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ORSA: The Clock is Ticking

CAMAR Meeting

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Lisa G. Chanzit, FCAS, MAAA, ARM, Senior Consulting Actuary



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Goals of Discussion

- What does “Risk-Focused” mean and how is it different? Goals of Risk-Focused exams
- Description of Risk-Focused framework
- Connection to Enterprise Risk Management and other best practices
- ORSA Considerations
- Examples of Reserving, Pricing & Liquidity Risks – how might ORSA come into play?



Risk-Focused Framework for Financial Examinations

Why Risk-Focused?

Risk-focused methodology:

- Directs selection of financial statement verification to only those key accounts and control objectives with greatest risks.
- Directs focus to identification of significant strategic and operating risks, and investigation of mitigation strategies to reduce their residual risks to a more acceptable level.

Goals of Risk-Focused Examinations

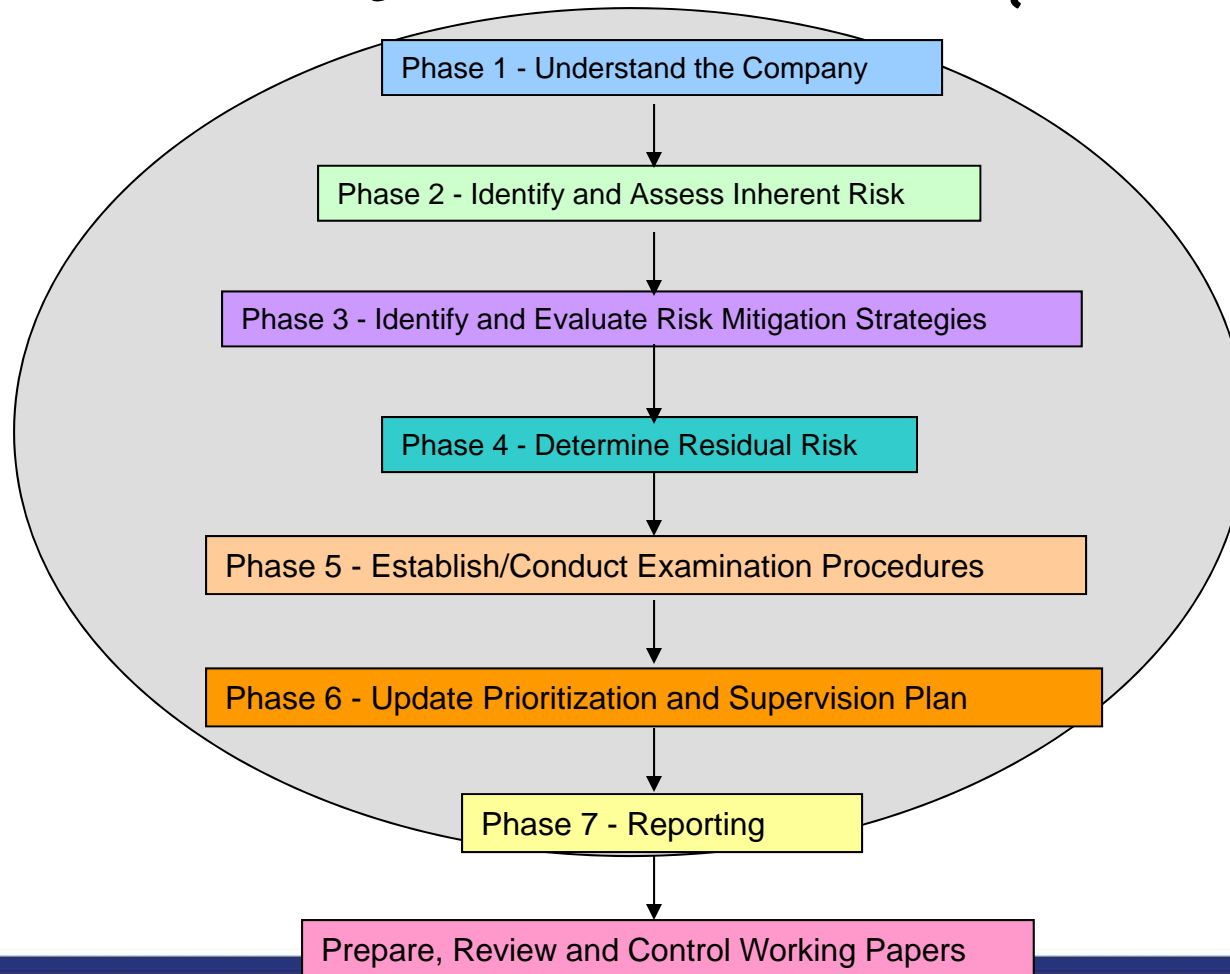
1. Assess quality and reliability of corporate governance to identify, assess and manage the risk environment facing the insurer in order to identify current or prospective solvency risk areas
2. Assess risk that company's surplus is materially misstated
3. Identify off-balance sheet risk
4. Leverage management's functions:
 - ▶ Enterprise Risk Management
 - ▶ Sarbanes-Oxley
 - ▶ Management self-assessment reports

Risk-Focused Objectives

- ▶ “The intent of the risk-focused surveillance process is to broaden and enhance the identification of risks inherent in an insurer’s operations and utilize that evaluation in formulating the on-going surveillance of the insurer.”
- ▶ “It has been recognized that the focus of the examination work will shift so that more time is spent during the planning and risk assessment processes of the examination accumulating the information necessary to determine which detail procedures are necessary to appropriately focus on the residual risks.”

Risk-Focused Examination Process

Understand and Document



Nine NAIC-Branded Risk Areas

1. Credit risk
2. Market risk
3. Pricing/underwriting risk
4. Reserving risk
5. Liquidity risk
6. Operational risk
7. Legal risk
8. Strategic risk
9. Reputational risk

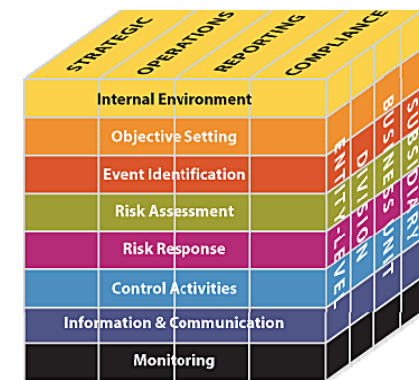
Risk Assessment Matrix

Various checklists and tools in the Handbook will assist with ensuring various aspects of planning are considered and documented in the examination process. Below is the risk assessment matrix, Exhibit K, the key output of the planning phase of the risk focused exam.

RISK ASSESSMENT MATRIX														
ABC Life Insurance Company														
1a <input type="text" value="Key Activity"/>														
1b – Overall Risk Statement:														
1c – Analytical Assessment:														
Phase 1	Phase 2					Phase 3			Phase 4			Phase 5	Phase 6	Phase 7
1d	2a	2b	2c	2d	2e	3a	3b	3c	4a	4b	4c	5	6	7
	Risk Identification		Inherent Risk Assessment			Risk Mitigation Strategy/Control Assessment			Residual Risk Assessment					
Sub-activities	Identified Risks	Branded Risk	Likelihood	Impact	Overall Inherent Risk Assessment	Risk Mitigation Strategy/Control	Evidence & Document Testing Controls	Overall Risk Mitigation Strategy/Control Assessment	Calculated Residual Risk	Judgmental Residual Risk	Overall Residual Risk Assessment	Examination Procedures / Findings	Prioritization Results Supervisory Plan	Report Findings & Management Letter Comments
Risks Other than Financial Reporting														
Financial Reporting Risks														

Importance of Strong Corporate Governance to Prospective Risks

- Presence of an Enterprise Risk Management (“ERM”) framework for proactively addressing and mitigating risks, including prospective business risks
- Effective corporate governance contributes to a company’s entity level (or monitoring level) controls
- Board of Directors involvement



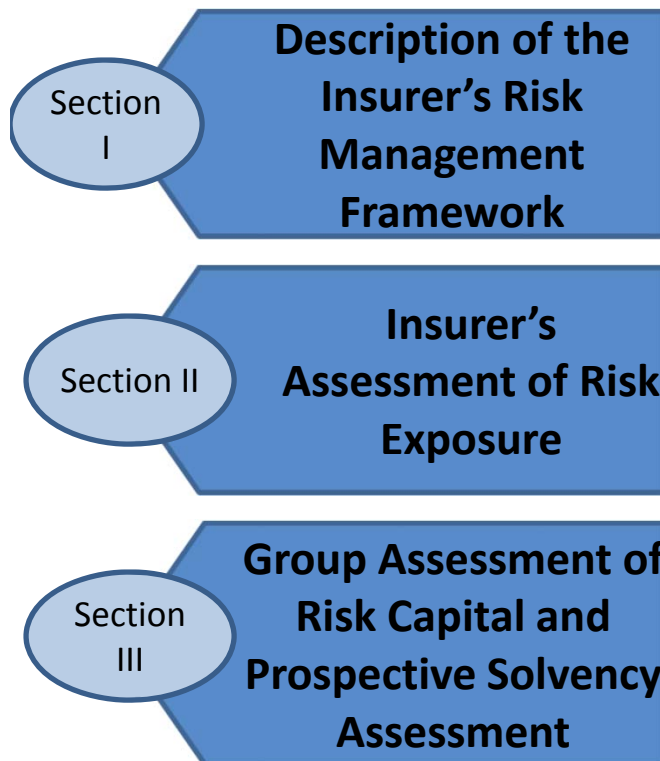
Critical Risk Categories – Actuarial Perspective

- i. Asset valuation**
- ii. Liquidity**
- iii. Investment strategy**
- iv. Reinsurance program structure**
- v. Reinsurance reporting/collectability**
- vi. Underwriting/Pricing Strategy/Quality**
- vii. Reserve Data
- viii. Reserve Adequacy
- ix. Related party/holding company considerations**
- x. Capital management**



ORSA Framework

Overview of ORSA



- ORSA provides a management view of risks and capital, which helps to “challenge” what is covered under traditional approaches to reserves and capital.
- ORSA aggregates risks across all the activities of the insurance company to enable a comparison of required capital to available capital.
- ORSA is not solely a quantitative representation of the risks but also requires a systematic identification, assessment and management of the risks.
- A thorough evaluation of risk requires that an insurance company not only evaluates its current exposure to risk but also its future potential risk, in light of strategic objectives.
- ORSA plays a key role in the communication between an insurance company and regulator.

ORSA Model Act

- Adopted September 2012
- ORSA defined
 - “confidential internal assessment, appropriate to the nature, scale and complexity of an insurer or insurance group”
 - “of the material and relevant risks associated with the insurer”
 - “and the sufficiency of capital resources to support those risks”
- Confidential report(s) to be filed at most 1x/year w/lead state
- Exemption
 - <\$500M legal entity premium
 - <\$1B group premium
- Effective January 1, 2015

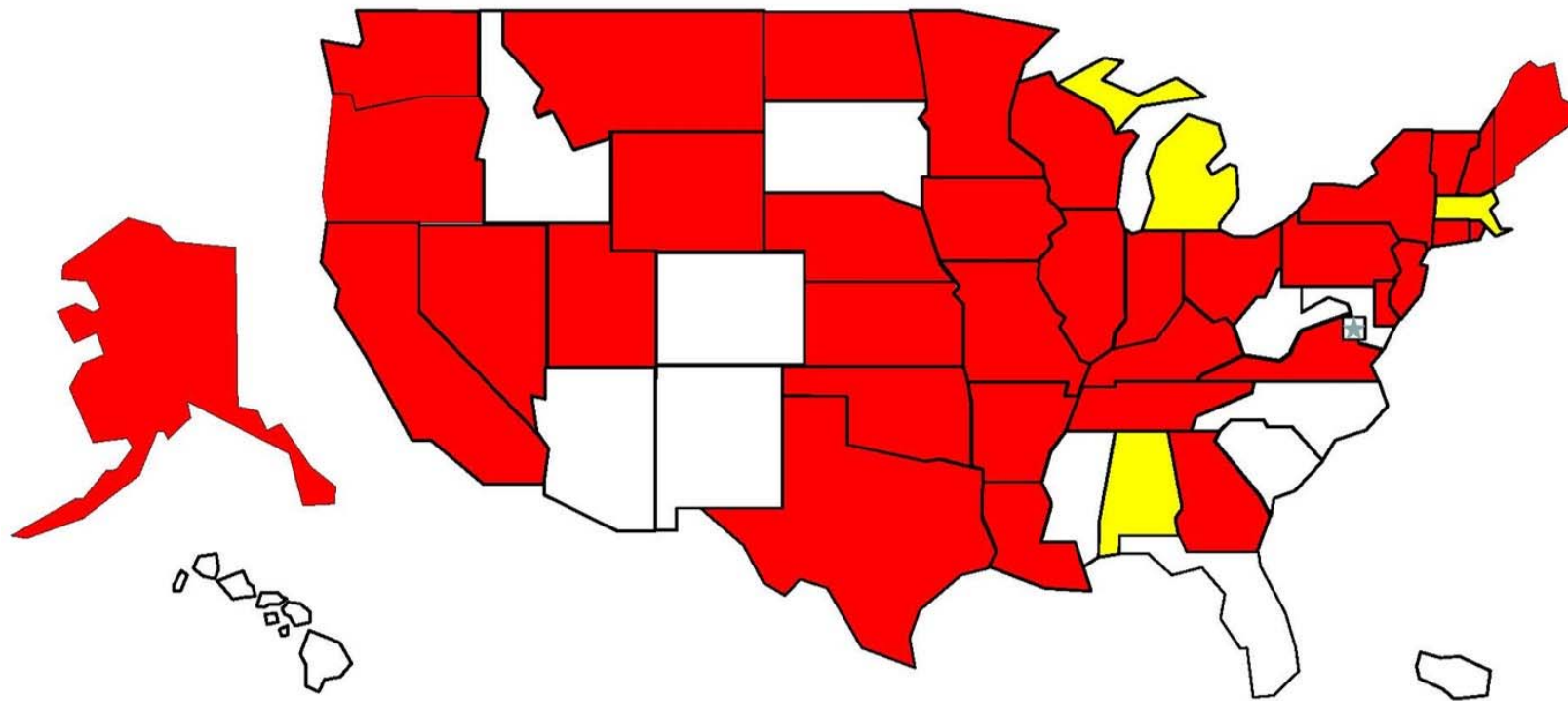
However regulator can decide, based on specific circumstances, to request anyway



ORSA Guidance Manual

- First issued in 2012; latest revision July 2014
- Provides further guidance on ORSA in support of Model Act
- ORSA Report should include:
 - Section 1: Description of Risk Management Framework
 - Section 2: Assessment of Risk Exposure
 - Section 3: Group Assessment of Risk Capital and Prospective Solvency
- Should identify accounting basis, time period, legal entities covered
- Signed by CRO or similar
- Further details for each of the 3 sections on what to include
- Clear focus on OWN

ORSA Status

Implementation of Model Act #505: Risk Management and Own Risk and Solvency Assessment Model Act
[status as of July 20, 2015]



-  Adopted Model #505 in full or in part (35: AK, AR, CA, CT, DE, GA, IA, IL, IN, KS, KY, LA, ME, MN, MO, MT, ND, NE, NH, NJ, NY, NV, OH, OK, OR, PA, RI, TN, TX, UT, VA, VT, WA, WI, WY)
-  Legislation under consideration (3: AL, MA, MI)

 No action to date

Source: NAIC



ERM Framework for ORSA



Source: North American CRO Council

ERM involves a control cycle, in which:

- The foundation is the risk culture and governance of the company
- An appetite for risk is established, linked to company strategy
- Risk limits are set
- Risks are identified, quantified, and prioritized
- Risks are monitored relative to limits, and risk mitigation actions are taken
- Risk capital is determined and allocated to business initiatives
- Risk analysis is communicated to leaders
- Results of risk analysis impact strategic objectives

ORSA section

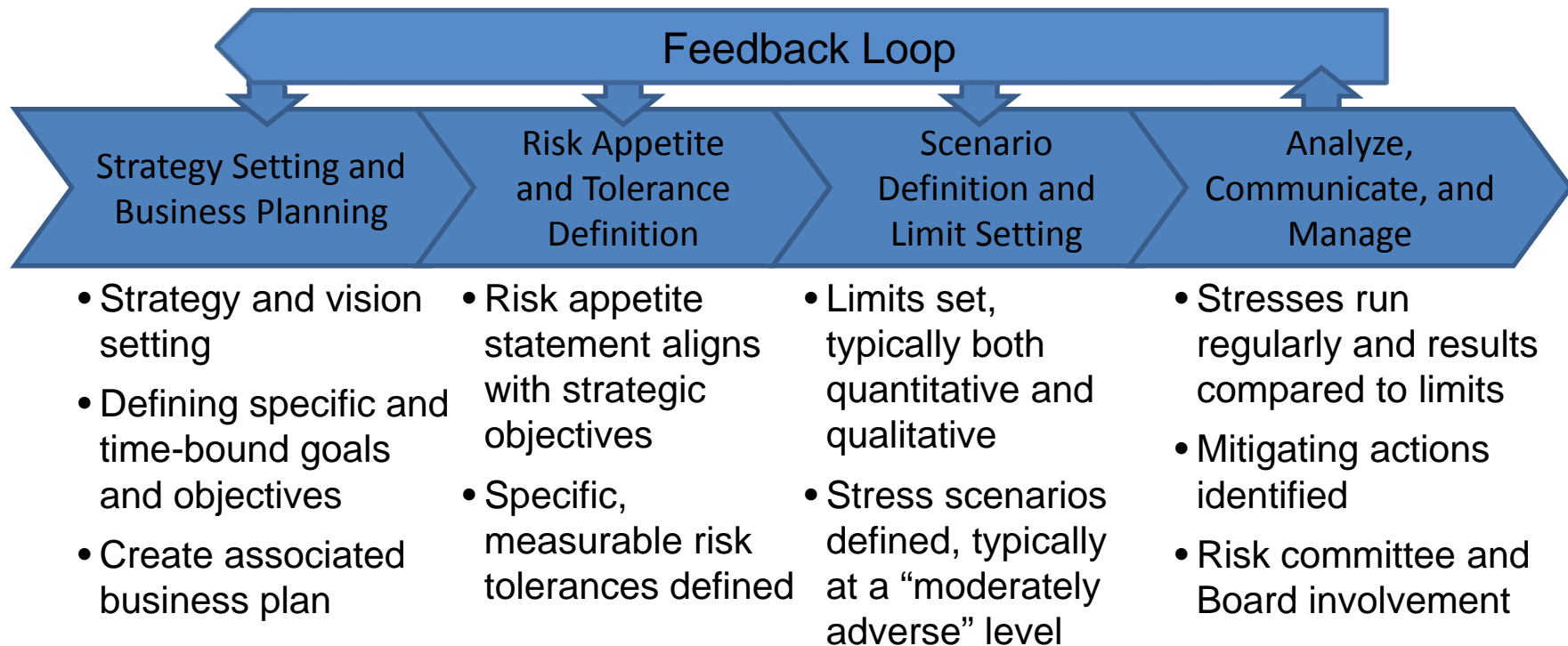
Section I

Section II

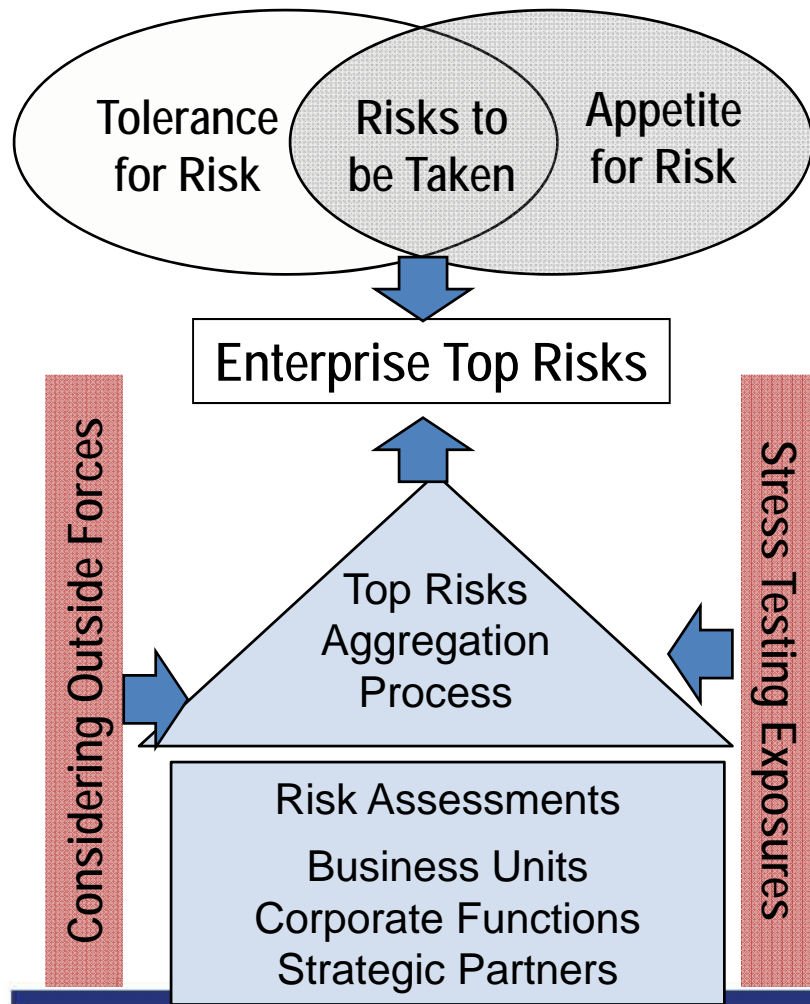
Section III

ORSA Section 1 – Risk Appetite, Tolerances and Limits

Risk Appetite establishes tolerances in adverse scenarios to both inform and protect the company’s ability to achieve strategic goals. Scenarios are informed by other risk management processes as well as external considerations.



ORSA Section 2 – Assessing Enterprise Risks



- Section 2 will cover identification, quantification, prioritization, and mitigation of top risks.
- The process for determining top risks typically involves both a top down and a bottom up approach.
- Top risks should be considered in light of the organization's strategy, risk appetite, and risk tolerance.
- Identification of risks should come from those in the business and corporate functions, with support from and aggregation by ERM.
- Consideration should be given to emerging risks and the impact of external factors such as regulatory change and competitor actions.

ORSA Section 2 – Risk Identification

A robust risk identification and prioritization process begins with business owners, includes a defined taxonomy, and includes consideration of emerging risks.

Market/Credit	Insurance	Operational	Strategic
Default	Mortality	Supplier	Competition
Equity	Morbidity	HR	Legislation
Interest Rate		Technology	

Risk Taxonomy

- Risk taxonomy facilitates broad thinking of the various types of risk exposures
- Also provides a tool for consistent classification of risks across the enterprise

Emerging Risk Areas

- Providing risk assessors in the business with input as to enterprise and external views on emerging risks can help avoid excessive focus on recently experienced risks



ORSA Section 3 – Risk Capital

- Sound process for assessing risk capital relative to risk profile (NOT RBC)
- Comparative view from prior year, explaining changes
- Describe approach for determining risk capital
 - Double gearing
 - Leverage
 - Diversification, fungibility
 - Contagion risks
 - Liquidity risks
- Project economic and regulatory capital over business planning cycle
 - Normal and stressed conditions
 - Remediation plans if needed
 - Include prospective risks
 - Solvency includes liquidity, not just capital

ORSA Section 3 Guidance

- Goal: Understanding the process used by the insurer to accumulate and present the information provided.
- General: Discuss accounting and valuation framework, internal capital model approach, stress tests, modeling methods, model validation. Consistent with size, scale, complexity.
- Capital models: Model governance framework, testing. May need to perform some independent review. Considerations for external/vendor models.
- Prospective solvency: Consistency with business planning, assumptions and methods used, stress scenarios, actions to be taken based on results.
- Document these items and resulting conclusions.



Using ORSA in Context of Risk-Focused Examinations

Risk Statements - Reserving

Oversight and Procedures

- The Board of Directors (or Committee thereof) is not involved in establishing and reviewing the Company's overall reserving policy and methodology.
- The Company is not following the reserving policy and methodology that has been adopted or reviewed by the Board of Directors.
- Management books reserves that are materially different than the actuary's best estimate or that are produced by the loss reserve model.
- Actuarial reports do not comply with NAIC requirements.

Risk Statements – Reserving (Continued)

Data

- Claims data utilized by the actuary to estimate reserves does not correspond to the data in the Company's claims system and to the data in the Company's accounting records.
- Individual case-basis reserve amounts are not appropriate.
- Loss triangles do not accurately reflect actual losses, per the ledger.

Risk Statements – Reserving (Continued)

Accuracy

- Loss reserve/IBNR computations are not performed correctly or the selected estimates are unreasonable.
- Assumptions and methodologies used in loss reserve estimates are not accurate and/or reasonable, nor do they take into account changes in the legal environment or changes to the Company's processes.
- Assumptions and methodologies used in applying discount factors to ultimate reserves are not accurate or correct.

Risk Statements - Other Than Reserving

Overall Pricing

- Pricing is not adequate for the risks assumed by the company.
- Premium is not appropriate for the risk being assumed due to a lack of discipline and/or desire to maintain market share.

Risk Statements - Other Than Reserving (Continued)

Pricing Guidelines/Price Monitoring

- The insurer has not established appropriate underwriting and pricing guidelines/processes, resulting in inadequate or excessive base premium rates.
- Policies are not priced in accordance with previously established Company guidelines.
- The insurer is not complying with or monitoring the overall pricing/underwriting strategy.
- Loss & LAE forecasts are not effectively monitored.
- Pricing is not effectively monitored by jurisdiction, profit center, or class.
- The Company is not effectively monitoring its pricing, particularly for the newer business segments.

Risk Statements - Other Than Reserving (Continued)

Pricing Other

- The actuarial pricing function has inadequate resources.

Risk Statements - Other Than Reserving (Continued)

Growth/Changes in Business Written/Acquisitions

- Rapid growth in new product lines results in inadequate reserving and pricing.
- The Company does not have the experience or infrastructure to support entry into new lines of business.
- The Company's frequent entry into and exit from business segments minimizes the volume of company-specific actuarial data available for reserving and pricing, resulting in inaccurate reserving and pricing indications.

Risk Statements - Other Than Reserving (Continued)

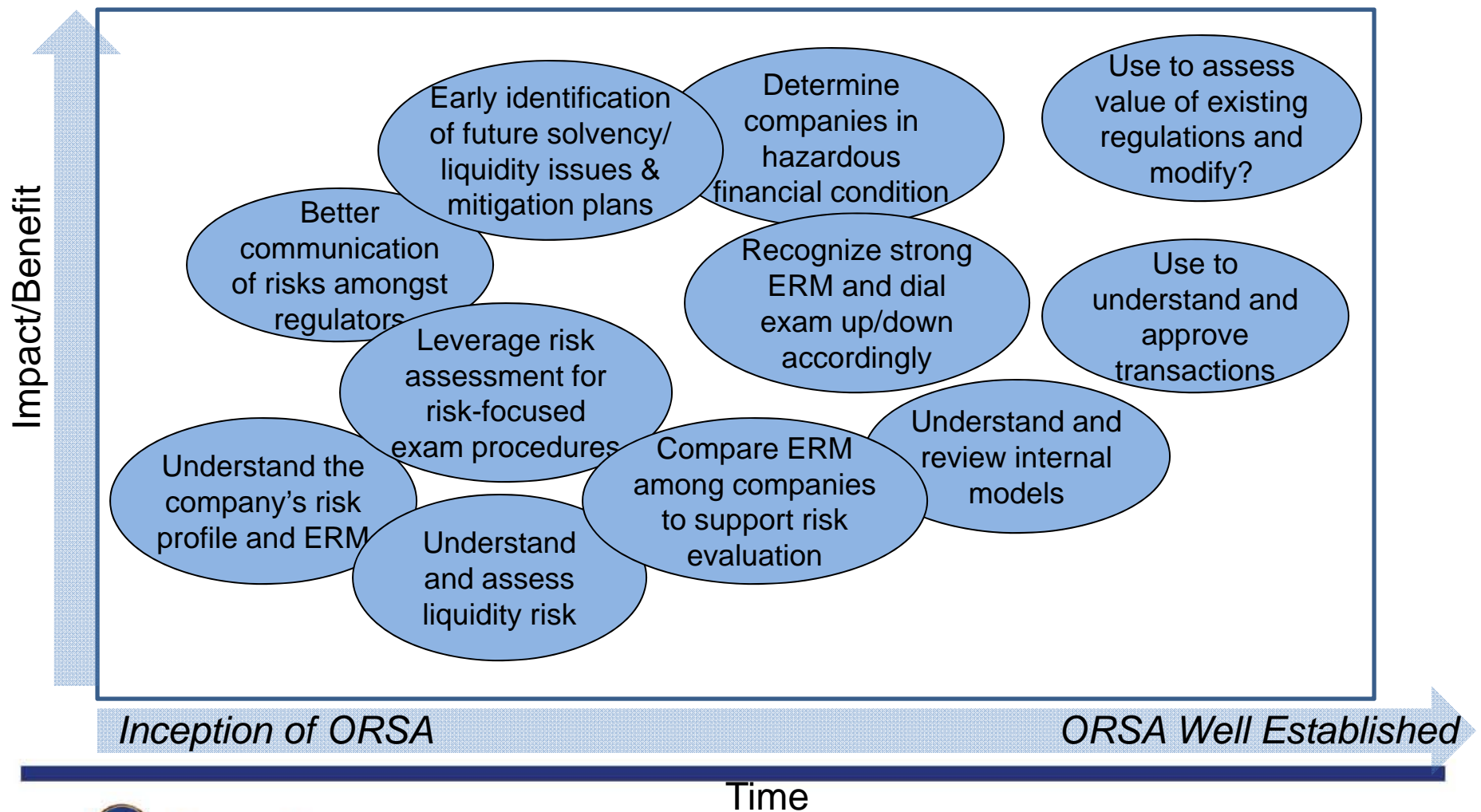
Reinsurance/Liquidity/CATS

- The Company has not established and maintained appropriate risk exposure limits, including those for catastrophes.
- The Company's concentration of risk potentially exposes it to event(s) that could impair solvency.
- A significant loss event or a series of loss events could occur that would trigger increased reinsurance utilization and strain assets.
- The Company's cat model is not appropriate or adequate.
- The Company's process for managing exposure to catastrophes is not effective.

Conclusions

- While the Risk-Focused Exam process is gradually becoming more prospective in nature, the ORSA is inherently prospective.
- Currently regulators find it difficult to “line up” many exam risks with anything in a typical Company’s ORSA report.
- Sophisticated Companies do a better job addressing their risks in an ORSA format.
- In the future, most Companies’ ORSA reports are expected to better address their risks in an ORSA format.

Potential Short and Long Term Uses of ORSA



Questions?