Session 5: Evolution of ORSA in the US

Moderator:

Michael Anthony McComis Jr. MAAA,FCAS

Presenters:

S Douglas Caldwell FSA,MAAA,CERA

Chad R Runchey FSA,MAAA

Elisabetta Russo MAAA

Enterprise Risk Management Symposium

Evolution of ORSA in the U.S.

April 18, 2018

Presenters:

Mike McComis, FCAS, MAAA – Senior Manager, EY

Elisabetta Russo, FIA, MAAA – ERM Advisor, NAIC

Doug Caldwell, FSA, CERA, MAAA – Chief Risk Officer, Transamerica

Chad Runchey, FSA, MAAA – Principal, EY

Canadian Institute of Actuaries / Institut canadien des actuaires

SOCIETY OF ACTUARIES

Antitrust Compliance Guidelines

Society of Actuaries

Active participation in the Society of Actuaries is an important aspect of membership. While the positive contributions of professional societies and associations are well-recognized and encouraged, association activities are vulnerable to close antitrust scrutiny. By their very nature, associations bring together industry competitors and other market participants.

The United States antitrust laws aim to protect consumers by preserving the free economy and prohibiting anti-competitive business practices; they promote competition. There are both state and federal antitrust laws, although state antitrust laws closely follow federal law. The Sherman Act, is the primary U.S. antitrust law pertaining to association activities. The Sherman Act prohibits every contract, combination or conspiracy that places an unreasonable restraint on trade. There are, however, some activities that are illegal under all circumstances, such as price fixing, market allocation and collusive bidding.

There is no safe harbor under the antitrust law for professional association activities. Therefore, association meeting participants should refrain from discussing any activity that could potentially be construed as having an anti-competitive effect. Discussions relating to product or service pricing, market allocations, membership restrictions, product standardization or other conditions on trade could arguably be perceived as a restraint on trade and may expose the SOA and its members to antitrust enforcement procedures.

While participating in all SOA in person meetings, webinars, teleconferences or side discussions, you should avoid discussing competitively sensitive information with competitors and follow these guidelines:

- **Do not** discuss prices for services or products or anything else that might affect prices
- **Do not** discuss what you or other entities plan to do in a particular geographic or product markets or with particular customers.
- **Do not** speak on behalf of the SOA or any of its committees unless specifically authorized to do so.
- **Do** leave a meeting where any anticompetitive pricing or market allocation discussion occurs.
- **Do** alert SOA staff and/or legal counsel to any concerning discussions
- **Do** consult with legal counsel before raising any matter or making a statement that may involve competitively sensitive information.

Adherence to these guidelines involves not only avoidance of antitrust violations, but avoidance of behavior which might be so construed. These guidelines only provide an overview of prohibited activities. SOA legal counsel reviews meeting agenda and materials as deemed appropriate and any discussion that departs from the formal agenda should be scrutinized carefully. Antitrust compliance is everyone’s responsibility; however, please seek legal counsel if you have any questions or concerns.

Presentation Disclaimer

Presentations are intended for educational purposes only and do not replace independent professional judgment. Statements of fact and opinions expressed are those of the participants individually and, unless expressly stated to the contrary, are not the opinion or position of the Society of Actuaries, its cosponsors or its committees. The Society of Actuaries does not endorse or approve, and assumes no responsibility for, the content, accuracy or completeness of the information presented. Attendees should note that the sessions are audio-recorded and may be published in various media, including print, audio and video formats without further notice.

Agenda

- Opening remarks and introductions
- US ORSA overview
- NAIC regulatory update

US ORSA Overview

Chad Runchey, FSA, MAAA
Principal, EY Insurance Risk Management
Chad.Runchey@ey.com

US ORSA overview

Background

- Many jurisdictions (e.g., US, Canada, Bermuda, EU) require companies to maintain an Own Risk and Solvency Assessment (ORSA) process and develop a periodic summary report as part of their solvency regimes
- The US NAIC defines the ORSA as *“an internal assessment…conducted by [the] insurer of the material and relevant risk associated with an insurer’s current business plan and the sufficiency of capital resources to support those risks.”*
- The two primary goals of the ORSA, per the US NAIC, are:
  - To foster an effective level of enterprise risk management at all insurers through which each insurer identifies, assesses, monitors and reports on its material and relevant risks, using techniques that are appropriate to the nature, scale and complexity of the insurer’s risks, in a manner that is adequate to support risk and capital decisions
  - To provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view

US ORSA overview

High-level requirements

- Design, implement and conduct an ORSA process
- Annually create a summary report including information regarding:
  - (1) Description of risk management framework;
  - (2) Assessment of risk exposures; and
  - (3) Group risk capital and prospective solvency assessment
- Produce and retain documentation and materials to evidence the efficacy of the ORSA process for internal and external stakeholder review

US ORSA overview

Experience to date

- Many companies submitted their first ORSA Summary Report in 2015 (making 2017 submissions the third annual report submitted to regulators)
- ORSA Summary Report submissions generally have, and are expected to continue, to evolve and mature over time
- Initial observations on ORSA Summary Reports
  - Length/level of detail varies across sections – body of most reports range from 30 to 60 pages
  - Risk framework information – generally covered well in Section 1 of the ORSA
  - Risk coverage
    - Essentially all reports cover market, credit, liquidity, insurance and operational risk
    - About 50-75% (most) cover strategic, legal/compliance, reputational and regulatory risk
    - Roughly half cover IT/Cyber risk, but we expect this to rise with continued focus from the NAIC and recent IT security-related issues at insurers
  - Stress/scenario testing approaches
    - Number of stress tests vary considerably, with a majority completing at least 6-10 stress tests
    - Most companies, but not all, include a forward looking capital projection, with 3-5 year projection periods most common
  - Level of regulatory engagement/feedback has varied by state

Connecting ERM and ORSA

Components of an ERM framework and ORSA

US ORSA Report
Section 1:
Description of the Insurer's Risk Management Framework

Overall governance arrangements

- Strategy and risk appetite
- Oversight arrangements

Decision and planning support

- Technical pricing and value contribution is core input to product design
- Metrics to identify underperforming portfolios

Risk identification

- Covers all types of risks
- Identifying emerging risks

Risk assessment and measurement

- Single version of truth
- Reflects risks presented

Risk monitoring and management

- "Industrialized" production of risk analysis

Risk reporting and management information

- Information to drive business decisions
- Clear, concise and reflective of current status

Data, IT, infrastructure

- Integration of risk and finance systems architecture
- Data to be consistent, complete, accurate and auditable

Policies, standards, internal controls, people and culture

- Clear ownership of tasks and activities
- Consistent policies and standards
- Robust internal controls

Insurance | Credit | Market | Liquidity | Operational | Legal/ Compliance | Reputational

US ORSA Report
Section 2:
Insurer's Assessment of Risk Exposures

US ORSA Report
Section 3:
Group Risk Capital and Prospective Solvency Assessment

The quality of an ORSA Summary Report is bounded by the quality of and insurer's ERM framework

Industry perspectives on ORSA
US ORSA Summary Report – Section 1

- Much of the industry has a well-documented ERM framework, but evidence of use and effectiveness remains inconsistent

Industry perspectives	Common capability gaps	Implementation challenges
• Many companies feel that current capabilities meet most of the requirements of Section 1 of the US NAIC ORSA Guidance Manual • Certain companies with immature ERM programs need to formalize aspects of their frameworks to address gaps • Governance structures in the insurance industry vary considerably from other financial services companies	• Risk appetite and limits frameworks • Strong risk culture • Evidence of risk management's role in the business and strategic decision-making process	• Companies have struggled to directly link risk appetite and limits across key risk types • Including quantitative measures in the risk appetite requires the adoption of a consistent quantitative measure of risk • Consistent implementation of an ERM framework across an insurance group can be a challenge across countries (e.g., multi-nationals) and lines of business (e.g., P/C vs. Life)

Industry perspectives on ORSA

US ORSA Summary Report – Section 2

- Companies must quantitatively and qualitatively assess key risk exposures in normal and stressed conditions

Industry perspectives	Common capability gaps	Implementation challenges

• Current risk assessments are highly dependent on risk taxonomy
    • In general, Life companies are less focused on operational risk
    • In general, P/C and Health companies are less focused on investment/market risk
• Companies that have moved towards an economic capital framework often have a more mature quantitative approach in place
	• Quantitative and qualitative assessments supporting all risks in a comprehensive risk inventory
	• Consistent metric/basis to measure risk exposure across risk types
		• Determining how to perform the assessment under “stressed” conditions when the metric may already be under a stress (e.g., stressing interest rates in a low interest rate environment)
		• Building a more robust approach for both qualitative and quantitative assessment of a broader range of operational risks
		    • Difficult due to a lack of exposure data
		    • Quantitative approaches often require significant approximations

Industry perspectives on ORSA

US ORSA Summary Report – Section 3

- The group risk capital and prospective solvency assessment components are both complex aspects of ORSA

Industry perspectives	Common capability gaps	Implementation challenges
• Group risk capital and prospective solvency assessments are complex and were not always a part of insurer ERM frameworks prior to ORSA • The flexibility provided by the US NAIC ORSA Guidance Manual has left many companies with questions on how to complete this section	• Limited focus on "group risks" (e.g., fungibility of capital between legal entities in stressed conditions) • Projection of future income statements and balance sheets (including new business) under stressed conditions for key risks documented in the ORSA Summary Report • Forecasting of future capital requirements, in particular, under internally developed measurement frameworks	• Accounting differences across geographies and product lines increase difficulty in relying on existing frameworks • Comprehensive views of future balance sheets under various accounting regimes (e.g., Statutory, GAAP, Economic) • Approaches for calculating future required capital components for calculation intensive balances (e.g., projections of stressed market value of liabilities) • Incorporation of multiple capital frameworks to model future distributions of excess capital • Reliable aggregation of financial statements across legal entities

Industry perspectives on ORSA

Areas of focus for 2018

- Areas of focus for 2018 ORSA Summary Report submissions include:
  - Risk appetite and limits framework
    - Stronger risk appetite statements with more connected limits and tolerance thresholds are a key area of improvement
  - Capital projections, quantitative analysis, risk reporting and explanations of analysis/results
  - Reflection of business and strategic planning in the ERM framework and ORSA process
  - Continued evidencing of use of the ERM framework and ORSA process in managing the company

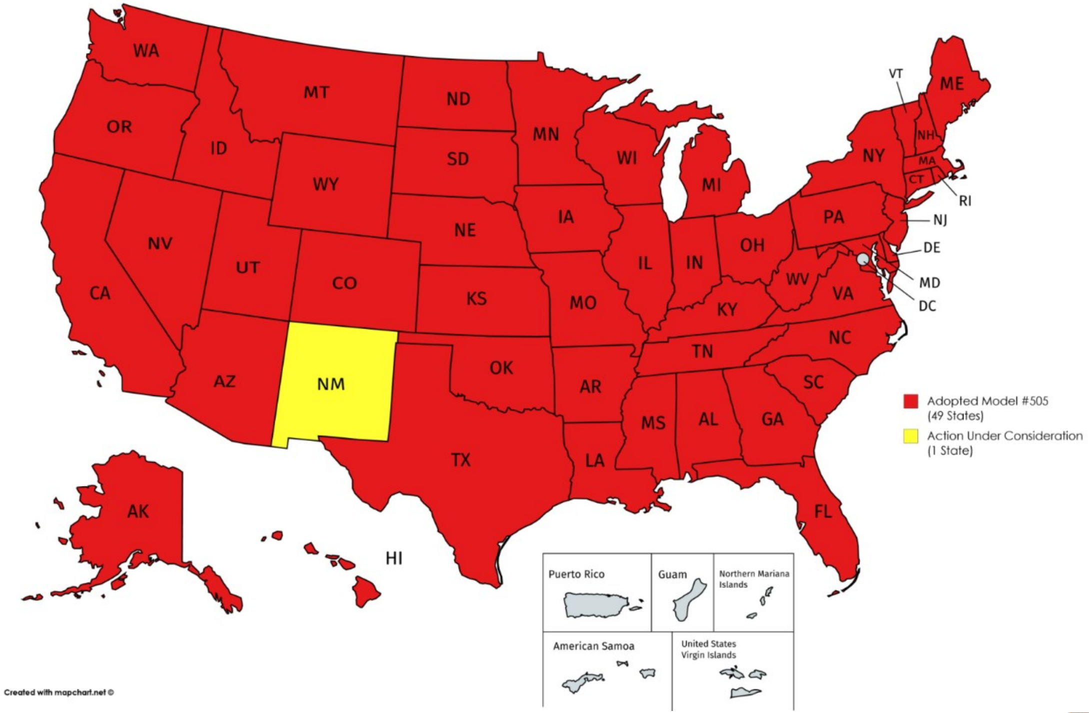
Enterprise Risk Management Symposium

NAIC Regulatory Update

Elisabetta Russo, FIA, MAAA
ERM Advisor, NAIC
erusso@naic.org

ORSA Implementation

State Adoptions of Model Act #505



Update as February 26, 2018

Source: http://www.naic.org/documents/committees_e_related_smi_dashboard.pdf

ORSA Implementation
Insurers' experience

- For several states, 2018 is the 4th round of ORSAs and ORSAs are improving
- 300+ reports expected in total (approx. 200 at group level, 100 legal entity only) - excluding international premium data
  - More than 100 from health insurers
  - Life insurers and P&C insurers are more ORSA-ready than health insurers
  - NAIC has reviewed half of them
  - NAIC industry feedback document after 2014-5 ORSA pilot still good reference: http://www.naic.org/documents/committees_e_isftf_group_solvency_related_orsa_feedback_pilot_project.pdf
- **The Good:**
  - US ORSA is principle-based and not prescriptive, so insurer chooses how to measure risks, how to quantify capital, the stresses, the projections
  - Forcing more discipline around risk management
- **The Not-So-Good:**
  - Interpretation issues – need for more guidance on NAIC ORSA Manual requirements and regulatory feedback
  - Compliance fatigue – more risk-related regulations than ORSA in the near future (see last slide)
  - Quantitative challenges – quantification of risk limits, risk exposures, risk capital
  - Robust rationale – evidence that methodologies, assumptions and stresses are "fit for own risk profile"
  - Use versus compliance – evidence of how ORSA is used in the business decision making process

ORSA Implementation

DOIs' experience

- Priorities of the Departments of Insurance (DOIs):
  - ORSA became a NAIC accreditation standard for the DOIs on January 1st,2018 (i.e. mandatory adoption of the model act for DoIs)
  - So far: Learn the requirements, review ORSAs, ask questions to the company, Lead State DOI to review and share review with other DOIs
  - Going forward: use the ORSA in the Holding Company Analysis to create the Insurer Profile Summary (or Group Profile Summary) and use it for prospective micro surveillance. Maybe use ORSAs for macro surveillance
  - Operational challenges: consistency of DOIs' reviews, timeliness of review

- The Good:
  - ORSA is additive – new and valuable info for regulators
  - One internal review framework in place for all DOIs: ORSA review procedures for financial examiners and financial analysts and documentation and 46 DOIs trained by the NAIC
  - No big surprises on what the keys risks are, but more insight in how big and how assessed
  - View of capital at group level (instead of legal entity) and on capital fungibility in the group
  - Prospective assessment of risks and capital adequacy

ORSA Implementation
DOIs' experience

- The Not-So-Good:
  - "How big are your key risks?"
    - Still to be fully answered (many risks not currently quantified)
    - Expect more pressure from DOI on quantification (including requests for more stresses)
  - "Are the numbers right?"
    - No DOI's approval of internal capital models but need to understand the model, its validation and its use
    - Expect to provide more evidence & documentation on calculations & model governance
    - Consider ORSA implications of new ASOP on Capital Adequacy Assessment (to be finalized by ASB this year) – DOI will ask for more information
  - Timeliness of information – too old, not prospective enough
    - Expect to provide more up-to-date information on risk exposures and prospective assessments
  - Foreign Group ORSA needed to understand group-ERM and group-capital
    - DOI to ask for a copy (it is an ORSA Manual requirement!)
    - Need to better understand foreign regulatory regimes (e.g. Solvency II, Swiss Solvency Test, Bermuda, Canada)
    - DOI may have to share ORSA review with foreign regulators (for example, under the US-EU Covered Agreement)

ORSA Implementation
DOIs’ Feedback – Section 1 (ERM Framework)

- Key questions answered:
  - What are the key risks (based on business strategy)?
  - How much risk do you (insurer) want or can you tolerate?

- Main questions of interest to the DOIs:
  - What are the main lines of defense against risk within the insurance group?
    - How are risk owners rewarded?
  - What are the key risks (given main strategic goals)?
  - How much risk do you want and what are the individual risk limits and overall risk appetite?
  - Which controls have been tested by Internal Audit?
  - What Key Risk Indicators (KRIs) are monitored and reported?

ORSA Implementation
DOIs' Feedback – Section 1 (ERM Framework)

- Feedback from DOIs:
  - Limited information on key strategic goals (resistance to disclose business strategy)
  - No information on compensation of risk owners
  - List of key risks is provided but limited information on the identification process
  - Not all key risks have limits
  - Risk appetite statement is disjoint from individual risk limits and very generic
  - Tendency to disclose mostly financial controls, less operational controls
  - Need for more up-to-date information (e.g. copy of the KRI dashboard)

ORSA Implementation

DOIs' Feedback – Section 2 (Assessment of Risk Exposures)

- Key questions answered:
  - How big are the key risks?
  - Are your risks within the limits and your risk appetite?
  - How big could they be in case of a stress?
  - What could you send you out of business?
- Main questions of interest to the DOIs:
  - How big are the key risks (on current and stressed basis)?
  - How often the exposure is assessed and how does it compare with the limit?
  - How is the exposure monitored?
  - What actions were taken in case of a breach? Were the controls effective?
  - What is the assessment methodology?
  - How did you select your stresses? What are stresses do you run? What is your "death" scenario?

ORSA Implementation

DOIs' Feedback – Section 2 (Assessment of Risk Exposures)

- Feedback from DOIs:
  - Not all key risks are assessed and the exposure is not compared to the limits
  - No explanation of why some key risks are not assessed
    - Lack of data or methodology?
    - Resistance to quantify operational and strategic risks
  - Very little support to the stresses selected and underlying assumptions
    - A handful of stresses rather than a framework
    - No evidence of selection process and governance process
    - No justification of assumptions
    - No tail risk analysis
    - No reverse stress test

ORSA Implementation

DOIs’ Feedback – Section 3 (Group Risk Capital and Prospective Solvency Assessment)

- Key questions answered:
  - How much group capital is put at risk in case of an unexpected loss (now and tomorrow)?
  - Are the key risks likely to change tomorrow because of your business strategy?
- Main questions of interest to the DOIs:
  - Does the company have sufficient capital resources to cover unexpected losses, now and in future (for the duration of the business plan)?
  - What are the potential “unexpected losses”?
  - How could unexpected losses impact your future p&l and cash flows?
  - How does the company manage and allocate capital to risks?
  - How fungible is capital across the enterprise?
  - Is the risk profile of the insurer likely to change as a result of the business strategy?

ORSA Implementation

DOIs’ Feedback – Section 3 (Group Risk Capital and Prospective Solvency Assessment)

- Feedback from DOIs:
  - Variety of metrics utilized to measure the risk capital:
    - No explanation of choice of risk metric or how it is calibrated (for economic capital)
    - Economic capital is mostly used by Life and P&C multi-line insurers
    - RBC multiples is the preferred metric by Health insurers but not enough. Not all risks are included in RBC (for example, operational, regulatory, strategic). Consider adding capital stresses.
    - Rating agency capital is ok as an additional capital benchmark, but not as your only OWN measure of risk capital
  - No quantification of risk capital for each key risk (e.g. operational risk)
  - No explanation of how the diversification benefit was determined (although often it results in a “significant” reduction in risk capital)
  - Usually no prospective assessment of risks and capital
  - Limited to no information on validation (framework, scope, status, results)

More risk regulations than just ORSA

- Form F (“enterprise risk” at the holding level) (Model Regulation #450)
  - Already nation-wide adoption. More NAIC guidance has been developed with examples of disclosures
  - You can ask the DOI for a filing exemption, if you file the ORSA at the holding level
- Corporate Governance Annual Disclosure Model Act & Regulations (#305 and #306)
  - 19 states have already adopted model act, 7 expected to adopt soon, nation-wide adoption by 1/1/2020
- New Insurance Data Security Model Law (#668)
  - Develop, implement and maintain a comprehensive written Information Security Program (ISP)
  - Approved on October 24th, 2017
  - http://www.naic.org/documents/cmte_ex_cswg_related_ins_data_security_model.pdf?782
- CAT charge for RBC
  - Earthquake and hurricane only for now (more perils to be added in future)
  - Use of own CAT internal capital model, in addition to third-party approved CAT models, starting YE18?
- Operational risk charge for RBC
  - 3% add-on to RBC after covariance from YE18 [Less Business Risk C4a, post tax for Life insurers]. 0% for YE17
- Group Capital Calculation
  - Still under development, calculation finalized by 2019/20? With stresses?
- Other: EU-US covered agreement, Comframe & ICS

Questions?