

The banner features a blue background with a pattern of white stars. On the left, there is a vertical strip showing the dome of the U.S. Capitol building. The text is centered in white, and the year '2016' is displayed in large, light blue digits on the right side.

AMERICAN ACADEMY *of* ACTUARIES Annual Meeting and Public Policy Forum

NOVEMBER 3-4, 2016 ★ CAPITAL HILTON WASHINGTON, D.C.



Lessons From ORSA Implementation

Jeff Schlinsog, MAAA, FSA – Vice President, Risk Management and Financial Reporting Council

Rhonda Ahrens, MAAA, FSA – Life & Health Actuarial Examiner, Nebraska Department of Insurance

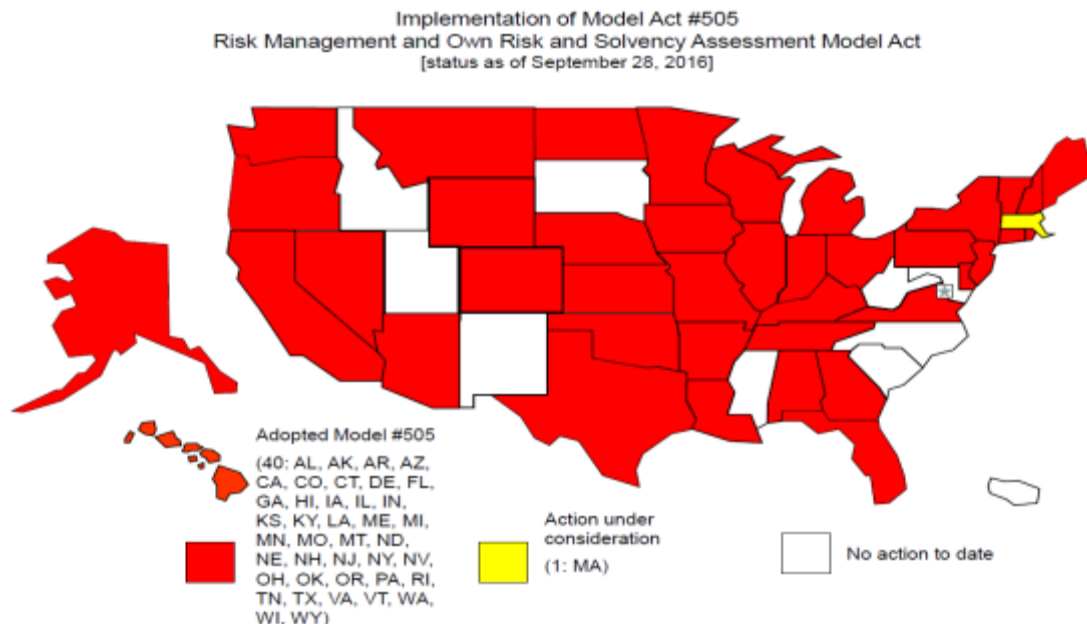
Elisabetta Russo, MAAA, FIA – ERM Advisor, NAIC



Agenda

- Introductions
- ORSA History and Guidance – Eli Russo, NAIC
- DOI Walkthrough and Observations – Rhonda Ahrens, Nebraska Department of Insurance
- Questions and Answers

Overview – State adoptions



This map represents state action or pending state action addressing the topic of the model. This map does not reflect a determination as to whether the pending or enacted legislation contains all elements of the model or whether a state meets any applicable accreditation standards.

Overview – Effective dates

- Of the 40 states:
 - Majority had a 2015 first ORSA filing date
 - 7 have 2016 date [AZ, LA, MO, OK, OR, TX, WA]
 - 5 have a 2017 date [AL, AR, CO, FL, KS]
 - 1 has a 2018 date [MI]
- ORSA to become a NAIC accreditation standard on Jan. 1, 2018
- 300+ reports expected in total (approx. 200 at group level, 100 legal entity only) - excluding international premium data
- Approximately half received so far by the Departments of Insurance (Dols)

Overview – Key actions to date

- NAIC ORSA Training for Dols:
 - Classroom training using real ORSAs and often company's participation
 - 23 states trained so far (including exam contractors)
 - Basic knowledge + Application of Exam & Analysis handbooks procedures + Lead State role & scope of documentation
- Re-establishment of NAIC ORSA Subgroup under GSIWG (Group Solvency Issues (E) Working Group)
 - Place to discuss common regulatory issues
 - Some calls open to the public
 - ORSA Confidentiality and Sharing Best Practices document
 - exposed till Sept. 9, 2016
 - http://www.naic.org/committees_e_orsai_wg.htm
- Two Form F documents posted on WG's page:
 - Form F Effectiveness Survey
 - Comparison of Form F and ORSA Reporting Requirements
 - http://www.naic.org/committees_e_isftf_group_solvency.htm

ORSA On One Page

Section 1			Section 2		Section 3		
Risks	Risk Owners	Limits	Exposure Normal	Exposure Stressed	Risk Capital Current	Risk Capital Stressed	Risk Capital Projected
Key Risk 1							
Key Risk 2							
Key Risk 3							
Key Risk 4							
Key Risk 5							

Overall feedback

- Feedback based on review of approximately 100 reports
- Overall, compliance with ORSA structure as per NAIC ORSA Manual
- Life and P&C ORSAs better than Health
- Quality of the information not always representative of maturity of ERM and Capital Management frameworks – dialogue between DoI and insurer remains key
- Most challenging building blocks for insurer:
 - Section 1: individual risk limits and enterprise risk appetite
 - Section 2: assessment of risk exposures
 - Section 3:
 - Quantification of risk capital for each key risk
 - Fitness of risk metric selected for risk profile
 - Prospective assessment
 - Group policies versus local implementation in U.S. (for international companies)
- 2016 ORSAs better than 2015 and better than 2014 pilots
- Still confusion on some ORSA requirements - DoI's feedback fundamental
- More evidence of “fitness of purpose” from insurer of choices made (e.g., assessment metrics, stresses)

Section 1 – DoI's focus and feedback

- Main questions of interest to the DoI:
 - What are the main lines of defense against risk within the insurance group? How are risk owners rewarded?
 - What are the key risks (given main strategic goals)?
 - What are the individual risk limits and overall risk appetite?
 - Which controls have been tested by Internal Audit?
 - What KRIs are monitored and reported?
- Feedback from first year's reviews:
 - Limited information on key strategic goals
 - Nice to know next ORSA initiatives
 - No information on compensation of risk owners
 - Names and responsibilities of key risk owners
 - List of key risks but limited information on ID process
 - Not all key risks have limits
 - Tendency to disclose mostly financial controls
 - Need for more up-to-date information (e.g., quarterly KRIs reported to management & BoD)

Section 2 – DoI's focus and feedback

- Main questions of interest to the DoI:
 - How big are the key risks (on current and stressed basis)?
 - How often is the exposure assessed and how does it compare with the limit?
 - How is the exposure monitored?
 - What actions were taken in case of a breach? Were the controls effective?
- Feedback from first year's reviews:
 - Not all key risks are assessed
 - No explanation of why some key risks are not assessed: lack of data or methodology?
 - Justification to the choice of stresses – very little disclosure of underlying analysis

Section 3 – Dol's focus and feedback

- Main questions of interest to the Dol:
 - Does the company have sufficient capital resources to cover unexpected losses, now and in future (for the duration of the business plan)?
 - What are the potential “unexpected losses”?
 - How does the company manage and allocate capital to risks?
 - How fungible is capital across the enterprise?
 - Is the risk profile of the insurer likely to change as a result of the business strategy?
- Feedback from first year's reviews:
 - Variety of metrics (RBC multiples, rating agency, economic capital) - no explanation of choice of risk metric
 - No quantification of risk capital for all key risks
 - No explanation of diversification benefit (often “significant”)
 - Often no prospective assessment
 - Limited support to choice of stresses (mostly focus on results)
 - Limited to no information on validation (framework, scope, status, results)

Stress Testing

- No prescribed stress testing in the ORSA but requirement to stress individual risk exposure and capital (on current and prospective basis)
- Feedback from first year's reviews:
 - Mostly single stresses for market (incl. credit), underwriting, cyber
 - Some common stresses
 - Financial crisis, interest rate, some geopolitical scenarios (China, Brexit)
 - Worsening of credit quality of investments
 - Natural CATs , man-made CATs (e.g. terrorism), pandemics
 - Cyber
 - Lack of impact of combined stresses
 - Very little disclosure of reverse stresses
 - Disclosure of results but not of underlying process for selection of stress & overall stress testing framework (including governance)
- Currently Dols in “observe & assess” mode
 - What is the regulatory value of stresses disclosed in ORSA? No benchmarking anticipated
- Future Dols' considerations:
 - May request more company specific stresses based on ORSA
 - Collaboration with other regulators and influence of other regulatory activities (e.g., Group Capital calculation, International Capital Standard, FRB oversight) may lead to request for industry-wide stresses

Overview – Next ORSA priorities

- Immediate:
 - Provide feedback to insurers
 - Continue to support Lead State role in reviewing and documenting ORSAs
 - Address Form F issue (Interpretative Guidance being drafted by NAIC)
- Medium term:
 - Define “deeper” scope of Section 3 review
 - Achieve consistency in the Dols’ reviews

Walkthrough of Department of Insurance Reviews

- Executive Summary
- Section 1 – Description of ERM Framework
- Section 2 – Assessment of Risk Exposures
 - Normal and Stressed Conditions
- Section 3 – Group Assessment of Risk Capital
 - Including Prospective Assessment

DOI Walkthrough – What Stands Out

- **“OWN” It**
 - Consistency With Strategy, Mission, Purpose
 - Part of ERM, not a regulatory exercise
 - ERM is a Culture Thing – Clear Owners of Each Risk
- **Risk Appetite Tells a Story**
 - Risks Sought, Tolerated and Avoided are Consistent with Strategy
 - Risk and Capital Assessment used to Establish Risk Limits and Tolerances
- **Management Understands Controls and Diversification Benefits**
 - Regular Reports
 - Dashboards and Heat Maps
- **Management Knows How Much Capital Is Available**
 - Amount of Capital Available
 - Amount of Free Capital
 - Cost of Capital – Amount Needed to Grow

DOI Walkthrough

Executive Summary

- Overview of Business Strategy
- Risk Appetite Consistent with Strategy
 - Sought
 - Accepted/Tolerated
 - Avoided
- ERM Maturity
 - Identification and Assessment of Risks
 - Strength of Controls/Effects of Diversification
 - History and Future of ERM at a Company
 - Especially changes from last ORSA and planned changes for next ORSA
- Summarize Capital Assessment
 - Amount of Capital Needed
 - Compared to Amount of Capital Available

DOI Walkthrough

Section 1 – Description of ERM Framework

- **Process Used to Identify Risks**
- **Stated Limits and Tolerances for Each Risk**
 - Should tie into general appetite: seek, accept, avoid
- **Specific Risk Appetite Statement**
 - Consistent with Strategy, Risks Identified
 - Ideally this is more than just an X% RBC minimum
- **Key Risk Indicators**
 - How Are Identified Risks Tracked
 - Risk Owners, Reports to Management, Action Plans, etc.
- **Identification of Emerging Risks**
 - How Are New or Emerging Risks Identified

DOI Walkthrough

Section 2 – Assessment of Risk Exposures

- Include All Risks From Section 1 - (“OWN” it?)
- Regulatory Review Includes All Branded Risk Categories – (Please the regulator?)
 - Branded Risks: Credit, Market (Equity and Interest Rate), Liquidity, Insurance, Reserving, Operational, Strategic, Legal/Regulatory, Other/Emerging
- Assessment
 - Deterministic or Stochastic Stresses
 - Defend Your Stressed Environment
 - Qualitative – with reasoning as to why
 - Lack of Data or History
 - Emerging Risk is Unpredictable - Cybersecurity
 - Consistency of Normal and Stressed Environment across Risks
 - Correlations among risks
 - Diversification Effects (often in Section 3)
- Pre- and Post-Mitigation
 - Help Board Understand the Importance of Controls

DOI Walkthrough

Section 3 – Group Capital Assessment

- **Metrics Used**
 - Capital: RBC, Rating Agency, Economic
 - Other: Dividend Paying Ability, IRR, Liquidity Ratios
 - Combined or Multiple Metrics
 - Justify the Selection of the Metric – Tie in with Strategy
- **How Does Each Key Risk Affect the Metric?**
- **Effects of Mitigation/Diversification**
 - Some reports show ONLY post mitigation/diversification
 - Test to be sure post mitigation/diversification results are reasonable – direction/magnitude
- **Justify Selection of Stressed Environments**
- **Include Prospective Assessment**
 - Assessment is often “Old” by the time it is reviewed

DOI Walkthrough – Best Practices

- “Own” your ORSA
- Risk Culture - Tie In Risk Management with Strategy
- Risk Assessment and Mitigation – Include All Risks
 - Defend the Value of Mitigation and Diversification
- Capital Assessment – Attribution to Key Risks
- Defend Model – Approach and Assumptions

Questions?

