NAIC OWN RISK AND SOLVENCY ASSESSMENT (ORSA) GUIDANCE MANUAL

Created by the
NAIC Group Solvency Issues Working Group
Of the Solvency Modernization Initiatives (EX) Task Force

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I. **INTRODUCTION**

The purpose of this Manual is intended to provide guidance to an insurer and/or the insurance group (herein referred to as “insurer” or “insurers”) with regard to reporting on its own risk and solvency assessment (ORSA) as outlined within the Form B – Insurance Holding Company System Annual Registration Statement of the *NAIC’s Insurance Holding Company System Regulatory Regulation (#450)*. As described more fully below, an insurer who is subject to the ORSA requirement 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. Whether an applicable state insurance regulator chooses to request the confidential filing each year may depend on a myriad of factors, such as the nature and complexity, financial position, and/or prioritization of the insurer/group, as well as the economic environment considerations.

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. The ORSA has two primary goals:

1. 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; and

2. To provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view.

An insurer that is subject to the ORSA requirement should consider the guidance provided in this Manual when conducting its ORSA and compiling the summary report. As the process and results are likely to include proprietary information, any report received by the regulators shall be held confidential as provided by state statutes.

An insurer should keep the commissioner or his or her designee abreast of the timing of the insurer’s ERM-related strategic planning and ORSA reporting requirements for all U.S. and international regulators so that the completion of the ORSA process and finalization of an ORSA Summary Report may be coordinated with the insurer’s internal processes and completed no more than once annually.

A. **Exemption**

An insurer shall be exempt from the requirements of the ORSA, if

a. 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, is less than $500,000,000; and,

b. The insurance group’s (all insurance legal entities within the group) 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 is less than $1,000,000,000.

If neither a. nor b. exemption elements are triggered, then an insurer or insurers may supply the ORSA Summary Report in any given combinations, as long as all insurance legal entities within the group are covered. For example, the property & casualty insurers within a group could be combined within one ORSA Summary Report, and the life insurers within the same group could be combined within another ORSA summary report, if such entities operate under different ERM Frameworks.

If exemption element a. is triggered and not b., then the insurer or insurers (within the group) may supply the ORSA Summary Report in any given combinations, as long as every insurance legal entity within the group are covered by the summations of the ORSA Summary Report.

If exemption element b. is triggered and not a., then only the legal entity ORSA Summary Report of the entity over the threshold is required, however, the insurer may include other smaller insurers within the holding company system, if desired.

An insurer that is otherwise exempt may be required to meet the ORSA requirement based on unique circumstances at the discretion of the commissioner including, but not limited to, the type of business written, federal agency requests, and international supervisor requests, etc.

A commissioner also has authority to require an ORSA if the insurer is in a RBC action level event, meets one or more of the standards of an insurer deemed to be in hazardous financial condition, or otherwise exhibits qualities of a troubled insurer.

B. Application for Waiver
An insurer may make application to the commissioner for a waiver from the requirements of the ORSA based upon unique circumstances. The commissioner may consider various factors including, but not limited to, the type of business entity, and volume of business written.

C. 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.

Each insurer’s ORSA process will be unique, reflecting its business, strategy and approach to ERM. The regulator recognizes this, and will use the ORSA Summary Report to gain a high-level understanding of the process. The report will be supported by the insurer’s internal risk management materials. However, at a minimum the ORSA Summary Report should discuss three major areas, which will be referred to as the following sections:

- **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
Guidance for completing each section is noted below. However, the depth and detail is likely to be influenced by the nature and complexity of the insurer. Additionally, each section is expected to be updated annually for the insurer. However, for some insurers, Section 1 could represent a voluminous amount of information. The discretion for determining the extent to which the Section 1 information is summarized is left to the insurer, who must determine how best to communicate its processes designed to manage its risks. Additionally, in order to avoid excessive volumes of detail or supporting documents for complex insurers, an insurer may simply reference other explanatory documents within the ORSA Summary Report, as long as those documents are available to the regulator upon request.

In analyzing an ORSA Summary Report, the supervisor 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.

The ORSA Summary Report may help determine the scope, depth and minimum timing of risk-focused analysis and examination procedures. For example, insurers have varying levels of ERM frameworks, ranging from a business plan, to a combination of investment plans and underwriting policies, to more complex risk management processes and sophisticated modeling. 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. Therefore insurers should consider developing an ORSA Summary Report that helps to demonstrate the strengths of their framework, including how it meets the expectations of this Manual document for the relative risk of the insurer.

In addition to the ORSA Summary Report, the insurer should internally document the ORSA results to facilitate a more in-depth review by the regulator through analysis and examination processes. Such a review may depend on a myriad of factors, such as the nature and complexity, financial position, and/or prioritization of the insurer, as well as external considerations such as the economic environment. For example, major changes to an insurer’s risk management policies, or specific concerns from a regulator regarding the insurer may result in the state requesting additional information about the policies through the state’s analysis or examination processes.

An internationally active insurer that is required to provide a group ORSA for a group-wide supervisor in a non-U.S. jurisdiction may be able to satisfy the NAIC’s filing requirement by providing that ORSA report. This ORSA report will be reviewed in relation to the principles expected of regimes as outlined in the International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) 16 Enterprise Risk Management (ERM), as well as the U.S. NAIC ORSA Guidance Manual to determine if additional information is needed. The U.S. state regulator might also review and consider the applicable jurisdiction’s FSAP and IAIS Self-Assessment in relation to ICP 16. One of the NAIC’s goals is to avoid creating duplicative regulatory requirements for internationally active insurers.

D. Extensions
An extension for the due date of submission of the ORSA Summary Report may be granted at the discretion of the Commissioner.
II. **SECTION 1 – DESCRIPTION OF THE INSURER’S RISK MANAGEMENT FRAMEWORK**

An effective Enterprise Risk Management (ERM) Framework should at a minimum include the following key principles:

- **Risk Culture and Governance** – Governance structure that clearly defines and articulates roles, responsibilities and accountabilities; and a risk culture that supports accountability in risk-based decision making.

- **Risk Identification and Prioritization** – Risk identification and prioritization process that is key to the organization; ownership of this activity is clear; the risk management function is responsible for ensuring that the process is appropriate and functioning properly at all organizational levels.

- **Risk Appetite, Tolerances and Limits** – A formal risk appetite statement, and associated risk tolerances and limits are foundational elements of risk management for an insurer; Board understanding of the risk appetite statement ensures alignment with risk strategy.

- **Risk Management and Controls** – Managing risk is an ongoing enterprise risk management activity, operating at many levels within the organization.

- **Risk Reporting and Communication** – Provides key constituents with transparency into the risk management processes and facilitate active, informal decisions on risk taking and management.

Section 1 of the ORSA Summary Report should provide a high-level summary of the aforementioned ERM Framework principles, if present. The Summary Report should describe how the insurer identifies and categorizes relevant and material risks and manages these as it executes its business strategy. It should also describe risk monitoring processes and methods, provide risk appetite statements, and explain the relationship between risk tolerances and the amount and quality of group risk capital. The ORSA Summary Report should identify assessment tools (feedback loops) used to monitor and respond to any changes in its risk profile due to economic changes, operational changes, or changes in its business strategy. Finally, it should describe how the insurer incorporates new risk information to monitor and respond to changes in its risk profile due to economic and/or operational shifts and changes in strategy.

Additionally, as part of the risk-focused analysis and/or examination process, the regulator may review supporting materials to supplement his or her understanding of information contained in the ORSA Summary Report. These materials may include risk management policies or programs, such as the insurer’s underwriting, investment, claims, asset-liability management (ALM), reinsurance counterparty and operational risk polices.

The manner and depth in which the insurer addresses these principles is dependent upon their own risk management processes, and any strengths or weaknesses noted by the regulator in evaluating this will have a bearing on the regulators’ ongoing supervisory plan of the insurer, as the regulator will consider the entirety of the risk management program and its appropriateness for the unique risks of the insurer.
III. **SECTION 2 - INSURER ASSESSMENT OF RISK EXPOSURES**

Section 2 of the ORSA Summary Report should document the quantitative and/or qualitative assessments of risk exposure in both normal and stressed environments for each material risk category identified in Section 1. 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 might include, but not be limited to, credit, market, liquidity, underwriting, and operational risks.

Section 2 may include detailed descriptions and explanations of the risks identified, the assessment methods used, key assumptions made and outcomes of any plausible adverse scenarios that are run. The assessment of each risk will depend on its specific characteristics. For some risks, quantitative methods are not well established, and in these cases, a qualitative assessment is appropriate. Examples of these risks may include certain operational and reputation risks. Additionally, it is recognized that each insurer’s quantitative methods for assessing risk will vary; however, insurers generally consider the likelihood and impact that each material and relevant risk will have on the firm’s balance sheet, income statement and future cash flows. Methods for determining the impact on future financial position may include simple stress tests or more complex stochastic analyses. When quantifying a risk, the insurer should provide the results under both normal and stressed environments. Lastly, the insurer’s risk assessment may consider the impact of stresses on capital. This may include consideration of risk capital requirements, as well as available capital, and may include regulatory, economic, rating agency or other views of capital.

The analysis should be conducted in a manner that is consistent with the way in which the business is managed, be it on a group, legal entity, or some other orientation. It is recognized that some stress tests for certain risks may be performed at the insurance group level. Where useful and relevant to the management of the business, some of the group-level stresses may be mapped into legal entities. The regulator may request additional information to map the results to an individual insurance legal entity.

Any risk tolerance statements should include material quantitative and qualitative risk tolerance limits, how the tolerance statements and limits are determined, taking into account relevant and material categories of risk and risk relationships that are identified.

Because the risk profile of each insurer is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer should run, however the regulator may have input regarding the level of stress that company management should consider for each risk category. The Summary Report should demonstrate the insurer’s process for model validation, including factors considered and model calibration. Unless a particular assumption is stochastically modeled, the group’s management will be setting their assumptions regarding the expected values based on their current anticipated experience studies and what they expect to unfold over the next year. The regulator may provide input to an insurer’s management on a stress factor that should be applied for a particular assumption that is not stochastically modeled. For assumptions that are stochastically modeled, the regulator may provide input on the level of the measurement metric to use in the stressed condition or specify particular parameters used in
the economic scenario generator. The aforementioned input provided by regulators will likely occur during either the financial analysis process and/or the financial examination process.

By identifying each material risk category independently and reporting results in both normal and stressed conditions, insurer management and the regulator are in a much better position to evaluate certain risk combinations that could cause an insurer to fail. One of the most difficult exercises in modeling insurer results is determining the relationships, if any, between risk categories. History may provide some empirical evidence of relationships, but the future is not always best estimated by historical data.

IV. **SECTION 3 – GROUP RISK CAPITAL AND PROSPECTIVE SOLVENCY ASSESSMENT**

Section 3 of the ORSA Summary Report should document how the company combines the qualitative elements of its risk management policy and the quantitative measures of risk exposure in determining the level of financial resources it needs to manage its current business and over a longer term business cycle, such as the next 2-5 years. The information provided in Section 3 is intended to assist regulators in forming subjective assessments of the quality of insurer’s risk and capital management.

**Group Risk Capital Assessment**

Capital adequacy assessment can be broadly defined as the testing of aggregate available capital against the various risks which may adversely affect the enterprise. The goal of such an exercise is to determine that a given level of capital is sufficient to withstand the various risks, individually and collectively, up to some defined security standard or risk appetite. The level of capital that just satisfies the security standard can be defined as “risk capital,” and can be compared to “available capital” to ascertain the degree of capital adequacy, including “excess” or “deficit” capital.

Insurers should have sound processes for assessing capital adequacy in relation to their risk profile and the process should be integrated into its management and decision making culture. These processes may assess risk capital through multiple lenses, reflecting varying time horizons and valuation approaches. While a single internal risk capital measure may play a primary role in internal capital adequacy assessment, insurers may evaluate how risk and capital interrelate over various time horizons, or through the lens of alternative risk capital or accounting frameworks (i.e., economic, rating agency, and/or regulatory frameworks). This section is intended to help regulators understand the insurer’s capital adequacy in relation to its aggregate risk profiles.

On an annual basis, the insurer subject to this reporting requirement should provide a group risk capital assessment within its ORSA Summary Report for the previous period. This information may also be requested by a Commissioner throughout the year, if needed, for example if material changes in the macroeconomic environment and/or microeconomic facts and circumstances suggest it’s needed for the ongoing supervisory plan.
The analysis of an insurer’s group risk capital requirements and associated capital adequacy should be accompanied by a description of the approach used in conducting the analysis. This should include key methodologies and assumptions used in quantifying both available and risk capital. Examples might include:

<table>
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<th>Considerations</th>
<th>Description of Consideration</th>
<th>Examples (not exhaustive)</th>
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<tr>
<td><strong>Definition of Solvency</strong></td>
<td>Describe how the insurer defines solvency for the purpose of determining risk capital and liquidity requirements</td>
<td>Cash flow basis, balance sheet basis, etc.</td>
</tr>
<tr>
<td><strong>Accounting or Valuation Regime</strong></td>
<td>Describe the accounting or valuation basis for the measurement of risk capital requirements and/or available capital</td>
<td>GAAP, Statutory, Economic or Market Consistent, IFRS, Rating Agency model</td>
</tr>
<tr>
<td><strong>Business Included</strong></td>
<td>Describe the subset of business included in the analysis of capital</td>
<td>Positions as of a given valuation date, New business assumptions, etc.</td>
</tr>
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<td><strong>Time Horizon</strong></td>
<td>Describe the time horizon over which risks were modeled and measured</td>
<td>One-year, multi-year, lifetime, run-off, etc.</td>
</tr>
<tr>
<td><strong>Risks Modeled</strong></td>
<td>Describe the risks included in the measurement of risk capital including a comment about whether all relevant and material risks have been considered</td>
<td>Credit, market, liquidity, insurance, operational, etc.</td>
</tr>
<tr>
<td><strong>Quantification Method</strong></td>
<td>Describe the method used to quantify the risk exposure</td>
<td>Deterministic stress tests, stochastic modeling, factor-based analysis, etc.</td>
</tr>
<tr>
<td><strong>Risk Capital Metric</strong></td>
<td>Describe the measurement metric utilized in the determination of aggregate risk capital</td>
<td>Value-at-risk or VAR (quantifies the capital needed to withstand a loss at a certain probability), Tail-value-at-risk or TVAR (quantifies the capital needed to withstand average losses above a certain probability), Probability of Ruin (quantifies the probability of ruin given the capital held), etc.</td>
</tr>
<tr>
<td><strong>Defined Security Standard</strong></td>
<td>Describe the defined security standard utilized in the determination of risk capital requirements, including linkage to business strategy and objectives.</td>
<td>AA solvency, 99.X% 1-year VAR, Y% TVAR or CTE, X% of RBC, etc.</td>
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<tr>
<td><strong>Aggregation and Diversification</strong></td>
<td>Describe the method of aggregation of risks and any diversification benefits considered or calculated in the group risk capital determination</td>
<td>Correlation matrix, dependency structure, sum, full/partial/no diversification</td>
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The approach and assessment of group-wide capital adequacy should also consider the following:
Elimination of intra-group transactions and double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities.

The level of leverage, if any, resulting from holding company debt.

Diversification credits and restrictions on the fungibility of capital within the holding company system, including the availability and transferability of surplus resources created by holding company system level diversification benefits.

The effects of contagion risk, concentration risk and complexity risk in the group risk capital assessment.

The effect of liquidity risk, or calls on the insurer’s cash position, due to micro- (i.e. internal operational) and/or macro (i.e. economic shifts) factors.

The goal of the assessment is to provide an overall determination of group risk capital needs for the insurer, based upon the nature, scale and complexity of risk within the group and its risk appetite, and to compare that risk capital to available capital to assess capital adequacy. Group risk capital should not be perceived as the minimum amount of capital before regulatory action will result (e.g. the triggers in US Risk-Based Capital (RBC) for insurance legal entities); rather, it should be recognized that this is the capital needed within a holding company system to achieve the group’s business objectives.

**Prospective Solvency Assessment**

The insurer’s capital assessment process should be closely tied to business planning. To this end, the insurer should have a robust capital forecasting capability that supports its management of risk over the planning time horizon in line with its stated risk appetite. The forecasting process should consider relevant and foreseeable changes to the insurer’s internal operations and the external business environment. It should also consider the prospect of operating in both normal and stressed environments.

The company’s prospective solvency assessment should demonstrate it has the financial resources necessary to execute its multi-year business plan in accordance with its stated risk appetite. If the insurer does not have the necessary available capital (in terms of quantity and/or quality) to meet its current and projected risk capital requirements then it should describe the management actions it has taken or will take to remediate any capital adequacy concerns. These management actions may include or describe any modifications to the business plan or identification of additional capital resources.

The prospective solvency assessment is in effect a feedback loop. The insurer should project its future financial position including its projected economic and regulatory capital to assess its ability to meet the regulatory capital requirements given its current risk profile, its current risk management policy, its current quality and level of capital and reflecting any changes to its current risk profile caused by executing the multi-year business plan. The prospective solvency assessment should also consider both normal and stressed environments.

If the prospective solvency assessment is performed for each individual insurance company legal entity, the assessment should take into account any risks associated with group membership. Such an assessment may involve a review of any group solvency assessment and the methodology used to allocate group capital across insurance legal entities, as well as consideration of capital fungibility, i.e. any constraints on group risk capital or the movement of group risk capital to legal entities.