


ERM: Regulatory and Professional Issues

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Part 1: Regulatory Issues

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International Association of Insurance Supervisors

Established in 1994, the IAIS represents insurance regulators and supervisors of some 190 jurisdictions in nearly 140 countries, constituting 97% of the world's insurance premiums. Its objectives are to:

- *Promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders; and to*
- *Contribute to global financial stability*

The NAIC and 56 jurisdictions in the US are members of the IAIS

Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame):

- Development began January 2010
- "... allow for a more integrated and international approach"
- "... foster global convergence of regulatory and supervisory measures and approaches"
- "ComFrame is designed to become a multilateral, coherent and sustainable IAIS policy response to operationalise the supervision of IAIGs"
– adopted January 2010

International Association of Insurance Supervisors

- Establish Insurance Core Principles (ICPs), which can be used to determine a country's compliance with the Financial Sector Assessment Program (FSAP) of the IMF and World Bank
- IAIS is revising ICPs with goal of completion/adoption by November 2011
- ICP 16 Enterprise Risk Management: "The supervisory regime establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks."

NAIC SMI

Solvency Modernization Initiative

- critical self-examination to update US insurance solvency regulation framework; includes review of international developments regarding insurance supervision, banking supervision, and international accounting standards and their potential use in U.S. insurance regulation.
- Includes the entire U.S. financial regulatory system and all aspects relative to the financial condition of an insurer, and is not limited to the evaluation of solvency related areas. The SMI focuses on key issues such as capital requirements, governance and risk management, group supervision, statutory accounting & financial reporting, and reinsurance.
- Includes an expansion of the ability to look at any entity within an insurance holding company system that may or may not directly affect the holding company system, but could pose reputational risk or financial risk to the insurer through a new **Form F – Enterprise Risk Report**.

NAIC SMI

The diagram illustrates the components of the Solvency Modernization Initiative (SMI). A central box labeled 'SMI' is connected to five surrounding boxes: 'Capital Requirements', 'Governance & Risk Management', 'Group Supervision', 'Statutory Accounting & Financial Reporting', and 'Reinsurance'.

NAIC SMI

Some Changes of Interest to Actuaries

- Form F
- Statutory Accounting changes
 - international accounting
 - reserve discounting
 - possibly risk margins
- Changes to RBC Requirements
 - Retain focus on identification of “weakly capitalized companies” and not calculate economic capital targets
 - Concentrating on priority risks and method to combine risk charges (the “square root formula”); making adjustments to reflect other SMI changes, such as statutory accounting (e.g. principles-based reserving) or reinsurance modifications.
 - Addition of Catastrophe risk
- Own Risk and Solvency Assessment (ORSA)

Form F

- Material developments regarding strategy, internal audit findings, compliance or risk management affecting the insurance holding company system;
- Acquisition or disposal of insurance entities and reallocating of existing financial or insurance entities within the insurance holding company system;
- Any changes of shareholders of the insurance holding company system exceeding ten percent (10%) or more of voting securities;
- Developments in various investigations, regulatory activities or litigation that may have a significant bearing or impact on the insurance holding company system;
- Business plan of the insurance holding company system and summarized strategies for next 12 months;
- Identification of material concerns of the insurance holding company system raised by supervisory college, if any, in last year;
- Identification of insurance holding company system capital resources and material distribution patterns;
- Identification of any negative movement, or discussions with rating agencies which may have caused, or may cause, potential negative movement in the credit ratings and individual insurer financial strength ratings assessment of the insurance holding company system (including both the rating score and outlook);
- Information on corporate or parental guarantees throughout the holding company and the expected source of liquidity should such guarantees be called upon; and
- Identification of any material activity or development of the insurance holding company system that, in the opinion of senior management, could adversely affect the insurance holding company system.

US ORSA

- Response to ICP 16 of IAIS
- An opinion on the adequacy of the ERM system and the Capital of the firm
- Made by the [management and the board](#)
- Based upon their own assessment of company FUTURE plans and risks and capacity to bear risks
- Still a work in progress. Target implementation late 2012.

U.S. ORSA

Section 1: Risk Management Policy

Section 2: Risk Quantification & Stress Tests

Section 3: Prospective Solvency Assessment

ORSA: Risk Management Policy

- Identify all relevant and material risk categories and describe how those risk categories are monitored and managed
- Include any management activities or policy related to processes of identifying, assessing, measuring, monitoring, controlling and mitigating risks associated with group membership
- Disclose how company's management uses its risk management policy in day-to-day operations
- Disclose how the risk management policy is related and tied to the determination of the amount and quality of its economic capital and regulatory capital

ORSA: Quantification & Stress Tests

For each material risk category

- Quantify measurements of risk exposure
 - In normal and stressed environments
 - Under a range of outcomes using risk measurement techniques appropriate to the nature, scale and complexity of the risks
- Expect no standard set of stress conditions that each company should run, but regulator may have input regarding the level of stress that company management should consider for each risk category

ORSA: Prospective Solvency Assessment


In effect a feedback loop

Given current

- Risk profile
- Risk management policy
- Quality and quantity of capital

Project future financial position

- ability to meet regulatory capital requirements, reflecting changes to current risk profile caused by executing 3 to 5 year business plan under normal and stressed environments
- Consider risks associated with group membership
- Contingency plans to resolve capital adequacy issues



Part 2: Professional Issues (ASB)

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Actuarial Standards of Practice

- Standards are a true sign of a profession
- Defines what can be considered true actuarial professional work
- Standards address work of the individual actuary
- Basis for Disciplinary Process
- Basis for Professional Opinions
 - Tied to regulatory requirements in some situations
 - Provides a way for actuaries to communicate when they are being asked to deviate from normal practices

ASB Appoints ERM Task Force

- ❑ 2005 – decided field was not yet ready
- ❑ 2010 – reported back with recommendations
 - Existing SOPs not sufficient to guide actuaries practicing in ERM area
 - ERM is significant new area of actuarial practice
 - Actuaries need standards in this new area
 - Regulators are moving towards ERM regulations where professional standards could be important

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Actuarial Standards Board

- ❑ May 2010
 - Accepted Task Force recommendations to develop new standards
 - Requested Task Force to develop draft standards
- ❑ March 2011
 - Task Force presents a discussion draft for ERM standards to ASB
 - Board decides to circulate the discussion draft for comments

Discussion Draft Topics

1. Risk Evaluation
 - Economic Capital Models
 - Other Risk Evaluation
2. Risk Treatment
 - Risk Control Cycle
 - Risk Tolerance/Appetite/Limits
 - *Risk measuring and reporting (Covered in #1 above)*
 - Risk Mitigation Emerging Risks

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Important ERM Topics that were not included

- Culture
- Organization
- Governance

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Key ERM elements in ORSA Proposal

- 1) Identify risks
- 2) Measure risks
- 3) Risk feedback loop
- 4) Risk tolerance statement
- 5) Risk policy

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Key ERM elements in ORSA Proposal

1) Identify risks	<==Specified
2) Measure risks	<==Risk Evaluation
3) Risk feedback loop	<==Risk Treatment
4) Risk tolerance statement	<==Risk Treatment
5) Risk policy	<==Risk Treatment

Adequacy of Capital

- Addressed by Risk Evaluation

Preliminary Conclusion:

- These two standards would support an actuarial professional opinion for the ORSA

Contents of Draft ERM Standards

- Scope
 - Discussion of tasks performed
 - Tells when to apply standard
- Considerations (Shoulds)
- Communication
- Disclosures (Musts)

Economic Capital Tasks (Examples)

- Design, build, operate and/or report on the findings of an organization's Economic Capital model.
- Review and validate the results of an organization's Economic Capital model.
- Develop, review or validate the assumptions and methodologies underlying an Economic Capital model.
- Provide an independent third party review of an organization's Economic Capital model.
- Provide documentation relating to an organization's Economic Capital model.
- Analyze the impact of a strategic decision on an organization's Economic Capital.
- Recommend allocations of Economic Capital to units with an organization.
- Communicate the purpose, use(s), results and limitations of an Economic Capital model to both technical and non-technical audiences.

Economic Capital Considerations (Examples)

- The appropriateness of the selected time horizon and confidence level underlying an organization's definition of Economic Capital.
- The degree to which the Economic Capital model captures all material risks of the organization in a consistent manner.
- The degree to which the Economic Capital model is dynamic and flexible in nature, robust, reproducible and adaptable to new risks.
- The appropriateness of an Economic Capital modeling framework that doesn't allow for Stress Testing and Scenario Testing.

Economic Capital Considerations (Examples)

- The degree to which the Economic Capital models reflect the nature, scale and complexity of the organization.
- The degree to which the methodology and supporting assumptions underlying an Economic Capital model are identified, supported and documented.
- The quality, accuracy, appropriateness and completeness of data underlying an Economic Capital model.
- The appropriateness of manual data entry and duplication of effort versus automation.
- The appropriateness of the methodologies for Economic Capital model validation and calibration.

Communication & Disclosures

- Model Results
- Model Limitations
- Expected usage
- Assumptions
- Whether reserve adequacy was considered
- Future Risk mitigation actions included
- Deviation from standard

Questions posed in Request for Comments

- ❑ Does this conflict with any other standards for ERM of firms?
- ❑ Are these too prescriptive or too little prescriptions
- ❑ Do these cover the ERM work of actuaries?
- ❑ Could these be of help to actuaries if they are doing ERM work outside of insurance?
- ❑ Are they clear?
- ❑ Do they encourage the right behaviors and discourage the wrong behaviors?

Future of these Drafts

- Comment Period requested by June 15
- Task Force will prepare discussion of comments and review with ASB
 - Not public response

Future of these Drafts


- If Board agrees, Task Force will proceed to write standards, hopefully by year end
 - There will be an Exposure Draft, with a second comment period
 - At the end of the second comment period,
 - the Board considers the comments,
 - agrees to changes (or not) and then
 - Makes the revised standard effective

Conclusion

- Thanks to the ERM Task Force for their work
 - David Ingram, Chairperson, Mary Ellen Coggins, Wayne Fisher, Kevin Madigan, Clause Metzner, David Rogers, Max Rudolph, Dave Sandberg, John Stark
- Please Read the draft standards
 - Available at ASB website
- Consider the questions raised
- Consider making comments to the board

Postscript

- There is a new movement in the International Actuarial Association to produce a set of International Actuarial Standards of Practice
 - Demand from smaller associations who would rather rely upon international standards than try to create their own
- The IAA has formed a committee to start to create a small set of standards
 - An ERM Task Force has been formed to create an ERM standard


Thank You For Your Attention

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