.

4. Implementing the FLAOR



Roadmap to implementing FLAOR



Summary slide – take-aways

- Solvency II is firmly back on the agenda
 - January 2016 implementation date
- FLAOR is a major part of Solvency II
 - Everyone must do an ORSA in 2014 and 2015
- 3 main components to FLAOR
 - Forward-looking assessment of own risks and capital
 - Continuous monitoring with SII capital requirements
 - Assessment of risk profile compared with Standard Formula
- All companies must do the forward-looking assessment of own risk and capital
- Threshold companies must consider all 3 components
- Many firms have a lot to do in the next 15 months and the PRA have highlighted that the FLAOR will be at the top of their agenda

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