



Draft Statement of Intent (SOI) for ISAP [6] – ERM Programs and IAIS Insurance Core Principles

Submitted by: The Actuarial Standards Committee (ASC)

1. Background

Regulation of financial services businesses has evolved rapidly in the years since the beginning of the Global Financial Crisis in 2007. The most radical changes have applied to banks, but insurers have not escaped. Enterprise Risk Management (ERM) programs that combine the idea of a comprehensive and deliberate approach to risk management with the concept of aggregate risk evaluation and management have come to be seen as a basic function of insurers by insurance regulators globally. The International Association of Insurance Supervisors (IAIS) has recognized the importance of ERM programs in two of the Insurance Core Principles (ICPs): ICP 8 Risk Management and Internal Controls and ICP 16 Enterprise Risk Management for Solvency Purposes.

These ICPs are intended to encourage insurance supervisors around the globe to incorporate the concepts expressed therein into the regulation of insurers. According to ICP 8 and ICP16, insurer managements are responsible for establishing and operating frameworks to manage the risks to which their firms are exposed, recognising that the intrinsic nature of insurance is to share or to manage risk for customers.

Depending on the level of sophistication or maturity, insurers' approaches to risk management may range from simple consideration of the adequacy of current financial resources to integrated holistic consideration and management of a wide range of risks. ICP 8 and ICP 16 encourage a supervisory-led minimum standard for these activities.

Insurance firms, their stakeholders and competent supervisors all therefore have a strong interest in the reliable operation and transparent governance by insurers of an effective risk management system. The risk management system envisaged by ICP 8 and ICP 16 includes, among other elements, the identification and quantification of risks, developing and maintaining a risk tolerance framework, policies for the management of the underwriting, ALM and investment risks, and the *Own Risk and Solvency Assessment* (ORSA) process. Actuaries play an important role both in advising firms and others on development or selection of appropriate methods, models and assumptions requiring a suitable professional judgment, and in the continuing



operation of the processes associated with such tasks. They do this variously within the actuarial function and as advisers on risk management within or external to firms.

In some jurisdictions, actuaries are called upon to give an actuarial professional opinion regarding the ERM program to the supervisor. It is possible that supervisors will find that their resources do not allow for a thorough review of ERM programs in insurers and may decide to rely upon professional advice and opinions provided by others, including actuaries, regarding the ERM program of an insurer.

Hence the adoption of an appropriate model standard by the International Actuarial Association (IAA) that serves as a basis for actuarial standard setters can greatly raise the trust of users of actuarial services in this area.

The ASC is proposing two International Standards of Actuarial Practice (ISAPs) on ERM:

- ISAP [5] – Insurer Enterprise Risk Models; and
- ISAP [6] – ERM Programs and IAIS Insurance Core Principles (this ISAP).

At the same time the IAA's Enterprise and Financial Risk Committee is developing a proposal for an International Actuarial Note (IAN) on Enterprise Risk Management. These three documents are intended to complement each other.

2. Purpose

Actuarial services in relation to ERM systems that are within the scope of regulations consistent with ICP 8 and ICP 16 are a rapidly growing and highly visible area of actuarial work. Because actuaries in many jurisdictions, with many different types of insurance contracts and practices, will be providing actuarial services in relation to ERM systems, an ISAP (a model actuarial standard adopted by the IAA) is the most effective means to facilitate widely accepted convergence of principle-based actuarial standards within and across jurisdictions (as per Council decision in Vienna in October 2010 and the IAA Strategic Objective 3¹). Hence ISAP [6] is expected to:

¹ Establish, maintain and promote common standards of actuarial education and common principles of professional conduct. Promote the development and issuance of actuarial standards in the jurisdictions of all Full Member Associations, and the global convergence of actuarial standards.



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- Provide useful and high quality guidance to actuaries providing actuarial services in relation to ERM systems that are consistent with ICP 8 and ICP 16, to facilitate widely accepted convergence of principle-based actuarial standards within and across jurisdictions;
- Help to increase public confidence in the ERM work provided by actuaries – With a robust set of standards, the public (including users of actuarial work products, employers and regulators/supervisors) will be more confident in ERM work produced by actuaries. Given the recent performance of the financial services industry, it is clearly in the public interest to promote enhanced ERM practices subject to strict professional standards to avoid future market turmoil.
- Help to achieve greater transparency and consistency – Prior to the financial crisis many firms had ERM processes in various stages of development, but there was little, if any, consistency or comparability. In addition, many ERM practitioners were applying techniques that were often new and untested. Actuaries have a 100+ year history of providing assessments of many types of risk. An ERM standard will support the expansion of this discipline into the areas of contingent losses that are not directly a part of traditional actuarial assessments but which will rely heavily on the time-proven techniques that underlie many traditional analyses of risk.
- Help to give comfort and confidence to boards/managements and regulators of insurance – The lack of a coherent set of standards puts all users of ERM work products in the difficult position of evaluating the quality of the work without knowing if it was done in a professional manner. Actuaries who practice within a set of clearly articulated professional standards (including those addressing ERM) will be relied upon more readily by managers and regulators who want to feel more comfortable regarding the quality of the ERM work they are reviewing. Thus ISAP [6] will help in this area of practice the acceptance of, trust in, and reliance on actuarial services provided in compliance with a professional standard substantially consistent with the proposed ISAP [6].
- Help to promote the development of the actuarial profession – ERM is an evolving discipline and the proposed ISAP will be drafted so as not to slow or stop further developments of this field. Taking a lead role in the development of professional standards for ERM practice, in conjunction with the CERA educational initiative, will clearly establish the actuarial profession as the thought leader in this area.



- Demonstrate the IAA's commitment to support the work of the profession in achieving acceptance of actuaries as valuable professionals in the ERM area.

The guidance provided in ISAP [6] is intended to motivate Member Associations of the IAA and their standard-setters to consider adopting or adapting ISAP [6] for their membership.

3. Scope, roles and content

This standard will apply to actuaries providing their advice or opinion on insurer ERM practices to comply with regulations consistent with ICP 8 or ICP 16.

For this standard, ERM programs are defined as the processes undertaken by insurers to identify, assess, measure, monitor, control and mitigate risks in respect of the insurance enterprise as a whole. ERM programs vary among insurance entities in both form and in the effectiveness of execution. This standard will provide guidance to an actuary who is developing, implementing and reviewing an ERM program, either as an employee of an insurance entity, as an independent professional, as part of an external audit or as a regulator or supervisor of insurance entities on the assessment of the disparate forms of ERM practices, as well as provide standards for effectiveness.

Actuaries are called upon to lead or participate in solvency assessment where ERM processes are considered to be the precursor to or fundamental element of that activity. For example, these activities are critical to the *Own Risk and Solvency Assessment* (ORSA) process.

This standard will assume compliance with ISAP 1 and will avoid restating considerations that are covered there. Issues discussed in ISAP 1 will be addressed if and only if the coverage in ISAP 1 requires further guidance in relation to ERM Programs and IAIS Insurance Core Principles. This standard will focus on processes involved in this work and will address underlying principles rather than prescriptions. In addition, the principle of proportionality will be reflected in the standard by stating that the work required should be proportionate to the nature, scale and complexity of the underlying risks. The following aspects of practice are proposed to be within its scope:

- Risk identification;
- Identification of causes of risks;
- General considerations for techniques for the quantification of various types of risk;



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- General considerations for the determination of risk interdependencies and aggregation of risks;
- The processes for measuring, analysing and modelling risks to the extent that we find any aspects of those processes that are not covered in other ISAPs but that are needed for compliance with ICP 8 or ICP 16 especially for the ORSA process;
- General considerations of the implications of the differences between economic and regulatory capital adequacy;
- ERM framework and risk policy statements including the risk appetite framework and statement;
- General considerations including risks arising in, controls to be applied to, and documentation requirements in relation to enterprise risk management;
- Considerations in relation to the differences between an ERM framework on a solo and on a group level.

The ASC believes that some specific actuarial issues such as the following items are better addressed by one or more IANs rather than in an ISAP:

- Detailed considerations for Risk and Control Self-Assessment;
- Risk Governance and Risk Culture;
- Detailed considerations for Risk Appetite, Tolerance and Limits;
- Infrastructure for risk taking;
- Guidance on specific risk categories;
- Detailed considerations for techniques for quantifying, analysing and modelling various types of risk;
- Detailed considerations for determination of risk interdependencies and aggregation of risks;
- Detailed considerations for implications of the differences between economic and regulatory capital adequacy;
- Reporting of risk management information;



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- Emerging risks; and
- Interactions between Risk management and Actuarial functions

The contents of ISAP [6] will be drafted in accordance with the [criteria and guidelines approved by the Actuarial Standards Committee](#). It is understood that the proposed ISAP will cover areas of emerging and developing practice where actuaries will sometimes be competing with others to provide services and it is not intended to unduly disadvantage actuaries working in such situations.

4. Principle of Subsidiarity

The ASC considered whether the proposal for a model ISAP [6] conflicts with the principle of subsidiarity and concluded that it did not. The ASC confirms its intent that the proposed ISAP [6] is to comply with the principle of subsidiarity.