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Unlocking value from the CISSA

Countdown to Solvency II

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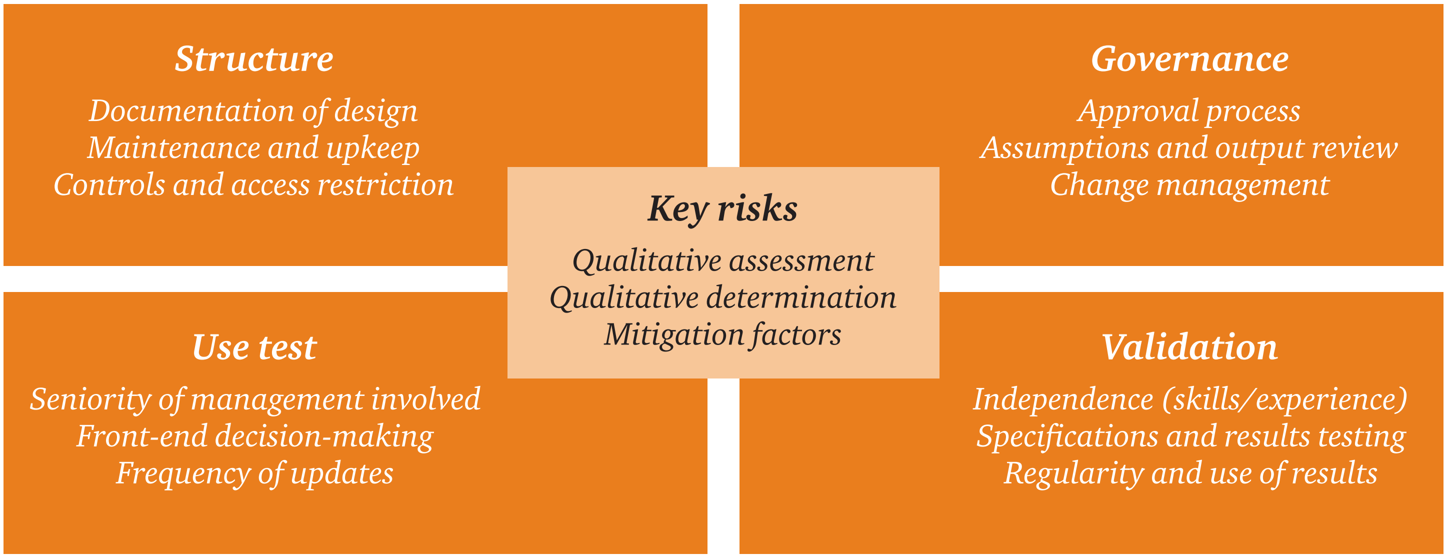
The Commercial Insurer's Solvency Self Assessment (CISSA) is designed to be the primary engine for embedding into the business the goals of the enhanced risk-based regulatory framework being developed in Bermuda in response to Solvency II. The CISSA requires (re)insurers to put a prospective view of their risks, together with their qualitative and quantitative implications, at the heart of decision making. A trial run of the CISSA filing is set for June 30, 2011 (for Class 4, 3B's and 3A's, using 2010 reporting year-end data), so the focus on this should be front and centre.

Figure 1 – Taking CISSA beyond regulatory compliance: a key tool for the risk and capital management process.



The introduction of the Bermuda Monetary Authority's (BMA) draft guidance on the CISSA, although still subject to amendment through the upcoming trial run period, promises to be the most important enhancement in the Bermuda regulatory framework, cutting across all the key elements of risk management, including risk appetite, risk assessment, capital management and business strategy.

Companies that approach the CISSA as a management tool, rather than as a compliance exercise, will be significantly more successful at demonstrating true integration into their business, thereby unlocking its value. The potential benefits of a well-structured CISSA include the ability to:

- Provide useful insights into the capital efficiency of the business and the deployment of funds across a group structure;
- Involve the Board and management teams in broader risk management discussions and decision making;
- Respond more proactively to potential future changes in risk profile; and
- Highlight the extent of management actions that may be needed in the future to respond to significant internal and external events.

When the similar Solvency II Own Risk and Solvency Assessment (ORSA) guidance was first published, many observers saw the ORSA as a stand-alone report, primarily for compliance purposes. That view has started to change significantly in Europe, as it is begun to be seen as part of a continuous process and key management tool; one that can be used to gain value even by those companies with "strong" ratings for their enterprise risk management programs.

In creating their guidance, and as part of the principles-based approach, the BMA want to give management a high degree of discretion in creating a process that can be moulded around their needs and provide a useful aid to decision making. The onus is therefore on each (re)insurer to develop a viable CISSA process and make it work for their business.

Management's view

The capital evaluations within the CISSA should focus on what management itself believes the business will need, and are therefore quite distinct from the capital requirements set by the BMA. Indeed, regulatory and management assessments generally differ quite markedly, especially in cases where one of management's goals is to manage to rating agency requirements at 'A' or better.

The BMA will expect boards and management teams to consider how much capital they need their company to hold to achieve their desired risk profile. This assessment of a (re)insurer's overall solvency needs is dependent on the level of understanding of its risk exposures and its appetite for them. It is therefore critical for companies to be able to identify and quantify their exposures.

As Figure 1 outlines, the assessment should take account of the company's risk appetite, risk profile and business strategy, covering both present and prospective risks.

For (re)insurers with a comprehensive internal model, demonstration of risk identification and quantification is likely to be a relatively straightforward task, although evidencing how embedded this is in management's decision making may still be a struggle for some. However, companies using all or parts of the Bermuda Solvency Capital Requirement (BSCR) as their primary means of determining capital requirements should still be able to demonstrate how they are quantifying their risks and determining their overall solvency needs for their own purposes.

Supervisory review

The BMA will want to see evidence that the CISSA is an integral part of each (re) insurer's risk and capital management system, and will use the CISSA filing to understand the company's attitude towards risk management. They will also expect the board and senior management to be fully conversant with the CISSA process and to demonstrate that the risk assessment is used to inform their key decisions and is embedded within appropriate governance procedures. Although there is no similar ORSA filing currently proposed in the EU, it is notable that a number of EU supervisors, including the Federal Financial Supervisory Authority (BaFin) in Germany and Financial Services Authority (FSA) in the UK, require the delivery of a full ORSA as part of their internal model approval process. This underlines the importance being placed on the process.

The CISSA also requires insurers to compare their quantified risk profile to the results of the BSCR. This is especially important for those insurers with existing capital levels close to the BSCR, as it will highlight to the BMA those areas where the BSCR is not well tailored to the company's actual risk profiles. In addition, for those companies wanting to seek internal capital model approval from the BMA, either in the short or long-term, an established and demonstrated CISSA practice will be an excellent initial step in the approval process.

The BMA also believes that a regular independent validation of the CISSA is a fundamental requirement, one that will also provide significant value to boards and management teams looking to ensure that what they are reviewing and signing off truly reflects the risk management activities and results of the company.

Extending horizons

The prospective view required under the CISSA may take companies beyond their normal capital allocation horizons, but it should align these horizons more closely with the time frame over which the board makes strategic decisions. This will depend upon the nature of the risks the business is exposed to, but is typically considered to be around three to five years.

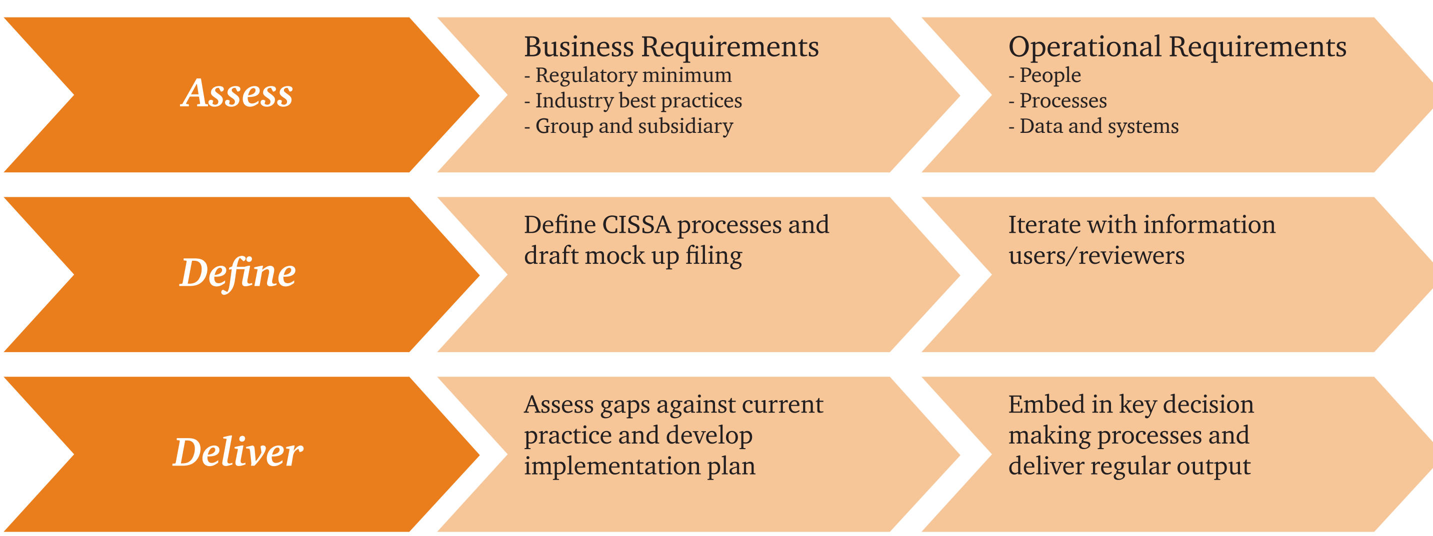
In building out their capital management framework, (re) insurers will have to ensure they continuously comply with regulatory capital requirements. Not only does this mean making sure that the company is solvent today, but also solvent over their business planning period. This will likely require projections of capital requirements over that period, along with the expected level of own funds, to take into account risks that are reasonably likely to arise during this time frame. Should this analysis reveal that the (re)insurer is at risk of breaching its capital requirements, it will be necessary to develop a plausible plan to show how it can strengthen its ability to meet the requirements.

As such, the CISSA goes beyond simply providing warning lights for capital adequacy. It also helps senior management to understand how potential difficulties can be dealt with proactively. Stress testing, including reverse stress testing, will therefore be critical in helping to identify potential threats to the business and preparing plans to alleviate the worst of the impact and appropriately de-risk the balance sheet. In severe circumstances, stress and scenario analysis will enable companies to assess ways to recapitalize the business.

Evidencing compliance

Figure 2 sets out a three-stage approach to articulating and delivering the CISSA. Although many of the elements may already be in place, systems and processes may be disjointed and companies may struggle to provide outputs in a format which have the capability to be efficiently reviewed, including details of how and why they manage risks as they do. The key is being able to consolidate, coordinate and industrialise all the various elements of a risk management framework in a structured and coherent way, enabling senior management

Figure 2 – A practical approach to articulating and delivering CISSA reporting.



to assess and manage the company's solvency position without the need to create a needless extra tier of compliance.

For many companies, one of the hardest elements will be to evidence risk and capital management at a meaningful way at the legal entity level. Although regulation appears to be increasingly focused at this level, most insurance groups align their operations along segment or business unit lines. This can result in difficulties in demonstrating that significant decisions really were taken after considering the impact on the position of the entity, for example in terms of insurance aggregation or investment concentration decisions. For some groups this has resulted in a change in reporting materials, for example allowing boards and executive teams to see legal entity positions, where in the past they were likely only focused on the group as a whole.

In addition, whereas subsidiary level boards have previously been filled by members of management and met only briefly through the year, the CISSA requirements will sharpen the focus of how these boards should look. Even if the independence criteria can be met through group board members, review of the CISSA filing and its supporting documents should likely occur at the entity level. This will again provide an opportunity for the broader senior management team to review the risks of the company and how those risks are managed through both significant decisions and day-to-day operations.

Bringing it all together

To bring all the elements together, we would advocate setting up responsibility to oversee the delivery of the CISSA. The specific components may be developed by dedicated teams (likely within risk and compliance departments) and therefore creating a work stream to deliver the CISSA in its own right is likely to create needless duplication. However, ensuring that a member of management has the ability to look over all of a company's risk management activities and determine what needs to be reported, as well as where the strengths and weaknesses lie, is a key first step to an efficient process and filing.

For the CISSA process to function effectively, risk management should have the power to influence and challenge business decisions. Senior management should also be involved from the outset and show that they are taking appropriate responsibility for the process.

One of the key challenges of bringing them on board will be helping them to develop a clear understanding of what may be complex or unfamiliar risk and capital analysis. This kind of early engagement is also an opportunity. In particular, it will encourage them to think about their approach to risk and how it impacts their decisions. It can therefore let them judge what kind of analysis they should be receiving to help them make more informed decisions.

The CISSA should be conducted regularly to ensure that it continues to reflect the company's solvency position. This includes re-running the CISSA following a significant change in the company's risk profile such as after significant market stress or new product launch. It should also chart how risk is managed, listing who is responsible for what and describing how risk considerations are integrated into decision making. The CISSA will thus be a fundamental driver for embedding and improving underlying enterprise risk management into the running of the business.

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