Best practices for ORSA implementation

October 21, 2014

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Agenda

I. What is ORSA?

II. Review process

III. What is enterprise risk management?

IV. Sections of an ORSA Summary Report

V. Building the engine for the ERM process

VI. Risk assessment process

VII. Key ERM challenges

VIII. Questions?

WHAT IS ORSA?

What is ORSA?

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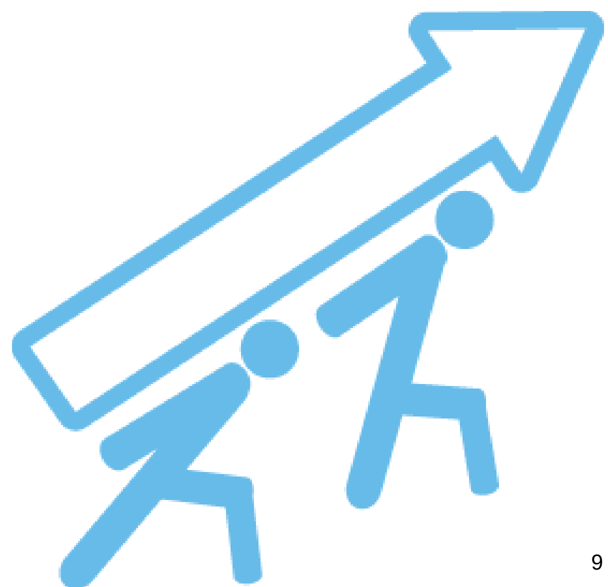
The Own Risk and Solvency Assessment (ORSA) is becoming a key part of the regulatory framework for US insurers.

The ORSA Guidance Manual states that ORSA is:

> A component of the insurer's Enterprise Risk Management (ERM) framework

> A confidential internal assessment appropriate to the nature, scale, and complexity of an insurer conducted by that insurer of the material and relevant risks identified by the insurer associated with an insurer's current business plan and the sufficiency of capital resources to support those risks

Overall, the ORSA is essentially an internal assessment of the risks associated with an insurer’s current business plan, and the sufficiency of capital resources to support those risks.



ORSA’s two primary goals

- To foster an effective level of enterprise risk management at all insurers, through which each insurer identifies and quantifies 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

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General guidance

The ORSA process is one element of an insurer's broader Enterprise Risk Management (ERM) framework. It links the insurer's risk identification, measurement, and prioritization processes with capital management and strategic planning.

Effective date: January 1, 2015 with the first Summary Report filing sometime in 2015, a date yet to be determined.

High-level ORSA Summary Report annually to the domiciliary regulator, **if requested.**

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General guidance

> Each ORSA process will be unique

> The ORSA Summary Report will be used to gain a high-level understanding of the process

> The report will be supported by the insurer's internal risk management materials

> Minimum the ORSA Summary Report should discuss:

  - 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

2013 ORSA guidance revisions

- Identify the basis of accounting for the ORSA Summary Report (e.g., GAAP, SAP, or IFRS)
- Explain the scope of the ORSA such that the ORSA Summary Report identifies which entities within the group are included, possibly accompanied by an organizational chart
- Include a summary of material changes to the ORSA from the prior year
- Provide a comparative view of risk capital from the prior year
- Included changes to synchronize guidance in the Manual with the requirements in the adopted *Risk Management and Own Risk and Solvency Assessment Model Act* (#505)

An ORSA program sets up a corporate governance structure.

- To obtain information regarding guidance and oversight provided by the board of directors and executive management, the examiner must understand the corporate governance structure and be able to assess the "tone at the top".

- This information, along with information on how the insurer identifies, controls, monitors, evaluates, and responds to risks will enhance the examiner's consideration of current and prospective risk areas and assist with the appropriate determination of detailed examination procedures that should be performed as described in the NAIC's 2012 Financial Examination handbook.

REVIEW PROCESS

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The biggest challenge facing companies submitting their first ORSA summary report?

Trying to understand what the regulator will be looking for.

Understanding the review process

Currently, many regulators are concerned that their staffs do not have the skills to understand a company's ERM programs.

The summary report should be drafted in a way that the key elements are laid out ***as plainly as possible***.

WHAT IS ENTERPRISE RISK MANAGEMENT?

What is enterprise risk management?

Traditional risk management, risk-based regulation, and capital management are converging.

Opportunity Maximization

Sustained Growth

Business Preservation

Risk Mitigation

Risk Opportunity

Across all functional Business Units
(e.g. Claims, Human Resources)

Compliance
SOX, Model Audit Rule, regulation driven - if you manage controls you have managed risks

Asset protection
Corporate insurance, loss prevention, fraud, privacy, health & safety, business continuity

Risk analytics
Risk & control assessments, loss impact & probability and scenario analysis, risk dashboards

Financial modeling
Catastrophe risk & economic capital modeling, capital allocation, financial forecasting rating agency & reg capital

Strategy and planning
Key risks to meeting objectives; strategic, operational & emerging risks; risk appetite statements

What is ERM?

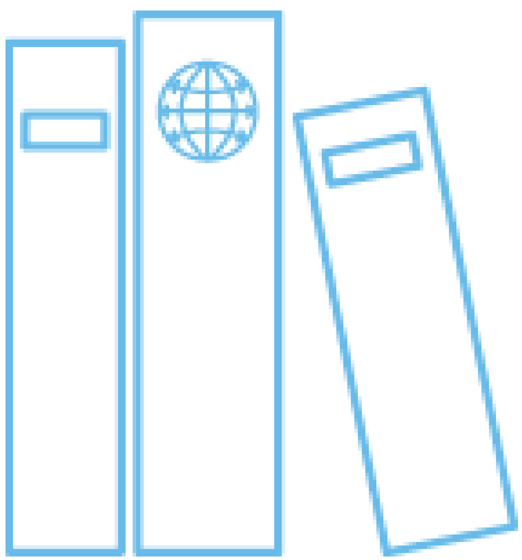
The process by which organizations identify, measure, monitor, and exploit key risks for the purpose of meeting business objectives and increasing shareholder value.

What is the ERM Value Proposition?

One perspective…

- To maximize return from an organizations chosen risk profile
- Achieved by use of a risk-based decision making processes that supports achievement of business objectives, and leverage the firms business acumen, analytics, and financial modeling capabilities

SECTIONS OF AN ORSA SUMMARY REPORT



3 sections of ORSA summary report

Section 1: Description of ERM Framework

- Risk culture and governance
- Risk identification and prioritization
- Risk appetite, tolerance, and limits
- Risk management and controls
- Risk reporting and communication

Section 2: Insurer Assessment of Risk Exposures

Section 3: Group Assessment of Risk Capital and Prospective Solvency Assessment

- Group assessment of risk capital
- Prospective solvency assessment

Sample outline of ORSA report

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ORSA Summary Report: Table of contents

Section 1

1) Risk Management Policy Statement (objectives, approach, and culture)
2) Corporate and Risk Governance (management boards and risk committees)
3) Business and Financial Management Planning Cycles (business strategy)
4) Risk Management Communication and Reporting Cycles

Section 2

1) Risk and Control Assessment and Monitoring Framework
2) Identification, Classification, Quantification, and Prioritization of Business Risks
3) Risk Appetite Statements and Risk Tolerance Limits

Section 3

1) Use Economic Capital Models (BCAR, ECM, RBC) and Financial Models (EAR)

Section 4

1) Key Business Risk Mitigation and Management Action Plans
2) Independent Assurance (actuarial review, internal and external audit)

COSO 2013 impact on ORSA

COSO 2013 Framework	
Control Objective	**Principle**
Control Environment	1. Demonstrates commitment to integrity & ethical values
	2. Exercises Oversight Responsibility
	3. Establishes Structure, Authority, and Responsibility
	4. Demonstrates Commitment to Competence
	5. Enforces Accountability
Risk Assessment	6. Specifies Suitable Objectives
	7. Identifies and Analyzes Risks
	8. Assesses Fraud Risk
	9. Identifies and Analyzes Significant Change
Control Activities	10. Selects and Develops Control Activities
	11. Selects and Develops General Controls over Technology
	12. Deploys through Policies and Procedures
Information & Communication	13. Uses Relevant Information
	14. Communicates Internally
	15. Communicates Externally
Monitoring Activities	16. Ongoing Monitoring and Internal Audit
	17. Evaluates and Communicates Deficiencies

COSO 2013 impact on ORSA

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ORSA Summary Report Guidance	
Section 1: Description of ERM Framework	Risk Culture and Governance
	Risk Identification & Prioritization
	Risk Appetite, Tolerance & Limits
	Risk Management & Controls
	Risk Reporting and Communication

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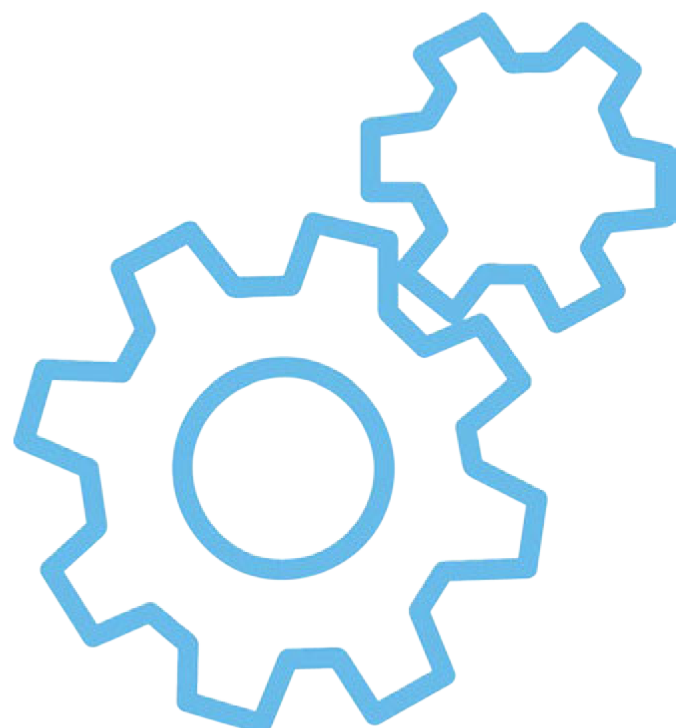
BUILDING THE ENGINE FOR THE ERM PROCESS



Determine that management is continuing to:

> Build consensus around the ERM process

> Gather relevant information and existing data

> Conduct interviews, surveys and facilitation work sessions

> Identify key risks and develop a risk profile

> Initiate risk mitigation, optimization activities, and ownership to emerging risks

Create ERM process → **Risk identification, analysis, and prioritization** → **Validate risk assessment and responses** → **Risk monitoring and reporting**

Confirm that management has

- Compiled a list of risks that impact the business sorted by category
- Performed risk assessment facilitated workshops and surveys to identify, analyze, and prioritize key risks and strategies

Risk identification, analysis, and prioritization

- Results of the risk identification process are compiled
- Risk are evaluated and assessed (high, medium, low) from two perspectives, impact and likelihood
- Options used:
  - Accept = monitor
  - Avoid = eliminate (get out of situation)
  - Reduce = institute controls
  - Share = partner with someone (e.g. re-insurance)
- Risk assessment is linked to strategic objectives
- Results are compiled and risk maps developed to summarize and prioritize key risks (top 10 to 15 risks)

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Validate risk assessment and responses

- Review management's feedback on risk assessment; identify and evaluate possible responses to risks (Accept, Avoid, Reduce and Share)
- **Evaluate options in relation to entity's risk appetite, cost vs. benefit of potential risk responses, and degree to which a response will reduce impact and/or likelihood**
- Select and execute response based on evaluation of the portfolio of risks and responses
- Facilitate meetings or work sessions with key members of management to address developed responses

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Risk monitoring and reporting

- Ensure accountability for risks
- Summarize a risk assessment report
- Create risk dashboards for high-level board reporting
  - Leverage technology tools
- Develop a continuous monitoring program
  - Ensure updates are reflected (i.e., changes in systems or processes)
  - Risks are being properly addressed
  - Controls are working to mitigate risks

Risk management framework

Strategy

- Strategic Goals & Objectives
- Risk Universe
- Risk Appetite / Tolerance
- Risk Limits

Organization

- Culture & Governance
- Accountability
- Roles & Responsibilities

Process

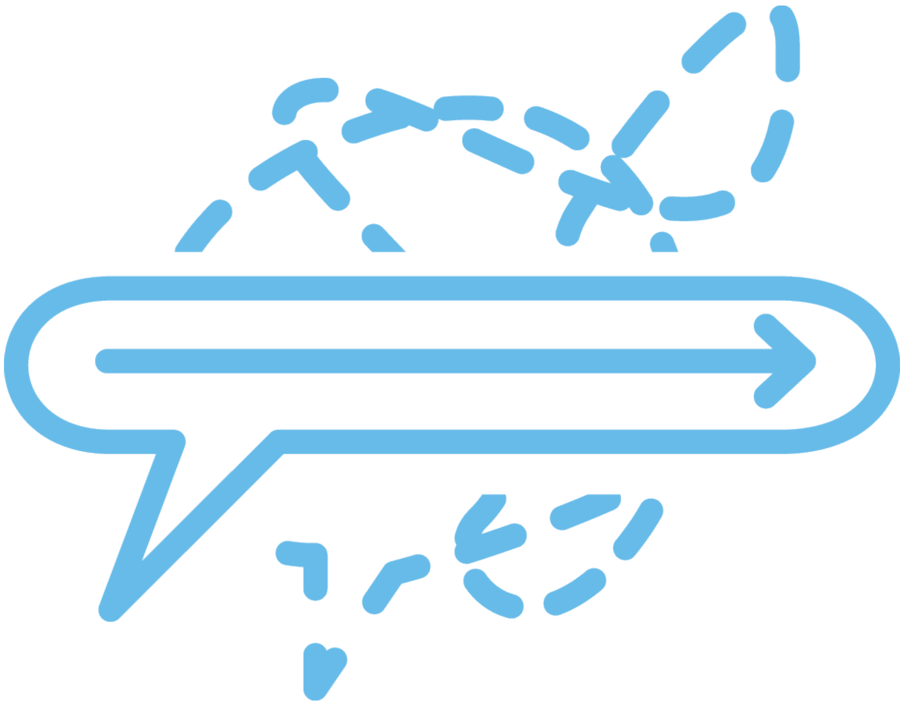
- Identification
- Quantification
- Prioritization
- Mitigation & Execution

Tools

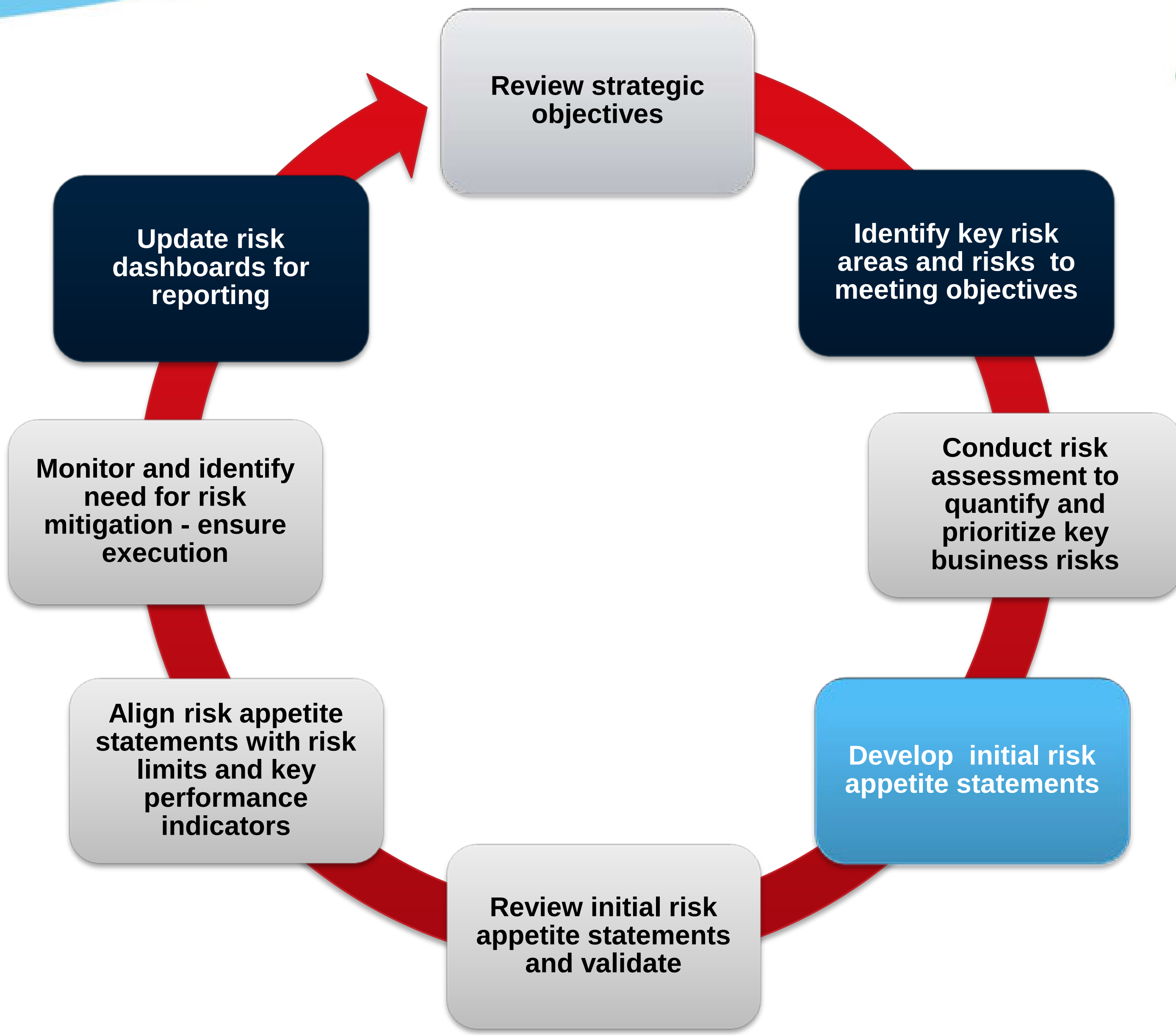
Monitoring and Reporting

- Risk Committees & Reports
- Key Risk & Performance Indicators
- Board Meetings & Reports
- Dashboard Reports (e.g. Balanced Scorecard)

RISK ASSESSMENT PROCESS



Risk assessment process



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Operationalizing risk assessments

Business Strategy
- Business Plan Objectives
- Key Risks to Objectives
- Emerging Risks

Risk Assessments
- Includes review of:
  - Strategic
  - Operational
  - Emerging Risks

Key Risk Mitigation

Risk Control Effectiveness
- Internal & External Audit
- Management Self Assessments
- Self Audit Testing

Management Action Plans

Risk Appetite Statements → **Key Risk Areas** → **Key Risk Indicators** → **Action Plan Activity Dashboard**

The ORSA requires an insurer to consider the following in its attitude towards managing risk capital:

- Sound processes for assessing capital adequacy in relation to their risk profile and those processes should be integrated into the insurer's business decision making
- Processes may assess risk capital through a myriad of metrics and future forecasting periods, reflecting varying time horizons, valuation approaches and capital management strategies (e.g. economic, rating agency, regulatory)
- This section is intended to assist commissioners understand an insurer's capital adequacy in relation to its aggregate risk profiles

Economic capital is typically assessed via use of financial modeling and includes analysis of key risks areas that may impact an organization:

- Underwriting and reserving risks
- Investment and credit risks
- Market and liquidity risks
- Strategic, emerging, and operational risks

Output from capital models (deterministic or stochastic) can be utilized to assess risk reward trade-offs and create a linkage between risk appetite and risk-based decision making processes.

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KEY ERM CHALLENGES

Some key ERM challenges

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1) Insurers may not have effective ERM programs in place today & struggle to realize an ***ERM Value Proposition***. This Value Proposition is simply to optimize return from a chosen risk-profile.

2) This Value Proposition can be achieved by employing an ***ERM Framework*** that enriches risk-based decision making processes, leveraging business and financial acumen across an organization.

3) This ERM Framework needs to be closely tied to the managing key business risks to be meeting strategic business objectives – the risks that really matter!

4) Some organizations struggle to clearly articulate ***Key Risks to Meeting Business Objectives*** - and their chosen ***Risk Profile*** - to key stakeholders such as: employees, management, board of directors, regulators, shareholders, policyholders, and rating agencies.

5) ***Risk Profile*** can be expressed as ***Risk Appetite Statements*** or ***Risk Tolerance Levels***, and should be defined as the level of risk a company is willing to accept in pursuing its goals & objectives.

6) Some consider ***Risk Appetite*** to be a theoretical concept, but organizations already have a risk appetite; the question is whether a mutual understanding exists between the board, management, and employees as to what it is.

7) ***Risk Appetites*** should be clearly linked to risks to meeting business objectives and demonstrate these key risks are effectively being ***Identified, Evaluated, Quantified, Monitored, and Mitigated***.

8) Output from ***Financial Models*** such as capital models, catastrophe models, and financial projections (whether stochastic, deterministic, or cash-flow driven) can be utilized to assess risk reward trade-offs and create a linkage between risk appetite and risk-based decision making.

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