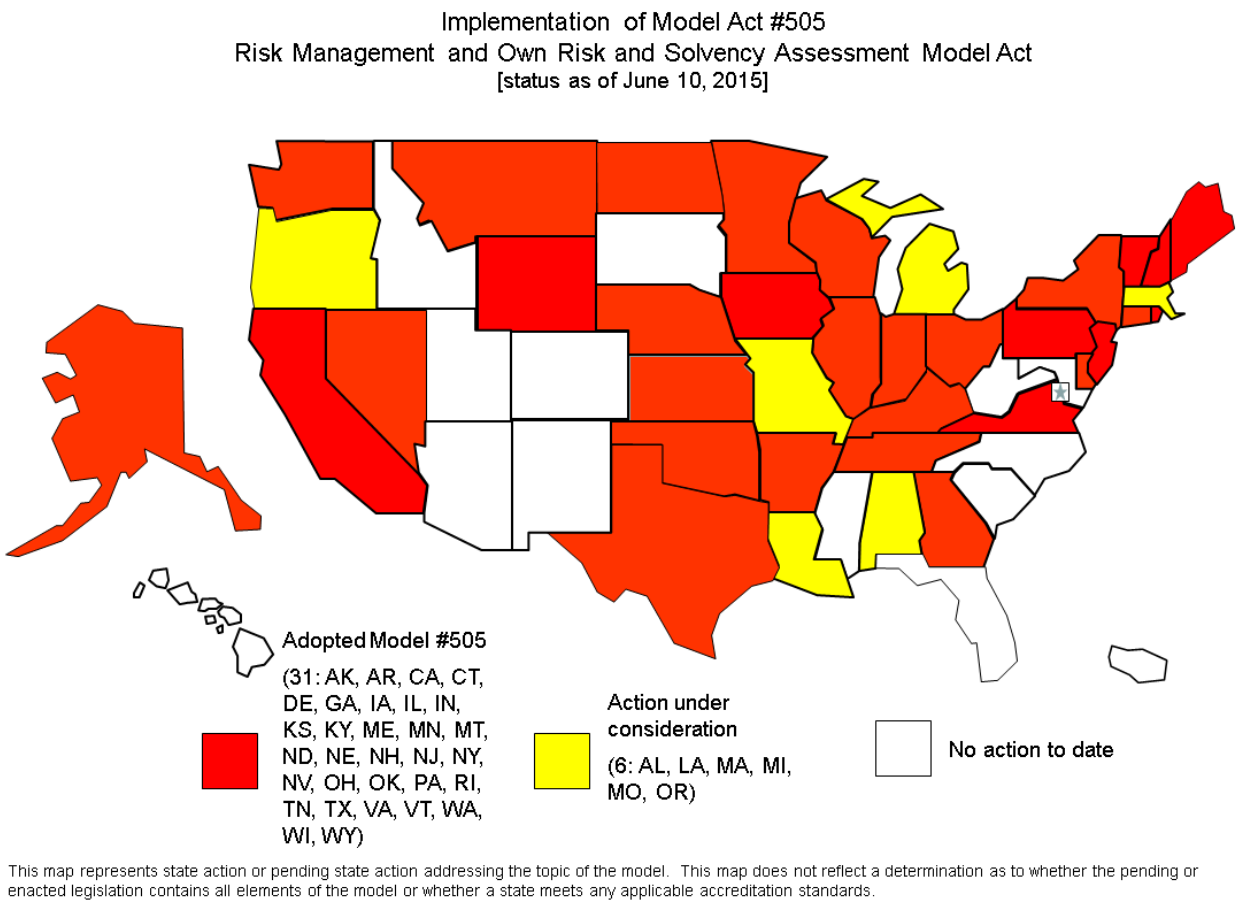
National Association of Insurance Commissioners

2014 Own Risk and Solvency Assessment (ORSA) Feedback Pilot Project
Observations of the Group Solvency Issues (E) Working Group

During October 2014 through June 2015, a third ORSA Feedback Pilot Project took place that followed the previous projects of 2012 and 2013. Following are the Group Solvency Issues (E) Working Group's observations of the ORSA Summary Reports that were reviewed as part of the 2014 pilot project. The NAIC and states that participated in the pilot project found it very beneficial and would like to thank participating companies for their significant investment of time and resources, as well as active engagement with regulators to discuss the report and receive feedback. We hope that this exercise has also provided value to participating companies and will assist in finalizing ORSA Summary Reports ahead of the first formal submission to lead regulators.

Background

The following map shows the adoption status of the *Risk Management and Own Risk and Solvency Assessment Model Act* (#505) as of May 20. States marked in red are those that have already adopted Model #505, those marked in yellow are in the process of adopting the model, and those marked in white have taken no action to date. Most of the adopting states will require the first ORSA Summary Report to be filed by the end of 2015.



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The table below shows the number of states and insurers/groups that participated in the three pilot projects. It also shows the number of ORSA Summary Reports that are expected to be filed with the states that participated in the pilot, both in absolute and percentage terms.

	2012	2013	2014
Number of States Participating	**12**	**16**	**26**
Estimated Number of ORSA Summary Reports Expected to be Filed with Participating States	**134**	**167**	**210**
% of Total Estimated ORSA Summary Reports Expected to Be Filed	**50%**	**64%**	**77%**
Number of Insurers/Groups Participating	**14**	**22**	**28**

Overall Observations

Overall, the ORSA Summary Reports submitted were generally found to be in compliance with the requirements of the NAIC *ORSA Guidance Manual* with regard to the organization of the reports in three sections:

Section 1—Description of the Insurer's Risk Management Framework
Section 2—Insurer's Assessment of Risk Exposures
Section 3—Group Assessment of Risk Capital and Prospective Solvency Assessment

The depth and breadth of the content vary significantly from company to company, even within the same industry segment, and is reflective of the maturity of the underlying enterprise risk management (ERM) and capital management frameworks in place. The reports of life insurers generally demonstrate more mature frameworks than the other segments of the industry, namely property and casualty (P/C) and health.

The findings indicate that Section 1 is the best presented of the three sections, while Section 2 and Section 3 could often benefit from additional information and description.

In particular, opportunities for improving the quality of ORSA Summary Reports reviewed are:

1. Providing additional explanation of the risk management strategy in the context of the key business strategy objectives.

2. Highlighting the maturity of the ERM process and status of development by covering what has been developed and embedded in the organization and what is still in development.

3. Offering additional information and clarity regarding the legal entities included in the scope of the group ORSA.

4. Maintaining consistency between the key risks identified in Section 1, those assessed in terms of exposure in Section 2 and those quantified in terms of risk capital in Section 3.

5. Providing additional support for the methodologies and assumptions selected in Section 2 for assessing and stress testing the exposures for key risks and to quantify risk capital in Section 3.

6. Offering additional evidence regarding how the management team utilizes the information provided in the ORSA Summary Report to pursue its business strategy objectives and how the board of directors utilizes it to oversee the company.

The following sections of the report provide detailed feedback with regard to the presentation of the overall ORSA Summary Report and the content of each section. The feedback is organized based on positives identified through the review, as well as opportunities for improvement, acknowledging the need for additional guidance and the approaching deadlines to file the first ORSA Summary Reports in several states.

Overall Presentation

In preparing the ORSA Summary Report, insurers/groups should refer to the NAIC *ORSA Guidance Manual*.

Positive attributes communicated to insurers/groups regarding their presentation of ORSA Summary Reports include the following:

1. The report is presented as a well-organized document including an informative executive summary, a detailed table of contents, a glossary of terms, accurate page numbers and cross-references, and clearly labeled exhibits.

2. The structure of the report reflects, or can be reconciled to, the three sections required by and described in the *ORSA Guidance Manual*.

3. The report includes a signed attestation of the chief risk officer or other executive responsible for the oversight of ERM indicating that the ERM process is applied within the organization and that a copy of the ORSA Summary Report has been shared with the board of directors.

4. The body of the report provides relevant and important information at an appropriate level of detail and use appendices to supplement this information.

5. The report provides a list of additional documentation available to the regulator upon request, showing the name of the document, a brief description of the content, the owner of each document and the date of the last update.

6. The report uses process flowcharts and heat maps to explain how the ORSA processes work (e.g., governance processes, risk identification processes and internal communication processes) and how processes are embedded in the operations of the insurers/group. In addition, the report uses tables and graphs to present more quantitative information (e.g., limits for key risks, exposures, stress tests and risk capital amounts by key risk).

7. The report provides comparatives for multi-year financial data.

Common opportunities for improvement recommended to insurers/groups regarding the presentation of the report include the following:

1. The report should clearly indicate which legal entities are included in the scope of the group. The ORSA Summary Reports that are the most effective in this regard have included an organizational chart showing the entities included/excluded. Another potential improvement would be to provide the NAIC CoCodes for each entity to ease the identification of the entities covered by the report.

2. To the extent that some legal entities are excluded from the report, the rationale for exclusion should be provided.

3. To the extent that various accounting bases are used in the assessment of group capital adequacy, the accounting basis for each legal entity or business segment should be clearly indicated.

4. There should be a balance between the amount of information provided in the main body of the ORSA Summary Report and the supplemental information provided in an appendix to the report or otherwise made available for consultation to the regulator.

5. The report should demonstrate a clear connection between each of the three sections. In particular, the report should show consistency between the key risks identified in Section 1, those assessed and stressed in Section 2, and those quantified in terms of risk capital required in Section 3.

6. The development status of each of the frameworks underlying ORSA processes should be clearly presented. Specifically, the report should present information indicating which frameworks/processes have been developed and implemented, which have not and the relative maturity of each of the frameworks (e.g., design stage, execution, dry-run and testing, and validation and adjustment). The pilot results have generally shown that some frameworks, such as risk governance and risk identification, are more mature than others, such as quantification of risk limits, development of risk appetites, assessment of risk exposures and calculation of group risk capital. Therefore, reports may be able to improve in this area by including a discussion of a plan-to-completion indicating how the insurer/group plans to finalize its ORSA processes, related testing and supporting documentation.

7. Given the prospective (or forward-looking) nature of the ORSA and the requirement for the insurer/group to assess risks and capital over the duration of the business plan, the insurer/group should clearly present how it expects the ERM framework to change over the selected time horizon in support of changes in business objectives and the risk profile of the organization.

8. The report should utilize and clearly present a consistent valuation date for the assessment of the group risk capital and for providing the data associated with underlying calculations.

Executive Summary

The executive summary is an important element of the ORSA Summary Report. Length and format of the summary should vary depending on the insurer/group's size and complexity of the risks. Positive attributes identified in the executive summary sections of ORSA Summary Reports and communicated to insurers/groups include the following:

1. The executive summary sets the overall tone of the report as a management tool rather than a regulatory reporting tool.

2. The executive summary outlines the key business strategy objectives (over the time horizon of the business plan), the key risks identified, a comparison of risk exposures to limits and the overall risk appetite selected by management, the amount of risk capital required and available to withstand unexpected losses, and commentary on the prospective assessment of risk and capital.

Common opportunities for improvement recommended to insurers/groups regarding the executive summary include the following:

1. The executive summary should provide more description of the business strategy of the insurer/group and business direction for the business plan—in particular, the core business initiatives and important corporate life events such as acquisitions and business disinvestments.

2. The executive summary should include a description of the core risk management initiatives utilized to support the business strategy.

3. The executive summary should highlight the use of any frameworks described in the ORSA Summary Report.

4. The executive summary should provide commentary on the prospective outlook from a business and a risk management perspective.

5. The executive summary should be concise yet comprehensive, bringing together all three sections of the ORSA Summary Report.

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

Positive attributes identified in Section 1 of ORSA Summary Reports and communicated to insurers/groups include the following:

1. A description of each of the five building blocks of the NAIC *ORSA Guidance Manual* is provided (risk governance and culture, risk identification and prioritization, risk appetite/tolerances and limits, risk management and controls, and risk reporting and communications).

2. The ORSA processes are placed in the context of the insurer/group's own ERM maturity and clarify what has been developed, what has not and how deep into the group's organization chart the ERM processes are embedded.

3. A timeline for the annual ORSA cycle is provided to explain when the various ERM activities take place in the course of the year and the frequency of each activity.

4. Under Risk Culture and Governance, clear definitions of the roles and responsibilities of all key stakeholders involved in risk management are provided, as well as the reporting and communication lines among them. While the NAIC *ORSA Guidance Manual* does not dictate a specific governance model, it is expected that the insurer/group will clarify who the risk owners, risk managers, ultimate supervisors and providers of independent assurance are and how they operate and exchange information.

5. Under Risk Identification and Prioritization, a robust and detailed process of identification of the key risks throughout the group is provided, describing the prioritization criteria (e.g., likelihood, impact, controllability, velocity, etc.) and tools used (e.g., meetings, targeted questionnaires, enterprise-wide questionnaires, etc.), as well as the participants in the process.

6. Under Risk Appetite, Tolerances and Limits, tolerances and limits for each of the key risks are articulated, and an explanation for the selection of the tolerance and limits and for setting the overall risk appetite at the insurer/group level is provided. In addition, limits, tolerances and appetite are clearly linked to the business objectives pursued by the insurer/group.

7. Under Risk Management and Controls, an outline of the process in place to manage, monitor and control both key and non-key risks is provided, setting out the key activities, key risk controls, and key mitigation activities and escalation activities in case of breaches. Examples of breaches occurred and actions taken are utilized to demonstrate the processes in place.

8. Under Risk Reporting and Communications, a description of the risk reports produced, a summary of the content, the intended audience and the owner of the report are provided. In addition, the section explains how feedback loops from implementation are embedded into ERM processes.

Common opportunities for improvement recommended to insurers/groups regarding Section 1 include the following:

1. Section 1 should provide a brief explanation of the genesis, development, and current and future state of the ERM process to assist the regulator in assessing the objectives and mechanisms of the process, as well as its focus on a current and prospective basis. For example, the section could cover whether the insurer/group chose existing ERM frameworks such as COSO and ISO31000 as a baseline or designed its own framework from scratch.

2. By including an assessment of the maturity of the ERM framework, the insurer can assist regulators in scoping their reviews and allow them to focus on those elements that are mature enough to be verified and tested.

3. Under Risk Culture and Governance, in the absence of a dedicated chief risk officer, this section should make it clear who the "risk-go-to" person is and the extent of his/her engagement with the management team and the risk owners. Also, insurers/groups should describe the tie between compensation/incentive plans and risk management objectives (i.e., how the various stakeholders involved in risk management are rewarded for their role and responsibilities).

4. Under Risk Identification and Prioritization, the section should make it clear how key risks are extracted from the universe of risks of the insurer/group and how emerging risks are identified. In particular, more clarity should be provided to demonstrate how deep into the corporate organization chart the risk identification processes go and where the risks are concentrated within the group.

5. Under Risk Appetite, Tolerances and Limits, consistency should be maintained with key risks identified in prior areas of the report, and tolerances and limits should be articulated for each of these risks. In addition, it is expected that the metric selected to define limits and tolerances makes sense in the context of the business objectives of the insurer/group.

6. Under Risk Management and Controls, the section should provide more clarity around how risk limits are translated into operational guidance and policies for risk owners. Controls described should not just be limited to financial controls, but should also address operational and strategic goals. Additional information regarding escalation processes in the event of breaches should be provided, as well as the current involvement of internal audit in providing tests of controls and independent assurance around risk management to the board of directors.

7. Under Risk Reporting and Communications, a list of documentation/reports produced can provide additional value, as opposed to limiting the discussion to an explanation of how risk information is exchanged and used within the group, including bottom-up feedback.

Section 2—Insurer's Assessment of Risk Exposure

Positive attributes identified in Section 2 of ORSA Summary Reports and communicated to insurers/groups include the following:

1. The section provides a detailed description of the assessment of the exposures for each key risk identified in Section 1, as well as an explanation of the methodology selected (whether qualitative or quantitative), the assumptions and underlying data used (e.g., description, source and valuation date/period), and the rationale for the selection of the methodology.

2. The section assesses exposures under both normal and stressed environments that can be qualitative or quantitative. Each key risk identified in Section 1 is stressed, or a reason for exclusion is identified. In addition, the risk drivers for each key risk stressed are clearly identified, and a detailed description of each stress is provided together with a summary of the results of the stresses and of the mitigation activities.

Common opportunities for improvement recommended to insurers/groups regarding Section 2 include the following:

1. Section 2 should maintain consistency between the risks that were assessed in this section of the ORSA Summary Report and the key risks identified in Section 1. Operational and strategic risks are often identified in Section 1, but it is rare for Section 2 to show an assessment of the exposure. In those cases, the assessment is often limited to market risks.

2. An explanation of the methodology used to assess exposures (regardless if qualitative or quantitative) should be provided, as well as the process for selecting the assumptions and the process for gathering data and testing the quality of the data used.

3. Section 2 should provide a comparison of the results against the tolerances and limits described in Section 1, as well as past experience of breaching the limits and resulting actions undertaken.

4. An explanation for the selection of scenarios used for the stress testing, the rationale for the selection of combined stresses and the analysis of the relationships between risks underlying the selection of the combined stresses should be provided.

<u>Section 3—Group Assessment of Risk Capital and Prospective Solvency Assessment</u>

Positive attributes identified in Section 3 of ORSA Summary Reports and communicated to insurers/groups include the following:

1. With regard to the group assessment of risk capital:

    a. An assessment was conducted for each of the key risks identified and assessed in Section 1 and Section 2.

    b. It described the metric used to define risk capital and provide a rationale for its selection.

    c. It explained the methodology used to aggregate individual risk capitals to obtain one group risk capital amount (before any diversification benefit).

    d. It stated the accounting basis used to measure the available capital that is compared with the aggregate risk capital to show the current solvency position of the insurer.

    e. It analyzed the correlations between key risks and provided robust support to the methodology selected to determine the "diversification benefit."

    f. It described the validation framework (e.g., governance, testing of models, data and results, and documentation) and the current state of validation of the models used.

2. With regard to the prospective assessment of risks and capital adequacy:

    a. It explained the changes in the insurer/group's risk profile (e.g., the key risks) over the time horizon of the business plan in light of the changes to the insurer/group's business strategy objectives.

    b. It estimated the future risk capital needed at an aggregate level to cover unexpected losses from the key risks.

    c. It compared the estimated projected risk capital against the estimated projected available capital to determine future solvency positions.

    d. In the case of potential insolvency, it identified additional sources of capital available to cover any shortfall—in particular, access to capital markets, liquidity of existing assets and fungibility of capital within the group.

Common opportunities for improvement recommended to insurers/groups regarding Section 3 include the following:

1. For the group assessment of risk capital:

    a. Consistency with key risks identified in prior parts of the ORSA Summary Report should be maintained.

    b. A description of the methodology used to quantify risk capital for each risk should be provided.

    c. Evidence of the “fitness for purpose” of the risk capital metrics should be provided.

    d. Explanation and overview of the calculation of the diversification benefit should be provided.

    e. Commentary on the underlying data used for the calculations should be provided—in particular, sources, quality and testing.

    f. A description of the validation framework should be included. In the case of less mature risk capital models, the insurer/group should describe the maturity of the internal capital models and the plans to validate them once they become more mature.

2. The prospective risk and capital adequacy assessment in many of the ORSA Summary Reports provides the greatest opportunity for improvement. While assessing future risk and projecting risk capital can be challenging, insurers/groups should find ways to estimate their future solvency needs and provide additional information to regulators in this area.

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