



MAF Spring 2012 Meeting

NAIC ORSA

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ORSA Overview

ORSA involves a self-assessment of the insurer's risk management framework and solvency position

- ORSA is a process that examines the full scope of the insurer's risk management framework
- The “own” in ORSA places the onus on management — to self assess the risk and capital management framework given current and future risks
- The ORSA output is a set of documents that demonstrate the results of management's self-assessment



It is important to differentiate between the ORSA as an internal process and an external reporting requirement

What is an ORSA

- A continuous process
- Determined by firm (i.e., “own”)
- Own risk profile and risk appetite
- Short- and long-term risks
- Both qualitative and quantitative
- Overall solvency needs
- Over business planning period
- Adequacy of group capital
- Continuous compliance

What an ORSA is not

- A point-in-time activity
- Pre-defined by regulator
- A regulatory report, a template or form to complete
- Just a mathematical calculation
- A requirement to develop an internal model
- A capital requirement
- Just a process to tick a regulatory box

The ORSA results in a richer view of the insurance group's capital and risk management framework



The ORSA improves the regulators view of risk and capital

- Risk-based capital will remain as the key determinant for minimum legal-entity regulatory capital
- The ORSA will provide the regulator with the insurer's view of its group risk capital and risk management based on proprietary factors and analysis
- The combination of the two will allow regulators to key in and focus on the most important issues for policyholder protection/security

Insurers will complete an annual “self-assessment;” the regulator may (or may not) request a summary report

U.S. ORSA — Regulatory Reporting Requirement

| | |
|--------------------|---|
| Threshold | <ul style="list-style-type: none"> • All individual insurers with gross premium > \$500M • All insurance groups with gross premium > \$1B • Includes unaffiliated domestic and international premium |
| Annual | <ul style="list-style-type: none"> • ORSA should be conducted at least annually • Summary report may be requested by the state regulator |
| Dynamic | <ul style="list-style-type: none"> • ORSA should reflect changes in business strategy • A refresh may be needed for significant shifts e.g., M&A |
| Capital Projection | <ul style="list-style-type: none"> • Should be consistent with business planning horizon • Suggests capital projections of two to five years |
| Documentation | <ul style="list-style-type: none"> • Supporting documentation should be in place • May be reviewed as part of the on-site financial exam |

The Summary Report should contain information in three sections

Section 1:

Description of Risk Management Framework

- A high-level summary of the insurer's risk management framework

Section 2:

Assessment of Risk Exposures (Quantitative and Qualitative)

- Detail showing the insurer's process for assessing risks, including stress tests

Section 3:

Group Risk Capital and Prospective Solvency Assessment

- Demonstration that current and future capital is sufficient to support risks identified

Section 1:

Description of the Insurer's Risk Management Framework

- Summary of the following elements:
 - Risk Culture and Governance
 - Risk Identification and Prioritization
 - Risk Appetite, Tolerances, and Limits
 - Risk Management and Controls
 - Risk Reporting and Communication
- Demonstration that the process is dynamic
 - On-going management, monitoring and feedback loops

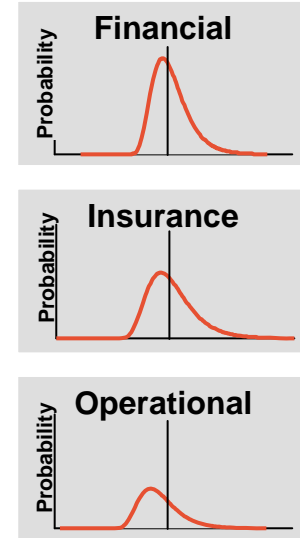
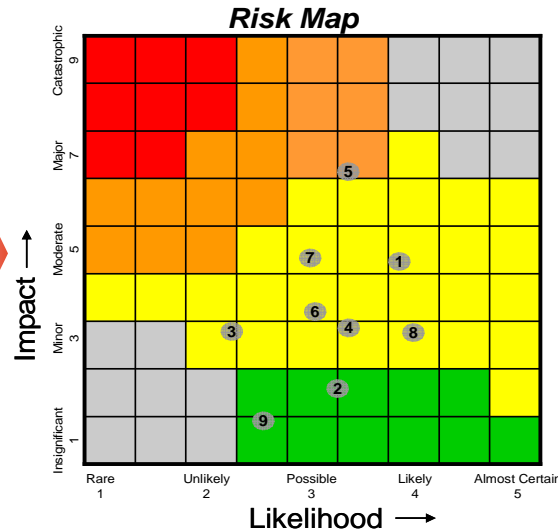
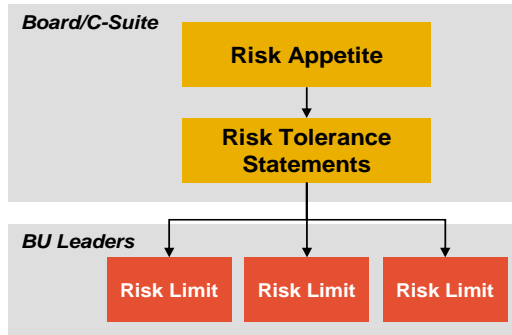
Supporting Risk Policies

- Underwriting
- Investment
- Claims underwriting/processing
- Asset-liability management (ALM)
- Reinsurance counterparty
- Mergers and acquisitions
- Compensation and incentives
- Anti-fraud
- All other ERM activities, policies or programs

“Any strengths or weaknesses noted by the regulator in evaluating...[the insurer's risk management processes]...will have a bearing on the regulators' ongoing supervisory plan for the insurer”

Section 2:

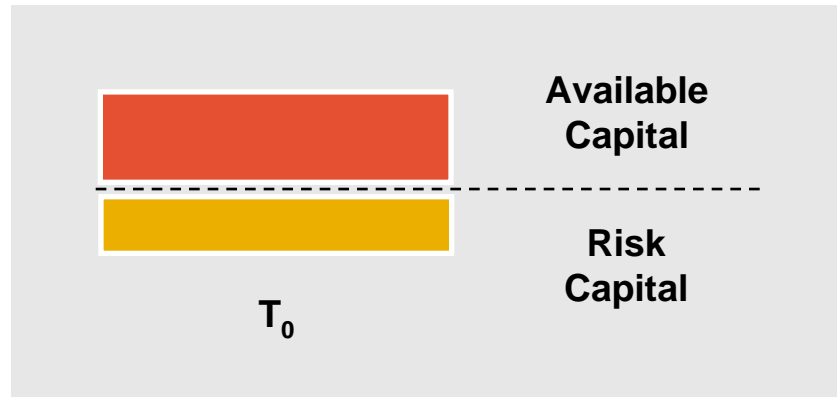
Insurer's Assessment of Risk Exposures



| | |
|-------------------|--|
| Assess | • Summary of assessment for each material and relevant risk |
| Method | • May be quantitative or qualitative depending on the nature of the risk |
| Stress | • Impact of risk should be shown in both normal and stressed conditions |
| Capital | • May use regulatory, economic, rating agency or other views of capital |
| Validation | • Should explain the process for model validation and calibration |

Section 3:

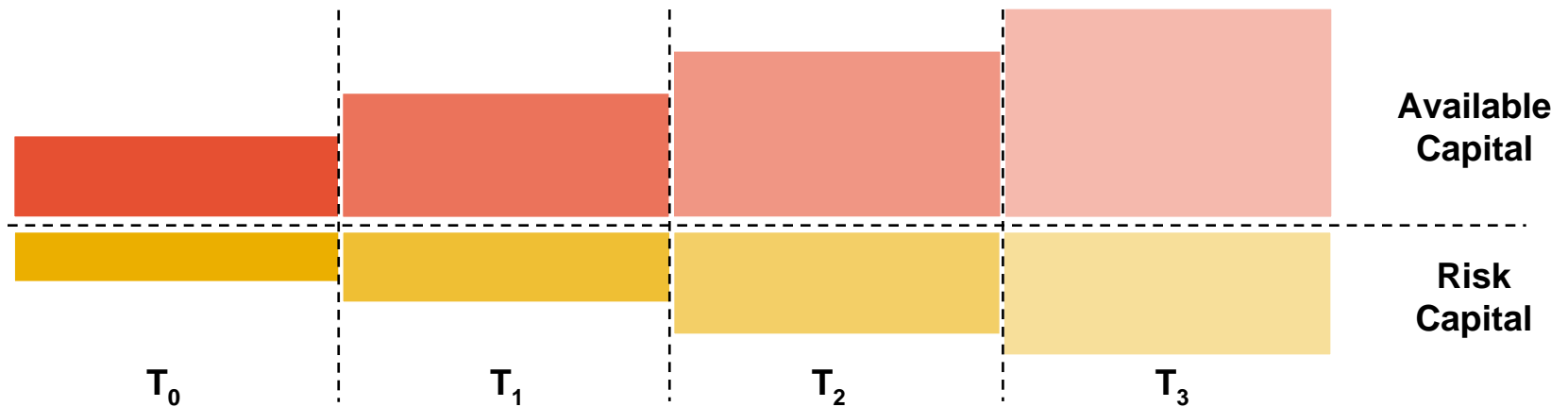
Group Risk Capital And...



- Group Risk Capital
 - Should address the question:
 - What level of capital is necessary to support the group’s individual and collective risks at the insurer’s defined solvency standard?
 - Risk capital:
 - Amount of capital that satisfies the insurer’s capital needs at the defined level of security
 - Available capital:
 - Amount of “excess” (or “deficit”) capital above (or below) the risk capital indication

Section 3:

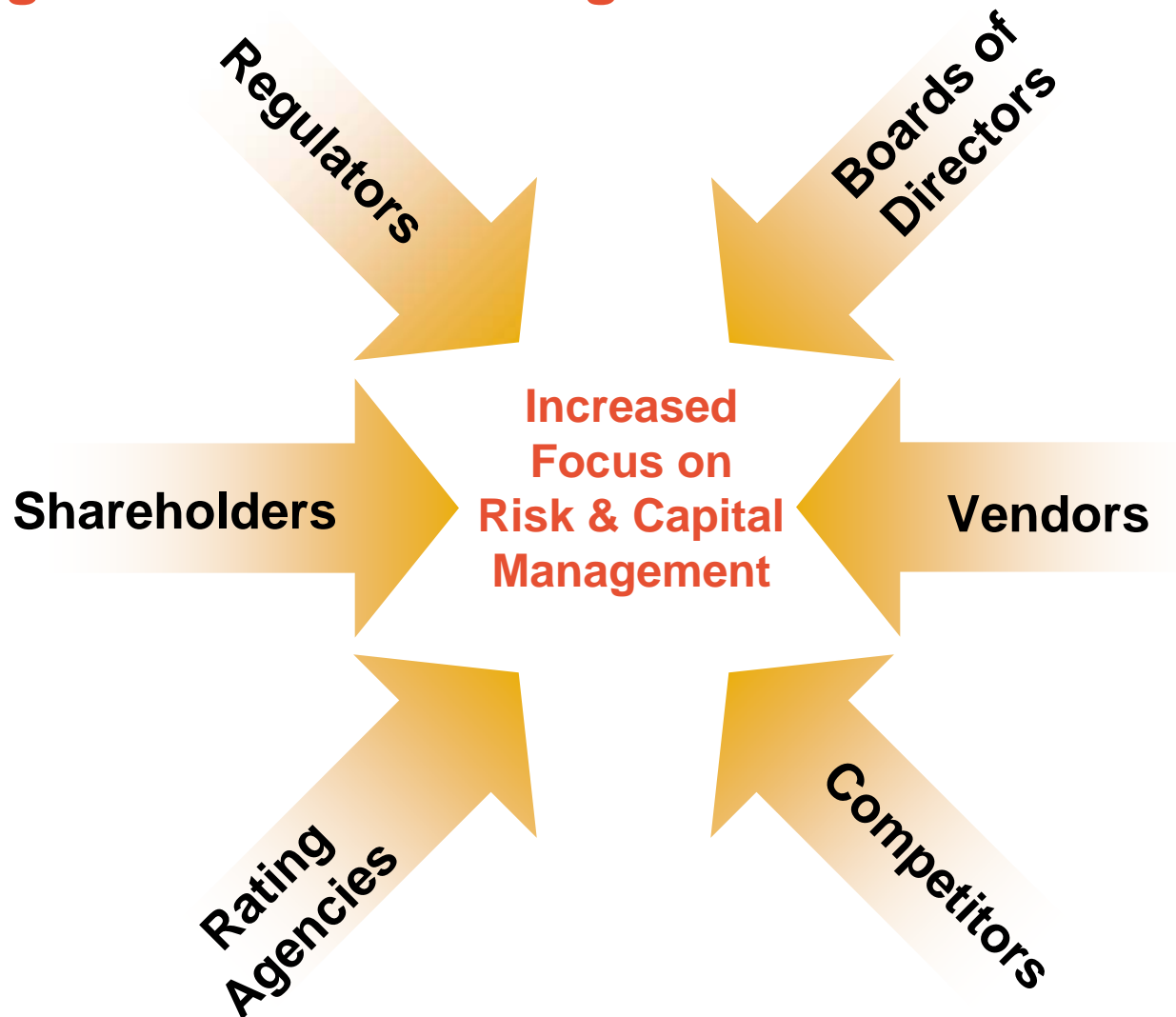
Prospective Solvency Assessment









- Prospective Solvency Assessment
 - 2 – 5 year look forward
 - Demonstrate and document link between business strategy and the amount, quality, and source of capital that is needed to support business strategy
 - Describe actions to address capital shortages or business strategy changes

ORSA Evolution

The demands for more rigorous risk and capital management continue to grow



Other reference points – Emerging regional and national standards

| Territory/ Domicile | Regulatory/ Supervisory Authority | Risk and Solvency Assessment | Status/Comment |
|--|--|---|--|
|  | European Insurance and Occupational Pensions Authority (EIOPA) | Own Risk and Solvency Assessment (ORSA) | Expected to come into force on 1 January 2014 |
|  | US National Association of Insurance Commissioners (NAIC) | Own Risk and Solvency Assessment (ORSA) for the Solvency Modernization Initiative | Group Solvency Issues Working Group finalized Guidance Manual in 2011; pilot implementation in 2012 for five to ten insurance groups |
|  | Bermuda Monetary Authority (BMA) | Commercial Insurer's Solvency Self Assessment (CISSA) | Implemented in 2011, CISSA applies to long-term and short-term insurers and combines ERM and ORSA requirements |
|  | Swiss Financial Market Supervisory Authority (FINMA) | Risk Management/Internal Control System Tool (RM/ICS Tool) | Developed in 2007 by FINMA as part of the Swiss Quality Assurance (SQA) |
|  | Australian Prudential Regulation Authority (APRA) | Internal Capital Adequacy Assessment Process (ICAAP) | Following a consultation period, draft prudential standards released late 2011 — final standards expected to apply from 1 January 2013 |
|  | Superintendent of Financial Institutions Canada (OSFI) | Dynamic Capital Adequacy Testing (DCAT) | OSFI published guidance (2009) on using stress, scenario and sensitivity testing beyond DCAT; internal target capital ratio guideline (2011) further emphasizes internal risk and capital assessment |

The International Association of Insurance Supervisors (IAIS) is shaping global regulatory practices



- Solvency Modernization Initiative
 - Capital requirements
 - Governance and risk management
 - Group supervision
 - Stat accounting and financial reporting
 - Reinsurance



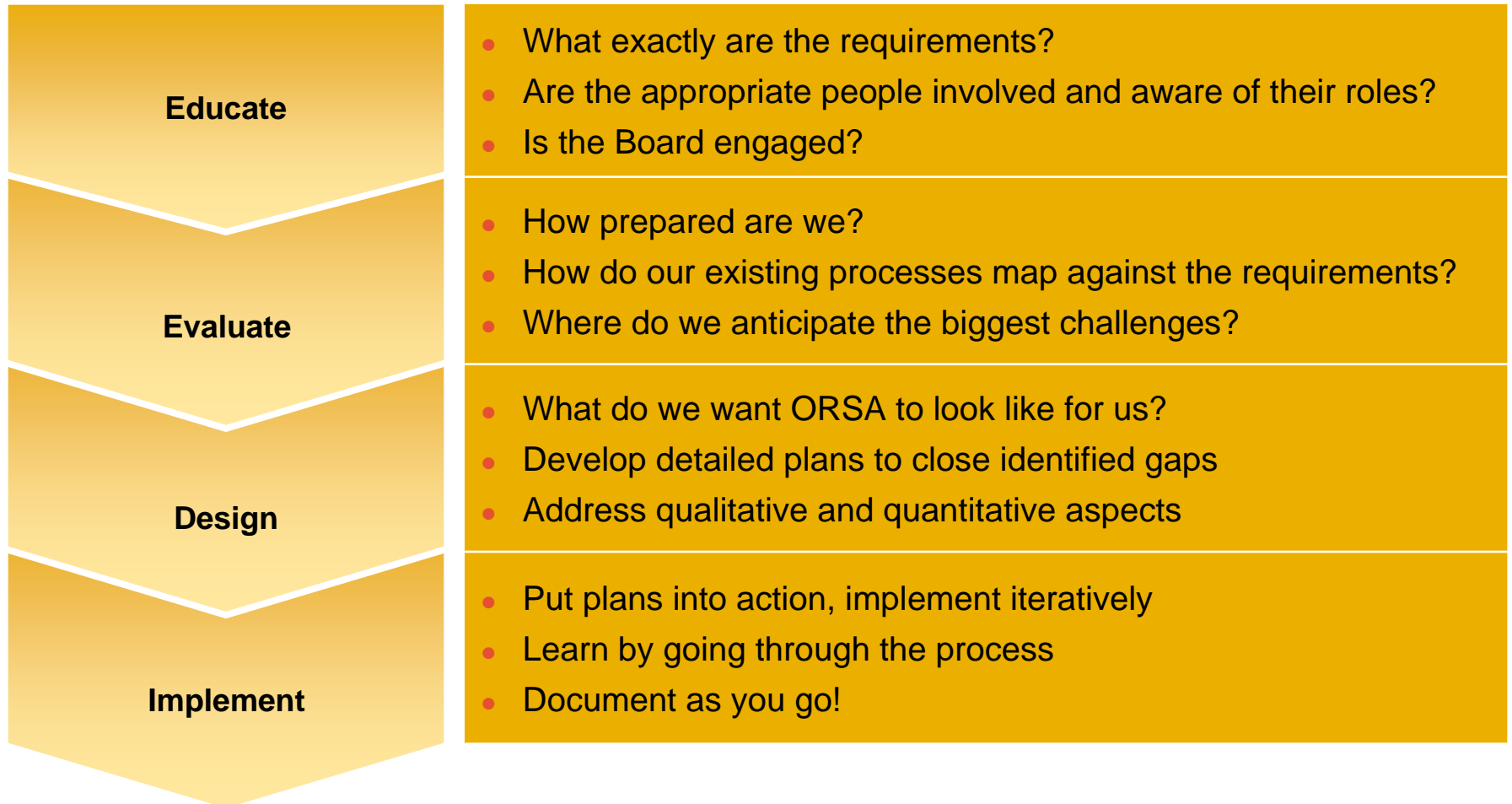
The IAIS' Insurance Core Principles (ICPs) shape policy making in over 190 markets – **including the United States**

ORSA Implementation

The intent of ORSA is to foster internal risk management within companies

| NAIC's Guidance Manual | Implications for Companies |
|--|---|
| Responsibility for ORSA belongs to the company | <ul style="list-style-type: none">● Design ORSA to suit the scope and scale of your business; management style and culture● Leadership must be engaged and accountable |
| ORSA should encompass all material risks | <ul style="list-style-type: none">● Risk identification and prioritization are key process● Establish risk register that defines and prioritizes all key risks |
| ORSA should reflect adequate assessment / measurement processes | <ul style="list-style-type: none">● Assess each material risk, using suitable measurement approach● Don't set out to "boil the ocean" |
| ORSA should be embedded into the company's decision-making processes | <ul style="list-style-type: none">● "Use test" is key measure for implementation● No point in developing risk management processes that "just sit on the side" |
| ORSA should be forward-looking | <ul style="list-style-type: none">● Capital needs to support plans for business |
| ORSA should be appropriately evidenced; independently assessed | <ul style="list-style-type: none">● Role of regulator is to assure that risk management process is in place at the company |

While companies are at various stages, most will follow a similar path to implementation



We suggest that companies treat ORSA as an opportunity to realize value from ERM, rather than an imposed compliance requirement

- Design ORSA to fit your own business and culture
 - ORSA requirements are intentionally non-prescriptive
 - Explicit recognition that one size does not fit all
 - There is no “approval process” for underlying models or processes
- Set broad goals for your ORSA, for example
 - Foster better risk awareness and foresight
 - More insightful decision making
 - Forward looking and proactive risk management
 - Focus management attention on risks that matter
 - Increase alignment of risk appetite and business strategy
 - ORSA pulls together existing ERM components

What the ORSA will deliver



A risk appetite that is used and understood



A positive risk culture



An understanding of the key drivers of risk



Timely reporting of risk information – at all levels



Active monitoring of risk against pre-agreed limits



Wider thinking about risk, including contingency planning



Forward-looking view of risk; linked to business plans / strategies



An assessment of future group capital needs

What challenges are companies facing?

- 1 Getting started with ORSA implementation
- 2 Making risk appetite operational
- 3 Creating a supportive risk culture
- 4 Getting risk management, actuarial and the business working together
- 5 Achieving an effective flow of risk management information
- 6 Gaining acceptance of model results, and embedding them
- 7 Getting risk management to be forward-looking

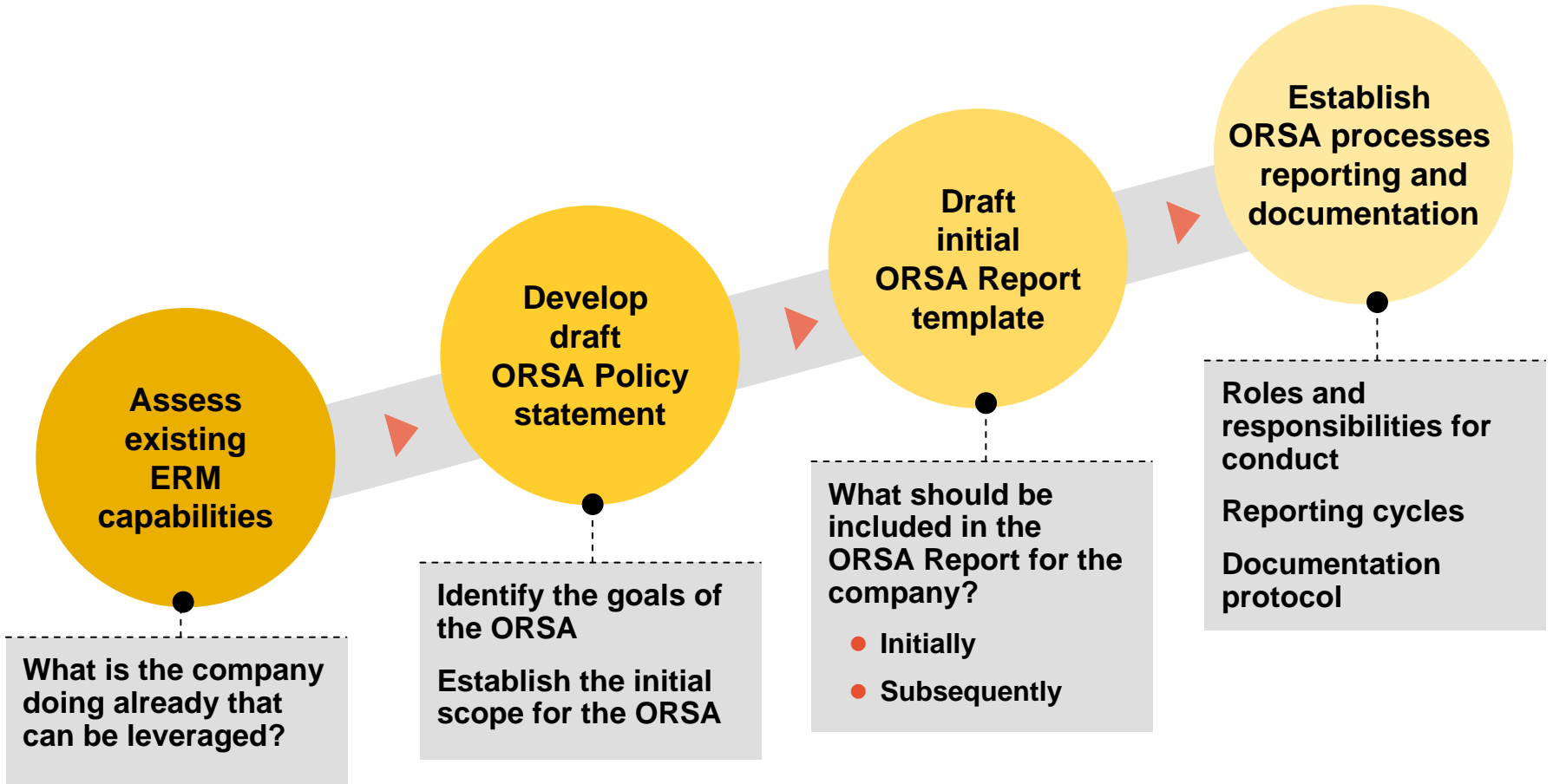
Getting started with ORSA

- Focus on deliverables
- Top down and bottom up
- Iterative approach

- Get the right people involved
- Education is important
- Utilise current processes and documents
- Culture is important
- Regular checkpoints and review



ORSA planning should focus on deliverables, and target early key wins



Making risk appetite operational

Risk Appetite: Strategic

- Stakeholders' risk and return preferences
- Link to business strategy and plans
- Four risk quadrants

| | |
|------------------------------|-----------------------------|
| Capital Preservation | Earnings Stability |
| Liquidity Maintenance | Franchise Protection |

Risk Tolerance / Limits: Operational

- SMART quantitative metrics
 - Corporate risk tolerances
 - Cascade to local risk limits
 - Key performance indicators
- Define triggers and responses
- Clear policies and procedures within the business
 - Ownership of each metric

Monitoring: Operational

- Continuous monitoring of all metrics by risk management
- Transparent dashboard reporting
- Actionable business response
- Escalation processes

3. Creating a positive risk culture



“**Vertical escalation** of threats and fears”

“**Active learning** from mistakes”

“An effective **governance** structure”

“Committed **leadership**”

“Continuous and constructive **challenging** of the organisation’s **actions** and **preconceptions**”

“Horizontal **information sharing**”

“Incentives that **reward thinking** about the **whole organisation**”

“Management **objectives** linked to **risk management** objectives”



Reform in the Financial Services Industry: Strengthening Practices for a More Stable System
Institute of International Finance, 2009.

Questions

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