Own Risk Solvency Assessment (ORSA) – Linking Risk Management, Capital Management and Strategic Planning

Moderator: *David Holland, Risk Director, Ally Insurance*

SPEAKERS

- ***Mary-ellen Coggins***, *Managing Director, PwC*
- ***Elisabetta Russo***, *Principal, Deloitte Consulting LLP*
- ***Adam Walter***, *Senior Manager, Ernst & Young LLP*

Antitrust Notice

- The Casualty Actuarial Society is committed to adhering strictly to the letter and spirit of the antitrust laws. Seminars conducted under the auspices of the CAS are designed solely to provide a forum for the expression of various points of view on topics described in the programs or agendas for such meetings.
- Under no circumstances shall CAS seminars be used as a means for competing companies or firms to reach any understanding – expressed or implied – that restricts competition or in any way impairs the ability of members to exercise independent business judgment regarding matters affecting competition.
- It is the responsibility of all seminar participants to be aware of antitrust regulations, to prevent any written or verbal discussions that appear to violate these laws, and to adhere in every respect to the CAS antitrust compliance policy.

Ground-Rules for our Discussion
Including disclaimers

- This presentation is prepared and intended for general educational and discussion purposes only.
- It should not be used as a substitute for consultation with professional advisors.
- The views and opinions expressed by the panelists and moderator may or may not be reflective of their own personal views and opinions; the views and opinions are not expressions of position by their employers.
- Enjoy the exchange of information and ideas.
- Contribute.

US Own Risk and Solvency Assessment (ORSA)

The Risk Management and ORSA Model Act and US ORSA Guidance Manual

"An insurer...will be expected to **regularly** conduct an ORSA to assess the adequacy of its risk management and current, and likely future, solvency position, internally document the process and results, and provide a high-level summary report annually to the domiciliary regulator, if requested"

NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual

- The NAIC adopted the US ORSA requirements as part of the Solvency Modernization Initiative (SMI).
- The US ORSA Guidance Manual was adopted in late-2011 after intense industry comment and debate, and will continue to be enhanced.
- A new Risk Management and ORSA model law implementing the requirements was also adopted in Fall 2012.
- The model act requires insurers to carry out the ORSA on an annual basis, and to maintain a risk management framework covering relevant and material risks.

Beyond the US, the ORSA marks the general shift in regulation towards risk-focused supervision

- Risk-focused supervision is not a new concept, and risk-based capital requirements, risk management and governance requirements have been part of regulation in many countries for many years.
- However, the last few years have seen a strengthening of risk-focused supervision around the world.
- Solvency II and the US SMI are high-profile examples, but risk-focused regulatory initiatives are also underway in other territories, including in key jurisdictions in South America and Asia.
- The ORSA, based on the principles of ICP 16, is now seen internationally as best practice for insurance supervision.

The role of the ORSA

"The ORSA should be one element of an insurer's Enterprise Risk Management (ERM) framework. The ORSA and the ORSA Summary Report link the insurer's risk identification, measurement and prioritization processes with capital management and strategic planning.

Each insurer's ORSA and ORSA Summary Report will be unique, reflecting the insurer's business, strategic planning and approach to ERM… To allow the commissioner to achieve an understanding of the insurer's ORSA, the report should discuss three major areas:

Section 1 – Description of the Insurer's Risk Management Framework

Section 2 – Insurer's Assessment of Risk Exposure

Section 3 – Group Risk Capital and Prospective Solvency Assessment"

The ORSA guidance manual requires a 3-section structure for the ORSA summary report

Section 1 – Description of the insurer's risk management framework

- Section 1 provides a summary of the risk management framework and policies, aligned to the following principles:
  - Risk Culture and Governance
  - Risk Identification and Prioritization
  - Risk Appetite, Tolerances and Limits
  - Risk Management and Controls
  - Risk Reporting and Communication
- The level of detail should be appropriate to the nature and complexity of the company, and is not intended to be lengthy.
- Section 1 can reference more detailed internal documentation (e.g. risk policies), providing these are available to the supervisor on request.

The ORSA guidance manual requires a 3-section structure for the ORSA summary report

Section 2 – Insurer's assessment of risk exposures

- Section 2 documents management's quantitative, or where quantitative assessment is not feasible, qualitative assessment of risk exposures in normal and stressed environments. The section should include:
  - Details of risks identified, measurement approaches used and assumptions
  - Quantification of risk for each major risk category
  - Outcomes of plausible adverse scenarios
  - The impact of stressed environments on available capital, considering multiple capital viewpoints if relevant (e.g. regulatory, rating agency)
- The structure of the assessment should reflect the way the business is managed in practice.
- Where appropriate or requested by the regulator, a group assessment may be mapped to legal entities.

The ORSA guidance manual requires a 3-section structure for the ORSA summary report

Section 3 – Group risk capital and prospective solvency assessment

- Section 3 explains how the assessment of risk is used to determine the financial resources the company requires to achieve its business objectives over its business planning period, considering normal and stressed conditions, and may include:
  - Definition of solvency
  - Accounting or valuation regime
  - Time horizon of risk exposure
  - Risks modeled
  - Quantification method
  - Measurement metric
  - Target level of capital
  - Aggregation and diversification
- The assessment should consider the group as a whole, including the impact of inter-group transactions and financing arrangements, the transferability and fungibility of capital, and contagion risk.

The ORSA guidance manual requires a 3-section structure for the ORSA summary report

Section 3 – Group risk capital and prospective solvency assessment

- The section should demonstrate that the organization has sufficient capital to executive its 2-5 year business plan, taking into account the potential impact of adverse scenarios, and should consider the company's own economic solvency needs in addition to regulatory capital requirements.
- Where necessary, the section should detail the actions that management has taken or will take where capital may not be adequate, for example, modifications to the business plan, or the raising of new capital.

The guidance exempts smaller insurers, although states or regulators may still require the ORSA

- The NAIC's guidance includes the following exemption thresholds:
  - if the **individual insurer's** annual direct written and unaffiliated assumed premium, including international direct and assumed premium, but excluding premiums reinsured with the *Federal Crop Insurance Corporation* and *Federal Flood Program*, does not exceed **$500M**; <u>and</u>
  - if the **group's** annual direct written and unaffiliated assumed premium, including international direct and assumed premium, but excluding premiums reinsured with the *Federal Crop Insurance Corporation* and *Federal Flood Program*, and excluding affiliated reinsurance premium, does not exceed **$1Bn**
- Where one or both of the threshold(s) is/are exceeded, the ORSA must be provided for the group and/or relevant legal entities.
- A regulator may require any insurer to provide the ORSA, and any insurer may request a waiver, based on unique circumstances.

The NAIC expects the US ORSA to play a significant role in US insurance supervision

"The ORSA Summary Report may help determine the scope, depth and minimum timing of risk-focused analysis and examination procedures... Insurers with ERM frameworks deemed to be robust for their relative risk may not require the same scope or depth of review, or minimum timing for a risk-focused surveillance as those with less robust ERM functions."

NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual

Risk management – The ORSA will be a tool to help supervisors understand the risks insurers are exposed to, and how adept insurers are at managing those risks. Regulators plan to assess ERM capability, and to use it to guide their supervisory strategy.

Group capital assessment – NAIC examiners will use the ORSA to assess groups' own assessment and management of their capital at group level. While the ORSA will not set a group capital requirement, it will provide information to regulators that will help guide supervisory action.

Encouraging ERM – The NAIC expects the ORSA to help foster effective ERM practices at all insurers.

NAIC US ORSA timeline

Significant progress in the development of the ORSA requirement has been made to date, however further refinements and education remain.

US ORSA	2012	2013 / 2014	2015 onwards
Industry	ERM frameworks are largely in place for most non-exempt insurance companies	Focus on closing gaps in process, governance and documentation	Effective date of January 1, 2015
NAIC	• RM and ORSA Model Act – Fall 2012 • ORSA Guidance Manual – Ongoing • 2012 Pilot Program	• 2013 Pilot Program • Enhancements to the ORSA Guidance Manual • Examiner's Handbook • Training	

While the model act was adopted, the NAIC continues to work on the US ORSA requirements

Many aspects of the US ORSA regulations still need to be finalized. The NAIC's key current priorities include:

US ORSA Guidance Manual	• The Guidance Manual is a "living document," and ongoing amendments will be made. • The manual is an NAIC document, so amendments will not have to be adopted by the states.
Financial Condition Examiners and Analysts Handbooks	• Expected to include examination goals, impact on the examination approach, resources, and coordination between US and international regulators. • The NAIC does not intend to produce a "checkbox" approach.
Accreditation standards	• The ORSA model act is intended to be an accreditation standard. • Part A and Part B accreditation standards are being drafted, with an initial focus on Part A.
ERM resources and training	• Specialist resources may be needed to evaluate ERM practices. • The NAIC is planning how to support the states centrally, including potentially a central NAIC ERM expert function. • The NAIC has already started providing training to regulators and examiners.
2013 ORSA pilot	• A second pilot exercise will be conducted in 2013. • The results will further inform the NAIC's work on examination and analysis procedures.

What will the key requirements of the ORSA Model Law mean for insurers in practice?

Effectiveness of risk management

- Is the risk management structure aligned to the way the business is organized?
- Are there policies and frameworks in place to identify all of the insurers' relevant risks?
- Do appropriately calibrated guidelines and limits help manage risk-taking?

Understanding of risk exposure and current and future solvency

- Meaningful suite of scenarios and stress testing.
- Qualitative and quantitative evaluation of risks.
- Robust capital forecasting model to support risk management over the planning time horizon.
- Analysis and planning of future capital needs.

Documentation of processes and results

- Effective and complete documentation of work performed.
- Documentation for internal and external audiences of policies and processes in place.
- Effective reporting of results and recommendations.
- Mitigation of key person and business continuity risks.

High-level annual Summary Report

- Responding to regulatory requirements efficiently, in multiple locations.
- Active engagement with state insurance departments and other regulators.
- Leveraging internal reporting.
- Aligned with communications to other stakeholders.

What ORSA Is / Is Not

ORSA is not…	ORSA is…
…something to be ignored.	…a way to embed sound risk management practices into advanced business processes, including capital management, performance management and strategic planning.
…a filing.	…a reflection of a continuous management behavior or culture.
…a policy stuffed in a 3 ring binder.	…an integrated, top down - bottom up influencer of business decision making.
…a 20 page presentation document the board sees once a year.	…the responsibilities of both the C-suite, the Board and attested by the CRO.
…just another regulatory mandate.	…"a regulatory game changer" and a cultural shift in how the regulator understands your business.

The ORSA guidance manual – Some key points

- “The ORSA Summary Report shall include a signature of the insurer’s chief risk officer...to the best of his/her belief and knowledge that the insurer applies the ERM process described in the report and that a copy of the report has been provided to the insurer’s board of directors or the appropriate committee.”
- “In analyzing an ORSA Summary Report, the commissioner will expect that the Report represents a work product of the enterprise risk management processes that include all of the material risks to which an insurer or insurers (if applicable) is exposed.”
- “This assessment process should consider a range of outcomes using risk assessment techniques that are appropriate to the nature, scale and complexity of the risks. Examples of relevant material risk categories may include, but not be limited to, credit, market, liquidity, underwriting, and operational risks.”
- “Because the risk profile of each insurer is unique, each insurer should utilize stress tests applicable to their risk profile.”
- “The ORSA Summary Report should demonstrate the insurer’s process for model validation, including factors considered and model calibration.”