



# IAIS: Enterprise Risk Management for Capital Adequacy & Solvency Purposes

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# Introduction

The Governance Block of the IAIS **Framework for Insurance Supervision** refers to:

“governance processes and controls in areas such as the Board, directors, senior management and other organisational aspects, fit and proper testing of directors and management; administrative, organisation and internal controls, including **risk management**; compliance with legislative requirements; shareholder relationships; and the governance risks posed by group structures”



# Introduction

- Sound governance is a pre-requisite for solvency regime to operate effectively
- **Enterprise risk management (ERM)** is the process of identifying, assessing, measuring, controlling and mitigating risk in respect of the insurance enterprise as a whole
- Enterprise risk management underpins effective solvency assessment and capital management



# Introduction

*Revised (Draft)*

## ICP 16: Enterprise Risk Management for solvency purposes

- The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.



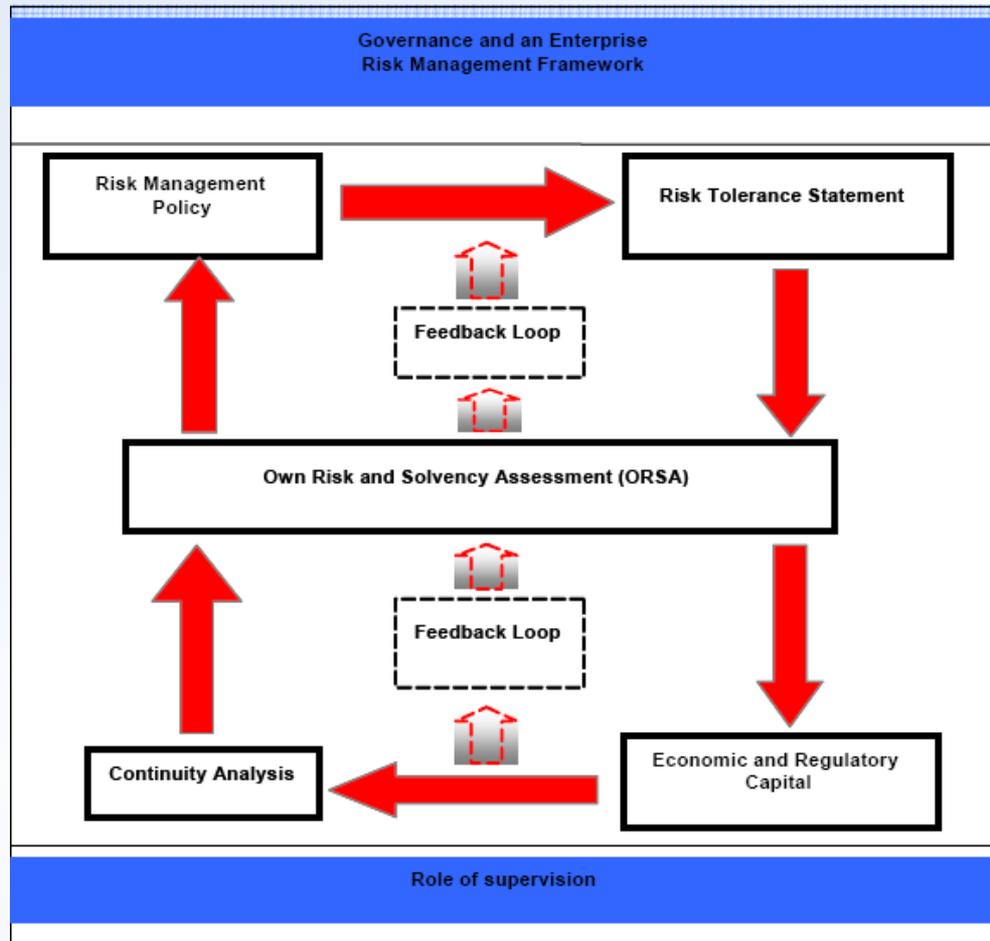
# IAIS: Standard & Guidance

## Standard on Enterprise Risk Management for Capital Adequacy & Solvency Purposes

- This Standard focuses on the enterprise risk management **framework** around the determination of technical provisions and capital for an insurer as a single entity.
- It also discusses conceptual issues related to regulatory financial requirements.
- The standard's **19 key requirements** are based around a best practice enterprise risk management framework.



# Introduction



# Governance and Risk Management

1. As part of its overall governance structure, an insurer should establish, and operate within, a sound ERM **framework** which is appropriate to the **nature, scale and complexity** of its business and risks.
2. The ERM framework should be **integrated** with the insurer's **business operations and culture**, and address all reasonably foreseeable and relevant material risks faced by the insurer in accordance with a properly constructed risk management policy.
3. The **establishment and operation** of the ERM framework should be led and overseen by the **insurer's board and senior management**.



# Risk Identification and Measurement

4. For it to be adequate for capital management and solvency purposes, the framework should include provision for the **quantification of risk** for a sufficiently wide range of outcomes using appropriate techniques
5. Measurement of risk should be supported by **accurate documentation** providing appropriately detailed descriptions and explanations of risks



# Risk Management Policy

6. An insurer should have a **risk management policy** which outlines the way in which the insurer manages each relevant and material category of risk, both **strategically and operationally**.
7. The policy should **describe the linkage** with the insurer's tolerance limits, regulatory capital requirements, economic capital and the processes and methods for monitoring risk.



# Risk Tolerance Statement

## Key Concepts:

- **Economic Capital** is the capital needed by the insurer to satisfy its risk tolerance and business plans from an economic assessment of the insurer's risks, the relationship between them and the risk mitigation in place.
- Techniques should be **proportionate** to the business and its risks.
  - Proportionality means that a complex economic capital model is not necessarily needed.



# Risk Tolerance Statement

8. An insurer should establish and maintain a risk tolerance statement which sets out its overall **quantitative and qualitative** tolerance levels and defines **tolerance limits** for each relevant and material category of risk, taking into account the relationships between these risk categories
9. The risk tolerance levels should be **based on the insurer's strategy** and be **actively applied** within its ERM framework and risk management policy
10. The defined risk tolerance limits should be **embedded in the insurer's ongoing operations** via its risk management policies and procedures



# Risk Responsiveness & Feedback Loop

11. The insurer's ERM framework should be **responsive to change**.
  
12. The ERM framework should incorporate a **feedback loop**, based on appropriate and good quality information, management processes and objective assessment, which enables the insurer to take the necessary action in a timely manner in response to changes in its risk profile.



# Own Risk & Solvency Assessment (ORSA)

13. An insurer should regularly perform its own risk and solvency assessment (ORSA) to provide the board and senior management with an assessment of the adequacy of its risk management and **current, and likely future, solvency position.**
14. The ORSA should encompass all **reasonably foreseeable and relevant material risks** including, as a minimum, underwriting, credit, market, operational and liquidity risks. The assessment should identify the **relationship** between risk management and the level and quality of financial resources needed and available.



# Own Risk & Solvency Assessment (ORSA)

## *Economic & Regulatory Capital*

15. As part of its ORSA an insurer should determine the overall financial resources it needs to manage its business given its own risk tolerance and business plans, and to demonstrate that **supervisory requirements** are met.

16. The insurer's **risk management actions** should be based on consideration of its economic capital, regulatory capital requirements and financial resources.



# Own Risk & Solvency Assessment (ORSA)

*Using an **internal model** for the ORSA*

- Most useful if model supports assessment of all risks as well as economic capital determination
- Useful for current capital and continuity analysis
- Model based on insurer's own modeling criteria, techniques and inputs and subject to its own governance
- No need for supervisory approval of model for ORSA
- Model useful for **supervisory review** as part of ORSA



# Own Risk & Solvency Assessment (ORSA)

## *Continuity Analysis*

17. As part of its ORSA, an insurer should analyse its **ability to continue in business**, and the risk management and **financial resources required** to do so over a longer time horizon than typically used to determine regulatory capital requirements.
18. Such continuity analysis should address a **combination of quantitative and qualitative** elements in the **medium and longer term** business strategy of the insurer and include projections of the insurer's **future financial position** and analysis of the insurer's ability to meet future regulatory capital requirements.



# Own Risk & Solvency Assessment (ORSA)

## **Continuity analysis** is

- the process of ensuring sound, effective, and complete processes, strategies and systems
- to assess and maintain on an ongoing basis
- the amounts, types and distribution of financial resources
- to cover the nature and level of the risks to which an insurer is or might be exposed to and
- to enable it to identify and manage all reasonably foreseeable and relevant material risks.



# Role of Supervision in Risk Management

19. The supervisor should undertake reviews of an insurer's risk management processes and its financial condition. The supervisor should use its powers to require strengthening of the insurer's risk management, including solvency assessment and capital management processes, where necessary.



# IAIS ComFrame

## Common Framework for the Supervision of Internationally Active Insurance Groups (IAIGs)

- Globally consistent
- Specific but not rules based
- Proportional
  
- ERM elements in Module 3



# ComFrame: ERM

## Module 3 Element 1a – Principles of ERM

- Parent of the group responsible for ERM framework of the group

ComFrame Standards	Parameters	Specifications
<p><b>M3E1a-1</b></p> <p>The board and senior management of <b>the parent of the IAIG</b> is accountable for ensuring implementation of the <b>ERM Framework</b> throughout the group.</p>	<p><b>M3E1a-1-1</b></p> <p>The <b>parent of the IAIG</b> demonstrates its accountability by:</p> <ul style="list-style-type: none"> <li>• Having a well defined operational and reporting structure within the IAIG so that information flows easily within the organisation.</li> <li>• Assigning sufficient resources to the formulation of ERM policy, feedback on compliance with the policy, control and enforcement</li> <li>• Ensuring group-wide participation, peer reviews and external review</li> </ul>	<p><b>M3E1a-1-1-1</b></p> <p>The <b>parent of the IAIG</b> demonstrates its accountability by:</p> <ul style="list-style-type: none"> <li>•</li> </ul>

# ComFrame: ERM

## Module 3 Element 1a – Principles of ERM

- ERM strategies, processes and reporting procedures
- Risks and their interdependencies on a continuous basis
- At an individual and aggregated level.

ComFrame Standards	Parameters	Specifications
	<p><b>M3E1a-2-7</b></p> <p>The IAIG has effective group-wide risk management systems in place which comprise strategies, processes and reporting procedures necessary to manage and report on risks and their interdependencies on a continuous basis at an individual and aggregated level.</p>	<p>[Comment: Specifications to be developed on strategies, processes and reporting procedures of effective group-wide risk management systems – examples might be the best way]</p>

# ComFrame: ERM

## Module 3 Element 1a – Principles of ERM

- Includes risk from operating in different countries, different regulatory environments
  - Through subsidiaries, branches & cross-border.

ComFrame Standards	Parameters	Specifications
	<p><b>M3E1a-2-8</b></p> <p>The IAIG embeds its risk management systems in its organisation through risk metrics, methods for aggregating risks, stress and scenario tests, risk tolerance limits, own risk and solvency assessment (ORSA), communication of risk strategy, contingency plans and the decision-making process.</p>	<p>[Comment: Specifications to be developed on risk metrics, methods of methods for aggregating risks, stress and scenario tests, risk tolerance limits, <b>ORSA</b>, communication of risk strategy, contingency plans and the decision-making process – examples might be the best way]</p> <p>Metrics/stresses may include maximum amount at risk and total surrender values and corresponding expected and extreme values..</p>
	<p><b>M3E1a-2-9</b></p> <p>The IAIG's <b>ERM Framework</b> pays particular attention to the risk from operating in different countries and different regulatory environments and considers operations through subsidiaries, branches and cross border.</p>	<p>[Comment: Specifications to be developed about these risks specific to IAIGs]. Examples may include:</p> <ul style="list-style-type: none"> <li>• currency risks</li> <li>• regulatory changes in the countries in which the IAIG does business</li> </ul>

# ComFrame: ERM

## Module 3 Element 1a – Principles of ERM

- Risks arising from non-regulated entities
- Risk management systems – implemented in all group entities & coordinated at group level

ComFrame Standards	Parameters	Specifications
	<p><b>M3E1a-2-10</b></p> <p>The IAIG pays appropriate attention to the risks arising from non-regulated entities.</p>	<p>Typical risks arising from non-regulated entities and how those risks might be addressed are:</p> <ul style="list-style-type: none"> <li>• difficulty in obtaining adequate information</li> <li>•</li> </ul>
	<p><b>M3E1a-2-11</b></p> <p>The IAIG has a proportionate, consistent and effective approach to risk management which uses risk management systems that are implemented consistently in all group entities and co-ordinated at group level. This approach adequately addresses both the risks and the requirements of the IAIG as a whole and those of the various legal entities within the IAIG.</p>	<p>[Comment: Specifications to be developed about consistent implementation and addressing the risks and the requirements of the IAIG as a whole and those of the various legal entities within the IAIG]</p> <p>An IAIG can, for example, verify a well integrated ERM framework in the organisation by:</p> <ul style="list-style-type: none"> <li>• giving evidence e.g. in the Board of Directors (BoD) meeting minutes and risk reports to BoD showing that risk appetite and risk tolerance are regularly discussed and reported.</li> <li>• documenting ERM work</li> </ul>

# ComFrame: ERM

## Module 3 Element 1a – Principles of ERM

- Intragroup transactions
- Counterparty risk

ComFrame Standards	Parameters	Specifications
<p><b>M3E1a-3 [was part of investments but this appears a wider issue than investments. Question: should this be moved to Module 2?]</b>  <u>Intra-group transactions</u></p> <p>Within its <b>Risk Management</b> Policy, an IAIG ensures there are appropriate qualitative restrictions on transactions with and exposures to intra-group counterparties and closely related counterparties or interests over which the IAIG has some influence to limit contagion or reputational risk</p>	<p><b>M3E1a-3-1</b>            Intra-group transactions are done using appropriate transfer pricing based on current market conditions so that there is appropriate recognition of the impact of these transactions for each of the entities involved and the group as a whole</p>	<p>Appropriate transfer pricing has the following characteristics:</p> <ul style="list-style-type: none"> <li>•</li> <li>•</li> </ul> <p><b>M3E1-3-1-1 [was M3E1a-15-1-1]</b>            This does not apply to transactions aiming to stabilize the financial condition of the group, for example the recapitalization of subsidiaries. Intra-group transactions at different than market conditions should be disclosed.</p>

# Questions?

*Thank you*

*Gracias*

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