

To: GSIWG
From: California Department
Date: 9/1/11
RE: ORSA Draft Guidance Manual

California wishes to submit written comments regarding the Appendix to the 8/5/11 Draft NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual. We realize that the issue of whether there should or should not be an appendix with illustrative examples is not a settled issue; however, if there is to be an appendix, we believe our comments provide a significant improvement over the appendix displayed in the original draft. We do not intend for our proposal to be in any way prescriptive, but do believe it provides a good illustration of one way in which such information could be meaningfully presented, and we also believe it is worthy of discussion.

**California Comments on the Appendix to the 8/5/11 Draft
NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual;
Proposal for Alternate Display**

We believe it is necessary to rework the Appendix to the Draft NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual dated 8/5/2011 if an appendix will be retained as part of the document. We are providing a specific illustrative proposal for a property-casualty insurer in the following pages of this comment letter, and we recommend that careful consideration be given to revisiting the Draft's illustrations for life and health insurers.

We do not have major concerns with the risk categories shown in the existing illustrations; they appear to be fairly representative. Our main concern is with the column headings and the values that are proposed to be shown.

The text at the beginning of the Appendix states that amounts to be displayed are the total exposure the insurer has to each particular risk, the amounts expected to be paid under normal conditions due to that risk over the next year, and the amounts expected to be paid under stressed conditions due to that risk over the next year. We do not see a great deal of value in displaying the total exposure amounts for property-casualty risks; the value for property coverages will be far greater than any remotely likely aggregate loss, and may be impossible to determine for liability coverages. More importantly, we do not believe the amount to be paid in the next calendar year is the most useful value to be displayed.

For property-casualty insurance, the great majority of the risk is contained in the pricing, underwriting, and reserving elements. For reserve risk, the fundamental question is reserve adequacy; this means we should be concerned with the amounts expected to be paid when all outstanding claims (reported or not) are finally paid and closed. Pricing (underwriting) risk similarly requires the long-term view; the key question is whether premiums charged are adequate to cover all costs of providing the coverage, including claims costs and all expenses, as well as providing a profit. The only way to answer this question is to know what the total of these costs will be once all claims are paid and closed.

It takes many years, sometimes decades, for this process to conclude; in the meantime, we have reserve estimates to use to try to obtain tentative answers to the key questions. It would seem that changes in incurred loss would be much more important to evaluating risk than would calendar year paid losses. It often takes several years in longer-tailed casualty lines to obtain a reasonable picture of what the ultimate cost of losses for those lines will be; in some lines, it can take significantly longer.

Another important concern is that this presentation seems to focus on only expected values, specific stressed scenarios, and the differences between the two. Full-scale enterprise risk management analysis using stochastic testing would produce probability distributions of the values that would be used to determine "exceedence curves": values that are expected to be exceeded in only 1%, 0.5%, or 0.1% of all years. It would seem that such information would be an essential element, to the extent it can be meaningfully determined.

We believe it would be more useful to provide displays in the Manual that would combine aspects of both Sections 2 and 3 of the ORSA. We propose the following display. It should be stated that it is meant to be illustrative rather than a definitive requirement, but we believe the illustration will be useful to help regulators and insurers visualize the types of questions the ORSA could answer and the insurance company management and regulatory purposes it could help serve.

**Proposal for Alternate Display for the NAIC Own Risk and Solvency Assessment (ORSA)
Guidance Manual**

Proposal: Risk Framework

Proposed Section 1: Risk Profile (Capital Requirements Analysis):

This section would display the required risk capital by component and on a combined basis, and compare it to the actual capital. Values would be displayed for the current year-end and the next five year ends of a five-year planning process. A property-casualty example is used. The numbers are fictitious, and the five-year time horizon is meant to be optional.

<u>Required Risk Capital</u>	<u>Year 0</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
R1. Asset	500	525	550	575	600	625
R2. Credit	200	210	220	230	240	250
R3. Premium non-Cat	600	630	660	690	720	750
R3. Premium Cat	1,000	1,050	1,100	1,150	1,200	1,250
R4. Reserve	1,000	1,050	1,100	1,150	1,200	1,250
R5. Operational	200	210	220	230	240	250
Total Required Capital	1,640	1,722	1,804	1,886	1,968	2,050
Actual Capital	2,460	2,497	2,887	2,829	2,755	2,665
Ratio to Required	150%	145%	160%	150%	140%	130%

This analysis could be performed using the company's own internal model(s), and should include a specified confidence interval. The internal model analysis could be repeated showing results for different choices of confidence intervals, such as 99%, 99.5%, and 99.9%. It is assumed that the same underlying distribution coming from the internal model will serve as the basis for all alternative confidence interval choices; the confidence interval choices are simply different points on the same distribution.

This analysis should also be performed by applying the NAIC's RBC formula as well as the A.M. Best BCAR and S&P RBC formulas, since the company needs to be aware of how it will be viewed by its regulators and rating agencies.

It is assumed that there would be a five-year plan (or a plan of some other length) underlying this display, with yearly income statements and year-end balance sheets. There would also be detailed planning assumptions for all key elements. Finally, there would be detailed modeling of the risk elements with additional assumptions.

Proposed Section 2- Risk Tolerance Analysis (Stress Scenarios)

This section would provide a view of what the impact would be of various moderate-stress scenarios that have a reasonably high likelihood of occurring within the next decade.

<u>Moderate (1-in-10 year) Stress Scenarios</u>	<u>Year 0 Actual Capital</u>	<u>Year 0 Capital Ratios</u>	<u>Year 0 \$ Differences</u>
0. Non-Stressed Base Case	2,460	150%	0
1. Equities down 30%	2,386	146%	-74
2a. Interest Rates up 200 basis points	2,288	140%	-172
2a. Interest Rates down 200 basis points	2,485	152%	+25
3. Reserves up 5%	1,993	122%	-467
4. 1 in 10 year cat event	2,067	126%	-393
5. Miss Plan top line by 10%	2,042	125%	-418

The scenarios are meant to be illustrative only; specific scenarios should be constructed that are likely to occur within the next decade. Separate testing should be done for each of the five years of the plan; the goal would be to see what the impact would be if the particular stress scenario occurred at different points in time. The changes in the capital ratios and the dollar changes to surplus would allow the insurer to evaluate which events were within its risk tolerance, and which were outside it, and to plan to mitigate the latter. It would also provide the regulator the opportunity to form its own opinions on this issue.

Underlying each of these values would be the individual risk components making up the overall capital charge, as well as the income statements and balance sheets as affected by the various stress scenarios.

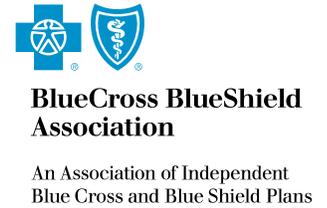
This display is meant to show only the impact each moderate stress scenario would have on that year's capital and capital requirements. A more complex analysis would involve carrying the impact forward to show how the plan performs in subsequent years after having been subjected to the particular stress scenario.

Severe Stress Scenarios; Reverse Stress Scenarios

Additional sections could be added showing the impact of more serious, less likely stress scenarios. Reverse Stress scenarios designed to find the company's "breaking point" under each risk category could also be modeled. The display shown in the section of moderate stress scenarios presented above could provide a format for these sections.

To: GSIWG
From: Illinois Department
Date: 8/8/11
RE: ORSA Draft Guidance Manual

Add to either paragraph c. or n. (n. would be a new para) of Section 1 on page 5 or 6. "Include a description of any off balance sheet financing engaged in by the insurer/group and how such activities impact the risk exposure of the insurer/group."



August 4, 2011

Director John M. Huff
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Sr. Associate Commissioner Danny Saenz
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Dvacca@naic.org

Via email

Re: ACLI Comments on NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual (8/5/11 Draft)

Dear Director Huff and Associate Commissioner Saenz:

We write regarding the efforts of the NAIC's Group Solvency Issues Working Group (GSIWG) to develop a framework for an Own Risk and Solvency Assessment (ORSA) and reflects the views of the undersigned trade associations representing the majority of the U.S. life, health and property/casualty insurance industry that have been actively engaged in this important NAIC endeavor.

We commend you for the open process and significant work that has been accomplished and appreciate your continuing willingness to work through these critical issues. We had been encouraged by the public dialogue indicating most regulators' preference to leverage existing company work and to minimize prescriptive elements, an appropriate response to an emerging concept and discipline. On the July 29 GSIWG call, however, a project path was unveiled that seems to turn towards the creation of an extremely resource-intensive and costly new regulatory requirement for many of our member companies. This approach is inconsistent with regulator statements during the recent ERM Symposium and during previous discussions that called for a more streamlined ORSA that is flexible enough to account for varied and evolving industry ERM practices.

Our substantive concerns with the current ORSA draft and process include:

- **Timing.** The self-imposed deadline of late 2011 for completion of this proposal suggests an urgency that is likely to be detrimental to the final product. Although we understand the basis for this proposal comes in part from International Association of Insurance Supervisors' Insurance Core Principle (ICP) 16, it is our understanding that the US will not be subject to ICP 16 as part of the FSAP review process until at least 2015. Also, ICP 16 explicitly states that it is not a compulsory set of requirements. Rather, it is an aspirational document, and the goals of ICP 16 can be achieved over time. Consequently, there is time to take a more deliberate approach in developing a final proposal and, in particular, to consider how insurers and regulators will implement this proposal as there are resource implications associated with both. We strongly recommend that the ORSA development timeline be expanded to allow creation of a work product that reflects existing ERM practices and other jurisdictions' views of the ORSA. ORSA also needs to be harmonized with the US legal system, existing regulatory requirements, and developing capabilities of the US industry and regulators.
- **Confidentiality.** In general the ORSA will include highly proprietary and confidential information, and therefore confidentiality is essential. The reporting framework must be appropriate and have full protections to ensure complete confidentiality of the ORSA submission.
- **Legal framework.** We commend NAIC legal staff for its helpful summary, introduced on the July 8 GSIWG call, of the questions that must be addressed in order for a decision to be made on how an ORSA requirement might be incorporated into the US framework. We question the need for the ORSA to become a new regulatory filing, and suggest instead that it represent information that is made available to the regulator through existing regulatory authority (such as the NAIC Model Law on Examinations) where all sections can be reviewed during a full scope, or limited scope examination, and sections II and III can be requested on a more periodic basis through the financial analysis process. Such an approach would aid in ensuring the information is kept confidential, which is vital, and would provide a better vision of how the information will be used by the regulator. These issues must all be addressed; however, the broad objectives and framework of the ORSA must first be determined before decisions can be made regarding the legal mechanisms.

The proposed US ORSA imports new regulatory concepts, raises complex issues, and potentially places extraordinary burdens on some US companies and regulators. Its importance warrants a thoughtful, deliberate, and collaborative drafting process. Our trade associations and member companies are committed to working with the GSIWG and NAIC to develop a US ORSA that meets regulators' needs while addressing the issues raised in this letter. We look forward to assisting in the development of this important process.

Respectfully,

American Council of Life Insurers
 America's Health Insurance Plans
 American Insurance Association
 BlueCross BlueShield Association
 Group of North American Insurance Enterprises
 National Association of Mutual Insurance Companies
 Property Casualty Insurers Association of America
 Reinsurance Association of America

cc: David Vacca
 Assistant Director, Insurance Analysis and Information Services Department
 NAIC Regulatory Services Division



AMERICAN ACADEMY *of* ACTUARIES

August 25, 2011

Director John Huff
Mr. Danny Saenz
Group Solvency Issues (EX) Working Group
National Association of Insurance Commissioners
Via email: DVacca@naic.org

Re: Comments on *NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual*

Dear Director Huff and Mr. Saenz,

The American Academy of Actuaries¹ ERM Committee is pleased to present comments on the NAIC's Group Solvency Issues (EX) Working Group's *NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual* (Manual).

As previously stated in our [letter](#) dated March 18, 2011 we agree that introduction of an ORSA requirement into the US solvency framework could provide regulators with meaningful insights into a company's risk management practices, and as a result, increase the efficiency and effectiveness of the regulatory review process. We also acknowledge the NAIC's consideration of the regulatory principles described within the International Association of Insurance Supervisors (IAIS) Insurance Core Principle (ICP) 16, Enterprise Risk Management.

In general, we believe that the Manual offers ORSA guidance that focuses on the most fundamental components of a strong ERM framework. We understand that this Manual was intentionally designed to avoid being overly prescriptive, and we believe the working group has largely accomplished this objective. We do, however, encourage the NAIC to add specific language into the Manual that reiterates that the ORSA is an internal process to which regulators will have access rather than a new regulatory process, thus avoiding any confusion.

We believe that the ORSA should be conducted and reported on the same basis as risk is managed within a group. If risk is in fact managed at an insurance group level, the ORSA would generally be conducted and reported at the group level. Should any given legal entities' risk profile materially differ from that of the group, a risk assessment at that legal entity level may be appropriate. We believe that the Manual appropriately allows for flexibility in approach by referencing "an insurance legal entity within an insurance group and/or the insurance group" in various contexts throughout the Manual, with further requests to "clearly identify diversification credits" and "address restrictions on the fungibility of capital" should group ORSAs occur. We

¹ The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

encourage the NAIC to clarify any group versus legal entity language within the Manual should our interpretation be incorrect. Regardless of the level at which the ORSA is conducted, we believe that ORSA documentation should clearly explain the group's rationale for the level at which it performs its analysis.

We recommend that the working group ensure that the Manual appropriately captures the distinction between an ORSA, which is an internal process, and an ORSA report, which may include a summary of the ORSA process, its results at a point in time, and any significant changes to those results over time, with further references to internal documentation. We have noticed several inconsistent references to ORSAs throughout the Manual.

We seek clarification on how frequently regulators would require an ORSA report to be filed. On page 8, the Manual states "On an annual basis, the insurer and/or insurance holding company system subject to this filing should provide a group economic capital assessment within their ORSA for the previous year-end." This sentence reads as though there is an expectation for a regulatory filing of an ORSA report annually, while the last sentence of the first paragraph on page 3 suggests a regulator would use its discretion to request an ORSA report "each year" subject to "a myriad of factors." This language should be clarified. As previously stated, we believe that the frequency and extent of ORSA reporting should be dependent upon how the regulators intend to use the information provided. To the extent annual reporting is required, we recommend that the NAIC further clarify its intended use of the information within the Manual.

We recognize that there is no single accepted definition of the term "economic capital" (referenced in the paragraph above) and therefore its meaning may differ from company to company. Regulators should anticipate observing many different bases for an insurer's internal measurement of economic capital. In addition, while not specifically stated within the Manual, it will be essential that regulators develop an understanding of how the results of an economic capital model are used within the business beyond a point-in-time solvency assessment. Such knowledge would shed further light on the company's understanding of and commitment to its ERM process.

Thank you for this opportunity to comment. If you have any questions, please contact Tina Getachew, senior policy analyst, Risk Management and Financial Reporting Council, via email (getachew@actuary.org) or phone (202/223-8196).

Sincerely,



Maryellen Coggins
Chairperson, ERM Committee
Risk Management & Financial Reporting Council
American Academy of Actuaries



August 25, 2011

Director John M. Huff
Missouri Department of Insurance
Co-Chair, NAIC Group Solvency Issues Working Group

Sr. Associate Commissioner Danny Saenz
Texas Department of Insurance
Co-Chair, NAIC Group Solvency Issues Working Group

Re: ACLI Comment Matrix on 8/5/11 Exposure Draft of the NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual, with draft revised Guidance Manual

Dear Director Huff and Senior Associate Commissioner Saenz:

The American Council of Life Insurers represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90% of the assets and premiums of the U.S. life insurance and annuity industry. We appreciate the opportunity to offer these comments on their behalf.

Although the Working Group's goals are still unclear to us, we appreciate its members' desire to substantially leverage off of information developed for rating agencies or for company management. We interpret the ORSA requirement as currently proposed as highly challenging—even daunting—going far beyond what most U.S. insurers are doing today. It would require voluminous reporting, using modeling techniques not currently in wide use in the U.S. Producing such a report would be quite expensive and would not be based on how companies are managing the risks in their businesses.

We attach a draft revised Guidance Manual that would leverage information that insurers/insurance groups already prepare for company management or rating agencies and at the same give state regulators substantial insight into how insurers are managing the risks in their businesses. We also attach a chart of our suggested edits to the Exposure Draft with our reason for each edit. Please note that, given the compressed exposure period, our members are still discussing the edits; we cannot represent that all of our members agree with each suggestion.

As the NAIC continues to develop the ORSA proposal and other elements of the SMI project, we strongly urge the Working Group, other state insurance regulators, and NAIC staff to consider the proven efficacy of U.S. state insurance solvency regulation. The Working Group has noted: “[T]he work being done at the international level is important, but must be looked at from the perspective of what works for U.S. regulation.” (July 8, 2011, draft minutes). Our system of state-based regulation can and should incorporate evolutionary change, as Dr. Vaughan has said many times. We suggest that our proposed revisions to the draft Guidance Manual accommodate the wide variety of ERM practices used today in the U.S. and are consistent with Dr. Vaughan's philosophy for the SMI project.

Circular 230 disclosure: This document was not intended or written to be used, and cannot be used, to: (1) avoid tax penalties, or (2) promote, market or recommend any tax plan or arrangement.

Director John M. Huff
Commissioner Danny Saenz
August 25, 2011
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We further emphasize that our recommendations in no way compromise the U.S. regulatory system's ability to satisfy ICP 16. Because ERM is a new and emerging discipline, ICP 16 explicitly positions itself as aspirational, not compulsory: "The IAIS envisages that solvency requirements will, over time, be developed towards conformity with the ICPs. The IAIS nevertheless wishes to emphasize that this ICP does not prescribe a specific aspect of solvency requirements which is to be applied compulsorily by IAIS members." (ICP 16.0.9, draft dated 8/10/11, as circulated to IAIS Solvency and Actuarial Issues Subcommittee). This language suggests that ACLI's proposed revisions would still allow the U.S. to meet fully the requirements of ICP 16.

We understand and appreciate the concerns of U.S. state insurance regulators in carrying out their statutory obligations to protect policyholders. We offer our full support for your efforts. We hope that your Working Group finds our views useful, and we look forward to continuing to work with you and your colleagues.

Very truly yours,



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*This is a working draft; not all ACLI members endorse each of these suggested edits
DRAFT ACLI Markup ver 8-25-11*



National Association of Insurance Commissioners

NAIC OWN RISK AND SOLVENCY
ASSESSMENT (ORSA) GUIDANCE
MANUAL

DRAFT (8/5/11)

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

DRAFT 8/5/11

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I. INTRODUCTION

Purpose

The purpose of this Manual is to provide guidance to U.S. insurers and/or U.S. insurance groups on completing a report on their enterprise risk management (ERM) processes and risk profile. This report is defined as the Own Risk and Solvency Assessment (“ORSA”). The ability of an insurer to reflect risks in a robust manner in its own assessment of risk and solvency is a key component of an effective overall ERM framework. Larger insurers should plan to complete an ORSA on a regular basis and should share the results of the assessment with senior management and the Board of Directors. The ORSA may assist regulators in assessing an insurer’s/insurance group’s ERM during its financial examination.

Annual ORSA

An insurer/insurance group shall annually submit a summary report of its ERM philosophy, practices, and current assessment to its domiciliary and/or lead regulator (“ORSA”). The ORSA shall provide a succinct, summary report of the insurer’s/insurance group’s ERM. The objective is to provide information to the domiciliary or lead regulator(s) similar to information submitted to the insurer’s/insurance group’s Board of Directors, executive management committees, and/or rating agencies. The domestic or lead regulator may inquire about those ERM practices and the current assessment, which relate to the nature, scale, and complexity of the insurer/insurance group, if necessary, depending on regulatory prioritization of the insurer/insurance group, its financial condition, as well as the economic environment considerations. Each insurer will decide when to file and whether to file on a legal entity or group basis depending on the framework and structure of its risk management function.

Confidentiality

Any such ORSA shall be held confidential by all who receive it in the course of their official duties, including designees. It shall not be subject to the federal Freedom of Information Act or to any state’s Freedom of Information Act or to subpoena.

Exemption

An insurer and/or insurance group shall be exempt from the requirements of the ORSA, if

- a. The individual insurer's annual direct written and 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 assumed premium including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program and excluding affiliated reinsurance premium is less than \$1,000,000,000.

Waiver

The domestic and lead regulator may jointly waive the submission of the ORSA. They may consider various factors including, but not limited to, the type of business entity, volume of business written, availability of qualified board members, or the ownership or organizational structure of the entity.

General Guidance

Each insurer or insurance group will report using its own assessment of its own processes. This is a critical step in state regulators' development of an understanding of how insurers run their businesses. In doing so, insurers/insurance groups will reflect the following three components in their ORSAs, as available.

- **Section 1** – Description of Risk Management Framework
- **Section 2** – Summary of Major Risk Exposures
- **Section 3** – Capital Assessment and Continuity Analysis

Guidance for completing each section is noted below. The depth and detail is likely to be influenced by the nature and complexity of the insurer/insurance group. Supporting detail must be available to the domiciliary and/ or lead regulator(s) upon examination. If the ORSA references other documents, a summary index is requested.

Insurance Groups

An insurance group may, in lieu of submitting the ORSA described above, submit to its lead U.S. regulator(s) its ERM/ORSA report as filed with its group or lead supervisor in another jurisdiction. This ORSA will be reviewed in relation to Insurance Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) 16 Enterprise Risk Management (ERM) and 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.

Extensions

The domestic and lead regulator(s) may jointly grant an extension of the due date of the ORSA.

II. SECTION 1— DESCRIPTION OF THE RISK MANAGEMENT FRAMEWORK

Section 1 of the ORSA should describe the insurer's/insurance group's Enterprise Risk Management (ERM) framework in the context of the following key principles:

ERM Key Principles

- **Risk Culture and Governance** — A governance structure that clearly defines and articulates roles, responsibilities and accountabilities is an essential requirement for ERM along with a risk culture that supports accountability in risk-based decision making.
- **Risk Identification and Prioritization** — Risk identification and prioritization is a key ongoing process to the organization; ownership of this activity within each major risk category 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** — Reporting and communication provide key internal constituents with transparency into the risk management processes and facilitate active, informed decisions on risk taking and management.

Significant Risk Categories

Section 1 should also identify and describe the insurer's/insurance group's major risk categories. These categories may include, and are not limited to, credit, market, liquidity, asset-liability management, underwriting, claim, expense, operational and risks associated with group membership.

For each major risk category, Section 1 should further:

- Explain how those risk categories are managed as the insurer/insurance group executes its business strategy;
- Include, if available, a risk policy statement;
- Describe any processes and methods used for monitoring risk; and
- Include risk limit(s).

III. SECTION 2 – SUMMARY OF MAJOR RISK EXPOSURES

Section 2 should provide a summary of the insurer's/insurance group's major risk exposures. If available, Section 2 should describe how an insurer/insurance group quantifies these risk exposures. It should include succinct descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made, and outcomes of plausible adverse scenarios that are run. Material risk categories may include, and are not limited to, credit, market, liquidity, asset-liability management, underwriting, claim, expense, operational and risks associated with group membership. Because the risk profile of each insurer/insurance group is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer/insurance group should run.

IV. SECTION 3 — CAPITAL ASSESSMENT AND CONTINUITY ANALYSIS

Section 3 should include two elements. One should be a capital assessment, and the other a continuity analysis.

Capital Assessment

An insurer/insurance group should have a sound process for assessing capital adequacy in relation to its risk profile, and the process should be integrated into its management and decision making culture. The insurer's/insurance group's ORSA should provide a current capital assessment.

The ORSA should describe how the insurer/insurance group determines its internal capital target(s), *e.g.*, rating agency capital, regulatory capital, economic capital, or other measures. That description should include the internal capital level as defined by its capital target(s) and a narrative describing the following as applicable:

- **Definition of required capital** — Describe how the insurer and/or insurance group defines solvency (e.g. Cash flow basis, balance sheet basis, etc.). If balance sheet basis, what basis of accounting is used.
- **Time horizon of risk exposure** — Describe the time horizon modeled, such as one year, lifetime, etc.
- **Risks to model** — Describe high-level risks and materiality (e.g. immaterial or material).
- **How risks are quantified** — Describe the stress tests, stochastic modeling or factors utilized in the quantification, as well as, the methodology for allocating the group capital across insurance legal entities.
- **Measurement metric** — Describe the measurement metric, such as value at risk in percentile (quantifies the capital needed to withstand a loss at a certain probability), tail value at risk (quantifies the capital needed to withstand average losses above a certain probability), probability to ruin (quantifies the probability of ruin given the capital held), etc.
- **Target level of capital** — Describe the target capital for the insurer's
- /insurance group's business objectives.
- **Reflecting diversification** — Describe relevant and material diversification benefits and amount that is being used to spread around the risks to which the group is exposed.

Continuity Analysis

Section 3 should provide a summary of the insurer/insurance group's business plan, a description of whether and how the business plan's viability is confirmed, and, if available, a quantitative demonstration of the plan's viability. The quantitative demonstration, which should be described, may involve stress testing, scenario modeling, and/or projections of future capital needs and resources. This analysis should be done over a 2-5 year period that is consistent with the company's business plan. If the insurer/insurance group performs a projection of future capital needs, and does not have the necessary financial capital to execute its business plan, it should describe the management actions it will take or modifications it will make to the business plan.

If the continuity analysis is performed for each individual insurance company legal entity, the assessment should take into account relevant and material risks associated with group membership. Such an assessment may involve a review of any group solvency assessment and consider relevant and material constraints on group capital or the movement of group capital to legal entities.

General Considerations

The capital assessment and continuity analysis should take into account:

- Intra-group transactions and consequently double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities.
- Level of leverage, if any, resulting from holding company debt.
- Restrictions on the fungibility of capital within the holding company system, and
- Effects of contagion risk and concentration risk

Please refer to the Draft ACLI ORSA Guidance Manual

#	§ and ¶	Current Text, if any	Recommended Edit and Rationale
1	1. Introduction, first sentence	The purpose of this Manual is to provide guidance to insurer and/or the insurance group on performing 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).	<p>Amend:</p> <p>The purpose of this Manual is to provide guidance to <u>U.S. insurers and/or the U.S. insurance groups on completing a report on their enterprise risk management (ERM) processes and risk profile. This report is defined as the Own Risk and Solvency Assessment ("ORSA").</u> performing 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).</p> <p><i>RATIONALE: Many ACLI members would find complying with the specifics of the Guidance Manual as drafted currently very challenging. Our draft comments propose an annual, succinct, high-level report to domiciliary regulators from their insurers/insurance groups on how they are running their businesses.</i></p> <p><i>We believe that building an ORSA framework within the U.S. system of regulation will take time, for regulators and industry alike. Implementing it should be a staged process to allow for evolution of company practices as well as regulatory practices. We emphasize that, given the long-standing success of the U.S. regulatory framework, which has no concept of 'economic capital,' it is not possible or meaningful to try to construct an ORSA data analysis framework at this time.</i></p>
2	1. Introduction, 2 nd & 3 rd sentences	The ORSA shall be completed at least annually to assess the adequacy of its risk management and current, and likely future, solvency position. However, whether the 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.	<p>Delete and replace with:</p> <p><u>The ability of an insurer to reflect risks in a robust manner in its own assessment of risk and solvency is a key component of an effective overall ERM framework. Larger insurers should plan to complete an ORSA on a regular basis and should share the results of the assessment with senior management and its Board of Directors. The ORSA may assist regulators in assessing an insurer's/insurance group's ERM during its financial examination.</u></p> <p><i>RATIONALE: We are recommending an evolutionary change in company practices, so we believe it is important to state expressly the regulators' goals at the outset. ICP 16.0.9 recognizes that the ICP itself is aspirational in nature..</i></p>
3	New paragraph		<p>Add:</p> <p><u>Annual ORSA</u></p> <p><u>An insurer/insurance group shall annually submit a summary report of its ERM philosophy, practices, and current assessment to its domicile and/or lead regulator ("ORSA"). The ORSA shall provide a succinct, summary report of the insurer's/insurance group's ERM. The objective is to provide information to the domiciliary or lead regulator(s) similar to information submitted to the insurer's/insurance group's Board of Directors, executive management committees, and/or rating agencies. The domestic or lead regulator may inquire about those ERM practices and the current assessment, which relate to the nature, scale, and complexity of the insurer/insurance group, if necessary, depending on regulatory prioritization of the insurer/insurance group, its financial condition, as well as the economic environment considerations. Each insurer will decide when to file and whether to file on a legal entity or group basis depending on the framework and structure of its risk management function.</u></p> <p><i>RATIONALE: This is the annual report that ACLI members believe would be practicable now and in the near to medium term future. We believe that it will provide regulators with meaningful information, since it will be based on how the reporting insurer/insurance group is actually managing the risks in its</i></p>

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			<p><i>business. That, after all, is the major purpose of an ORSA in the U.S. framework, since regulatory capital is not set using internal models.</i></p> <p><i>We add the last sentence because—</i></p> <ol style="list-style-type: none"> <i>1. The ORSA should be based on how the insurer or insurance group is actually managing its risks, and</i> <i>2. The ORSA should be filed at the time of year that the insurer/insurance group is actually engaged in its annual strategic planning rather than at a prescribed time.</i>
4	New		<p>Add:</p> <p><u>Confidentiality</u></p> <p><u>Any such ORSA shall be held confidential by all who receive it in the course of their official duties, including designees. It shall not be subject to the federal Freedom of Information Act or to any state's Freedom of Information Act or to subpoena.</u></p> <p><i>RATIONALE: Confidentiality is critical to sharing this highly proprietary information with regulators, especially in an annual report submitted outside the FOIA protections of states' financial examination statutes.</i></p>
5	A. Exemption, 2 nd and 3 rd paragraphs	<p>An insurer may be required to provide an ORSA 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.</p> <p>A commissioner also has authority to require an ORSA if the insurer and/or an insurer within the insurance group 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.</p>	<p>Delete.</p> <p><i>RATIONALE: The paragraphs are unnecessary, as they restate existing authority, and they are also redundant.</i></p>
6	B. Application for Waiver	<p>B. Application for Waiver</p> <p>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, volume of business written, availability of qualified board members, or the ownership or organizational structure of the entity.</p>	<p>Amend:</p> <p>Application for Waiver</p> <p><u>The domestic and lead regulator(s) may jointly An insurer may make application to the commissioner for a waive the submission of r from the requirements of the ORSA based upon unique circumstances the ORSA. They commissioner may consider various factors including, but not limited to, the type of business entity, volume of business written, availability of qualified board members, or the ownership or organizational structure of the entity.</u></p> <p><i>RATIONALE: The paragraph should grant certain specific regulators permission to waive the requirement. The current wording does not grant that permission.</i></p>
7	C. General Guidance, 1 st paragraph	<p>C. General Guidance</p> <p>While the ORSA is completed entirely by an insurance legal entity within an insurance group and/or the insurance group, and therefore represents its internal risk management assessment, the resulting ORSA filing should contain three major sections as follows:</p> <p>Section 1 - Description of the Risk Management Policy Section 2 - Quantitative Measurements of Risk Exposure in Normal and Stressed Environments</p> <p>Section 3 – Group Economic Capital and Prospective Solvency Assessment</p>	<p>Amend:</p> <p>General Guidance</p> <p>While the ORSA is completed entirely by an insurance legal entity within an insurance group and/or the insurance group, and therefore represents its internal risk management assessment, the resulting ORSA filing should contain three major sections as follows:</p> <p><u>Each insurer or insurance group will report using its own assessment of its own processes. This is a critical step in state regulators' development of an understanding of how insurers run their businesses. In doing so, insurers/insurance groups will reflect the following three components in their ORSAs, as available.</u></p> <p>Section 1 - Description of the Risk Management Policy Framework</p> <p>Section 2 - Summary of Major Risk Exposures—Quantitative Measurements of Risk Exposure in Normal and Stressed Environments</p> <p>Section 3 – Group Economic Capital Assessment and Continuity Analysis Prospective Solvency Assessment</p>

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			<p><i>RATIONALE: We added the first sentence to clarify that each insurer or insurance group is reporting its OWN risk and solvency assessment, not an assessment of its adherence to prescribed standards. We agree that the insurer's/insurance group's report should have 3 components. See below for our rationales for the new Section titles.</i></p>
8	C. General Guidance, 2 nd paragraph	<p>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 and/or insurance group. Additionally, in order to avoid excessive volumes of detail or supporting documents for complex insurance groups, an insurer and/or insurance group may simply reference other explanatory documents within the ORSA, as long as those documents are available to the regulator upon request. If the referencing of other detailed documentation is performed, a summary index is requested.</p>	<p>Amend:</p> <p>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/insurance group. Additionally, in order to avoid excessive volumes of detail or supporting documents for complex insurance groups, an insurer and/or insurance group may simply reference other explanatory documents within the ORSA, as long as those documents are available to the regulator upon request. <u>Supporting detail must be available to the domiciliary and/or lead regulator(s) upon examination.</u> If the referencing of other detailed documentation is performed, ORSA <u>references other documents,</u> a summary index is requested.</p> <p><i>RATIONALE: As the supporting documentation will be highly proprietary, we recommend that it be accessed during a financial examination. Other changes we recommend are editorial.</i></p>
9	C. General Guidance, 3 rd paragraph	<p>An internationally active insurance group required to file an ORSA, may be able to satisfy the filing requirement by providing an ORSA that has been provided to another jurisdiction who serves as the group-wide supervisor. This ORSA will be reviewed in relation to Insurance Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) 16 Enterprise Risk Management (ERM) and 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.</p>	<p>Amend:</p> <p><u>Internationally Active Insurance Groups</u></p> <p>An internationally active insurance group required to file an ORSA, may, in lieu of submitting the ORSA described above, submit to its <u>lead U.S. regulator(s) its ERM/ORSA report as filed with its group or lead supervisor in</u> able to satisfy the filing requirement by providing an ORSA that has been provided to another jurisdiction who serves as the group wide supervisor. This ORSA will be reviewed in relation to Insurance Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) 16 Enterprise Risk Management (ERM) and 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.</p> <p><i>RATIONALE: We recommend that any insurance group, not just insurance groups that the IAIS may designate as "IAIGs," should be able to submit its group report to its lead U.S. regulator(s) in lieu of any additional filing requirements.</i></p>
10	D. Extensions	<p>An extension for the due date of submission of the ORSA filing or a partial ORSA (i.e. specific sections) may be granted at the discretion of the Commissioner.</p>	<p>Amend:</p> <p><u>The domestic and lead regulator(s) may jointly grant an An</u> extension for the due date of submission of the ORSA filing or a partial ORSA (i.e. specific sections) may be granted at the discretion of the Commissioner.</p> <p><i>RATIONALE: We recommend that it be clear which regulator(s) may grant an extension.</i></p>
11	II. Section 1	<p>DESCRIPTION OF THE RISK MANAGEMENT POLICY</p> <p>An effective Enterprise Risk Management (ERM) Framework should at a minimum include the following key principles:</p> <p>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.</p> <p>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.</p>	<p>Amend:</p> <p>DESCRIPTION OF THE RISK MANAGEMENT POLICY <u>FRAMEWORK</u></p> <p><u>Section 1 of the ORSA should describe the insurer's/insurance group's An effective Enterprise Risk Management (ERM)</u> Framework should at a minimum include the following in the context of the following key principles.</p> <p><u>ERM kKey Pprinciples:</u></p> <p>Risk Culture and Governance – <u>A gGovernance structure that clearly defines and articulates roles, responsibilities and accountabilities is an essential requirement for ERM along with and</u></p>

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		<p>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.</p> <p>Risk Management and Controls – Managing risk is an ongoing enterprise risk management activity, operating at many levels within the organization.</p> <p>Risk Reporting and Communication – Provides key constituents with transparency into the risk management processes and facilitate active, informal decisions on risk taking and management.</p>	<p>a risk culture that supports accountability in risk-based decision making.</p> <p>Risk Identification and Prioritization – Risk identification and prioritization process that is a key <u>ongoing process</u> to the organization; ownership of this activity <u>within each major risk category</u> is clear; the risk management function is responsible for ensuring that the process is appropriate and functioning properly at all organizational levels.</p> <p>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.</p> <p>Risk Management and Controls – Managing risk is an ongoing enterprise risk management activity, operating at many levels within the organization.</p> <p>Risk Reporting and Communication – <u>Reporting and communication</u> provides key constituents with transparency into the risk management processes and facilitate active, informed decisions on risk taking and management.</p> <p><i>RATIONALE: We recommend use of the term “framework” rather than the term “policy.” Other suggested edits would conform the structure of the descriptions to one another.</i></p>
12	II, Section 1, 2 nd full paragraph	<p>Section 1 of the ORSA should document the aforementioned ERM Framework principles, if present, as well as summarize or reference (e.g. in an appendix) the insurer/group's risk management policies. The risk management policies should:</p> <p>a. Identify all relevant and material risk categories and describe how those risk categories are managed on a day-to-day operational basis as the insurer/group executes its business strategy.</p> <p>b. Describe any processes and methods used for monitoring risk and should include any risk tolerance statements and describe the relationship between any risk tolerance statements and capital requirements both regulatory and economic.</p> <p>c. Include the insurer/group's investment policy which should specify the nature, role and extent of the insurer's investment activities, how the investment policy complies with the solvency regime investment requirements and specifies explicit risk management procedures regarding more complex and less transparent classes of assets and investments in markets or instruments that may be subject to less governance or regulation. The investment policy should address credit risk, market risk, liquidity risk and any counterparty risk that may be associated with any hedging programs. The ORSA should provide the insurer/group's own internal analysis processes used to identify such risks and not rely exclusively on investment managers or rating agencies and their use of diversification to mitigate such risks.</p> <p>d. Include any underwriting policy used by the insurer/group to manage underwriting risk and describe the relationship of the underwriting policy to product design and product pricing.</p> <p>e. Include any claims underwriting or claims processing policies implemented by the insurer/group to manage any risks associated with determining whether claims are covered under the contract and how claim amounts are determined.</p> <p>f. Include a description of any anti-fraud policies that have been implemented to detect fraud in filing of claims.</p> <p>g. Include a description of any asset-liability management (ALM) activities which clearly specifies the nature, role and extent of ALM activities and the relationship with product development, pricing and investment management functions.</p> <p>Include a description of any retention or conservation policy or</p>	<p>Add new heading, amend, and delete c. –m.</p> <p><u>Significant Risk Categories</u></p> <p>Section 1 of the ORSA <u>should also identify and describe the insurer's/insurance group's major risk categories. These categories may include, and are not limited to, credit, market, liquidity, asset-liability management, underwriting, claim, expense, operational and risks associated with group membership. document the aforementioned ERM Framework principles, if present, as well as summarize or reference (e.g. in an appendix) the insurer/group's risk management policies.</u></p> <p><u>For each major risk category, Section 1</u> The risk management policies <u>should further:</u></p> <p>a. <u>Explain</u> Identify all relevant and material risk categories and describe how those risk categories are managed on a day-to-day operational basis as the insurer/<u>insurance</u> group executes its business strategy.</p> <p>[new] <u>Include, if available, a risk policy statement:</u></p> <p>b. <u>Describe</u> any processes and methods used for monitoring risk and should include any risk tolerance statements and describe the relationship between any risk tolerance statements and capital requirements both regulatory and economic.</p> <p><u>[new] Include risk limit(s)</u></p> <p><u>[delete c. thru m.]</u></p> <p><i>RATIONALE: We've recommended edits to this paragraph because:</i></p> <ol style="list-style-type: none"> <i>We believe that the introductory statement—"The risk management policies should"—mandates specific risk policies listed in a. through m. This would produce voluminous amounts of information not based on how the insurer/insurance group is managing the risks in its business. We recommend replacing the word "should" with the word "may."</i> <i>We've deleted use of the terms "any" and "all." GSIWG have advised that they want a succinct, big-picture, readable report of how the insurer/insurance group is managing the risks in its</i>

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		<p>program designed to retain assets, policies in force or market share. Such programs may include multiple coverage discounts, extra interest credits or other policyholder options.</p> <p>i. Include a description of any reinsurance counterparty policy related to any reinsurance programs the company has in effect.</p> <p>j. Include, if applicable, any management activities or policy related to processes of identifying, assessing, measuring, monitoring, controlling and mitigating risks associated with group membership.</p> <p>k. Include any activity related to mergers or acquisitions of business including a description of the policy or program for completing due diligence on the transaction.</p> <p>l. Include a description of how compensation and incentives are assessed and considered within the ERM Framework.</p> <p>m. Include a description of any other management activity, policy or program designed to assess enterprise risk not already described in a category above.</p>	<p><i>business.</i></p> <p>3. <i>We strongly urge this report should not be a 'data dump' that insurers perform to specification. It should instead give regulators an overview of how the insurer/insurance group is actually managing the risks in its business.</i></p> <p>4. <i>We've condensed the a.-m. list to the essentials because GSIWG members have stated that they want a readable report.</i></p>
13	II, Section 1, 3rd full paragraph	<p>The ORSA should also disclose how the insurer/group's management uses its risk management policy including any tolerance statements and limits in its day-to-day operations as it executes its business strategy. The ORSA should disclose insurer/group information, management processes, and 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. The ORSA should also 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.</p>	<p>Delete.</p> <p><i>RATIONALE: This paragraph is redundant. Also see Rationale for condensing c.-m. in II, Section 1.</i></p>
14	III, Section 2, Title	<p>SECTION 2 - QUANTITATIVE MEASUREMENTS OF RISK EXPOSURE IN NORMAL AND STRESSED ENVIRONMENTS</p>	<p>Amend:</p> <p>SECTION 2 – <u>SUMMARY OF MAJOR RISK EXPOSURES QUANTITATIVE MEASUREMENTS OF RISK EXPOSURE IN NORMAL AND STRESSED ENVIRONMENTS</u></p> <p><i>RATIONALE: We recommend these edits because the ORSA should reflect how insurers actually run their businesses and do so in a succinct, readable report.</i></p>
15	III, Section 2, 1 st full paragraph	<p>Section 2 of the ORSA should document the quantitative measurements of risk exposure in both normal and stressed environments for each risk category identified in Section 1. This quantitative measurement process should require a quantification of risks under a range of outcomes using risk measurement techniques that are appropriate to the nature, scale and complexity of the risks. Section 2 should include detailed descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made and outcomes of any plausible adverse scenarios that are run. Examples of relevant material risk categories may include, but not be limited to, credit, market, liquidity, cash flow mismatch, underwriting, claim, expense, operational and risks associated with group membership. Although it is recognized that some stress tests for certain risks may be performed at the insurance group level, the regulator may request additional information to map the results to an individual insurance legal entity.</p>	<p>Amend:</p> <p>Section 2 of the ORSA should provide a summary of the <u>insurer's/insurance group's major risk exposures</u>. <u>If available, Section 2 should describe how an insurer/insurance group quantifies these</u> document the quantitative measurements of risk exposures. in both normal and stressed environments for each risk category identified in Section 1. This quantitative measurement process should require a quantification of risks under a range of outcomes using risk measurement techniques that are appropriate to the nature, scale and complexity of the risks. Section 2</p> <p><i>RATIONALE: We recommend these edits because the ORSA should reflect how insurers actually run their businesses. Many ACLI members do not quantify all the risks listed in a.-m. of Section 1 because the U.S. regulatory system uses RBC to determine target capital levels and reserving formulae to calculate liabilities.</i></p> <p><u>It should include succinct detailed</u> descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made and outcomes of any plausible adverse scenarios that are run. Examples of relevant Mmaterial risk categories may include, <u>and are</u> but not be limited to, credit, market, liquidity, asset-liability management, underwriting, claim, expense, operational and risks associated with group membership. Although it is recognized that some stress tests for certain risks may be performed at the insurance group level, the regulator may request additional information to map the results to an individual insurance</p>

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			<p>legal entity.</p> <p><i>RATIONALE: We believe that, to be useful to regulators, the ORSA must be succinct, rather than detailed. We recommend deleting the last sentence because any commissioner already has the authority to request additional information of a licensed insurer and because we don't understand 'mapping stress results to a legal entity.'</i></p>
16	III, Section 2, 2 nd & 3 rd full paragraphs	<p>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.</p> <p>Within the Appendix are three examples that illustrate the types of outcomes of risk measurement a regulator may desire to observe for risk categories identified within a life insurance company (attachment 1), a property casualty company (attachment 2) and a health insurance company (attachment 3). These examples are not intended to be used as prescribed templates.</p>	<p>Delete.</p> <p><i>RATIONALE: We believe that, to be useful to regulators, the ORSA must be based on how the insurer/insurance group is managing the risks in its business. Companies have various approaches to assessing capital needs, so we believe that it is not possible or meaningful to try to construct an ORSA data analysis framework at this time. Any such process must be evolutionary. ICP 16.0.9 recognizes that the ICP itself is aspirational in nature.</i></p>
17	III, Section 2, 4 th paragraph	<p>Because the risk profile of each insurer/group is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer/group should run, however the regulator may have input regarding the level of stress that company management should consider for each risk category. 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/group'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.</p>	<p>Amend:</p> <p>Because the risk profile of each insurer/group is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer/group should run, however the regulator may have input regarding the level of stress that company management should consider for each risk category. 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/group'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.</p> <p><i>RATIONALE: We believe that, to be useful to regulators, the ORSA must be based on how the insurer/insurance group is managing the risks in its business. Companies have various approaches to assessing capital needs, so we believe that it is not possible or meaningful to try to construct an ORSA data analysis framework at this time. Any such process must be evolutionary. ICP 16.0.9 recognizes that the ICP itself is aspirational in nature.</i></p>
18	III, Section 2, 5 th paragraph	<p>By identifying each material risk category independently and reporting notional amounts, expected amounts in both normal and stressed conditions, insurer/group management and the regulator are in a much better position to evaluate certain risk combinations that could cause a insurer/group to fail. One of the most difficult exercises in modeling insurer/group 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.</p>	<p>Delete.</p> <p><i>RATIONALE: We believe that, to be useful to regulators, the ORSA must be based on how the insurer/insurance group is managing the risks in its business. Companies have various approaches to assessing capital needs, so we believe that it is not possible or meaningful to try to construct an ORSA data analysis framework at this time. Any such process must be evolutionary. ICP 16.0.9 recognizes that the ICP itself is aspirational in nature.</i></p>
19	IV, Section 3, Title	<p>SECTION 3 – GROUP ECONOMIC CAPITAL AND PROSPECTIVE SOLVENCY ASSESSMENT</p>	<p>Amend:</p> <p>SECTION 3 – GROUP ECONOMIC CAPITAL ASSESSMENT AND CONTINUITY ANALYSIS PROSPECTIVE SOLVENCY ASSESSMENT</p> <p><i>RATIONALE: Some ACLI members do not use 'economic capital' concepts currently because the U.S. regulatory framework does not use them. We recommend GSIWG adopt instead the concept of 'target capital,' which would include RBC as well as economic</i></p>

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			<i>capital.</i>
20	IV, Section 3, 1 st paragraph	Section 3 of the ORSA 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 business over the longer term business cycle such as the next 2-5 years.	<p>Amend:</p> <p>Section 3 of the ORSA should include two elements. One should be a capital assessment, and the other a continuity analysis. 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 business over the longer term business cycle such as the next 2-5 years.</p> <p><i>RATIONALE: This succinctly states an expectation that most companies can meet and will be useful to regulators. Note that ICP 16.15 recommends a 'continuity analysis.'</i></p>
21	IV, Section 3, 1 st heading	Group Economic Capital	<p>Amend:</p> <p>Group Economic Capital</p> <p><i>RATIONALE: Most ACLI members do not use 'economic capital' concepts currently because the U.S. regulatory framework does not use them.</i></p>
22	IV, Section 3, 2 nd & 3 rd paragraphs	<p>Insurers and/or holding company systems 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. This section is intended to help regulators understand insurers' capital adequacy in relation to the risk profiles.</p> <p>On an annual basis, the insurer and/or insurance holding company system subject to this filing should provide a group economic capital assessment within their ORSA for the previous period year-end. This information may also be requested by a Commissioner throughout the year, if needed.</p>	<p>Amend:</p> <p>An insurers/insurance group and/or holding company systems should have a sound processes for assessing capital adequacy in relation to its their risk profile and the process should be integrated into its management and decision making culture. This section is intended to help regulators understand insurers' capital adequacy in relation to the risk profiles.</p> <p><i>RATIONALE: The first sentence is clearer using the singular rather than the plural. The second sentence seems unnecessary.</i></p> <p>On an annual basis, the insurer and/or insurance holding company system subject to this filing ORSA should provide a current group economic capital assessment. within their ORSA for the previous period year-end. This information may also be requested by a Commissioner throughout the year, if needed.</p> <p><i>RATIONALE: The phrase "on an annual basis" is redundant with our definition of an ORSA. Using the term "insurer/insurance group" conforms to our recommended definition of the ORSA. We recommend using "current" rather than "for the previous year-end" to clarify that an insurer/insurance group should use the most recent data available. The last sentence is unnecessary.</i></p>
23	IV, Section 3, 4 th paragraph, introductory sentence	The figure representing the group economic capital must be accompanied with a narrative describing the following:	<p>Amend:</p> <p>The ORSA should describe how the insurer/insurance group determines its internal capital target, e.g., rating agency capital, regulatory capital, economic capital, or other measures. That description should include the internal capital level as defined by its capital target(s) and figure representing the group economic capital must be accompanied with a narrative describing the following as applicable:</p> <p><i>RATIONALE: We recommend this revision to recognize that different insurers target capital levels in different ways. The ORSA should summarize how they run their own processes rather than mandate the process itself.</i></p>
24	IV, Section 3, 4 th paragraph, first bullet	Definition of solvency – Describe how the insurer and/or group defines solvency (e.g. Cash flow basis, balance sheet basis, etc.). If balance sheet basis, what basis of accounting is used.	<p>Amend:</p> <p>Definition of <u>required capital</u> solvency – Describe how the insurer and/or group defines solvency (e.g. Cash flow basis, balance sheet basis, etc.). If balance sheet basis, what basis of accounting is used.</p>

#	§ and ¶	Current Text, if any	Recommended Edit and Rationale
			<i>RATIONALE: This replacement clarifies that ORSA should contain the insurer's/insurance group's own definition of its target capital.</i>
26	IV, Section 3, 4 th paragraph, last bullet	Reflecting diversification – Describe any diversification benefits and amount that is being used to spread around the risks to which the group is exposed.	<p>Amend:</p> <p>Reflecting diversification – Describe <u>relevant and material</u> any diversification benefits and amount that is being used to spread around the risks to which the group is exposed.</p> <p><i>RATIONALE: We recommend this modification so the ORSA will highlight material diversification benefits, which will focus the report and be an important signal to regulators.</i></p>
26	IV, Section 3, 5 th paragraph, first bullet	<p>The approach and assessment of group-wide capital adequacy should also consider the following:</p> <ul style="list-style-type: none"> • Eliminate intra-group transactions and consequently double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities. • Take account of the level of leverage, if any, resulting from holding company debt • Clearly identify diversification credits and adequately address 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. • Reflect the effects of contagion risk, concentration risk and complexity risk in their group capital assessment. 	<p>Amend:</p> <p><u>General Considerations</u></p> <p>The <u>capital assessment and continuity analysis approach and assessment of group-wide capital adequacy should take into account</u> also consider the following:</p> <ul style="list-style-type: none"> • Eliminate i <u>Eliminate</u> intra-group transactions and consequently double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities. • Take account of the l <u>Level of leverage, if any, resulting from holding company debt</u> • Clearly identify diversification credits and adequately address R <u>estrictions 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.</u> • Reflect the e <u>Effects of contagion risk, concentration risk and complexity risk in their group capital assessment.</u> <p><i>RATIONALE: This clarifies what the ORSA should contain and that it should reflect how the insurer/insurance group runs its business. We've relocated it to the end of Section 3, so it applies to both the group capital assessment and the continuity analysis.</i></p>
27	IV, Section 3, 6 th paragraph	The goal of the assessment is to provide an overall determination of economic capital needs for the insurer and/or holding company system, based upon the nature, scale and complexity of risk within the group. Group capital should not be perceived as the minimum amount of capital before regulatory action will result (e.g. US risk-based capital 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.	<p>Delete.</p> <p><i>RATIONALE: We recommend deleting this paragraph because it mandates that the insurer/insurance group calculate economic capital. We believe that the ORSA should instead reflect how the insurer/insurance group manages the risks in its business.</i></p>
28	IV, Section 3, 2 nd heading	Prospective Solvency Assessment	<p>Amend:</p> <p><u>Continuity Analysis</u> Prospective Solvency Assessment</p> <p><i>RATIONALE: We believe the term "continuity analysis" describes a broader range of insurer's/insurance group's practices within our U.S. regulatory framework.</i></p>
29	IV, Section 3, 7 th paragraph	Most companies, as part of their strategic planning process, compile a 2-5 year business plan. Section 3 of the ORSA should contain a demonstration and documentation that: given the current capital requirements both economic and regulatory, the quality of that capital, the current risk management policy consisting of its current risk tolerance limits, current risk exposure amounts in both a normal and stressed environments and the projected 2-5 year business plan; the company has the financial resources necessary to execute its 2-5 year business plan. If the insurer/group does not have the necessary financial capital or quality of capital to execute the 2-5 year business plan, the insurer/group should describe the management actions it will take or describe any modifications to the	<p>Amend:</p> <p>Most companies, as part of their strategic planning process, compile a 2-5 year business plan. Section 3 should provide a summary of the insurer's/insurance group's business plan, a description of whether and how the business plan's viability is confirmed, and, if available, a quantitative demonstration of the plan's viability. The quantitative demonstration, which should be described, may involve stress testing, scenario modeling, and/or projections of future capital needs and resources. This analysis should be done over a 2-5 year period that is consistent with the insurer's/insurance group's business plan. discuss whether the insurer/insurance group will have contain a demonstration and documentation that: given the</p>

#	§ and ¶	Current Text, if any	Recommended Edit and Rationale
		business plan it has made to resolve the adequacy of its financial capital, including potential other resources of capital.	<p>current capital requirements both economic and regulatory, the quality of that capital, the current risk management policy consisting of its current risk tolerance limits, current risk exposure amounts in both a normal and stressed environments and the projected 2-5 year business plan; the company has the financial resources necessary to execute its 2-5 year business plan. If the insurer/insurance group performs a projection of future capital needs and does not have the necessary financial capital or quality of capital to execute the 2-5 year its business plan, it the insurer/group should describe the management actions it will take or describe any modifications that it will make to the business plan it has made to resolve the adequacy of its financial capital, including potential other resources of capital.</p> <p><i>RATIONALE: We believe the ORSA should be a succinct, readable document; details of how the insurer/insurance group is running its business should be part of the financial examination.</i></p>
30	IV, Section 3, 8 th paragraph	The prospective solvency assessment is in effect a feedback loop. The insurer/group 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 2-5 year business plan. The prospective solvency assessment should also consider both normal and stressed environments.	<p>Delete.</p> <p><i>RATIONALE: This paragraph appears redundant of the paragraph above.</i></p>
31	IV, Section 3, last paragraph	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 consider any constraints on group capital or the movement of group capital to legal entities.	<p>Amend:</p> <p>If the <u>continuity analysis</u> prospective solvency assessment is performed for each individual insurance company legal entity, the assessment should take into account <u>any relevant and material</u> risks associated with group membership. Such an assessment may involve a review of any group solvency assessment and consider <u>any relevant and material</u> constraints on group capital or the movement of group capital to legal entities.</p> <p><i>RATIONALE: We recommend that the ORSA focus on risks and constraints that are relevant and material.</i></p>
32	Appendix	[not reproduced here]	<p>Delete.</p> <p><i>RATIONALE: Most ACLI members are not prepared to perform an ORSA either within the meaning of ICP 16 nor within specifics of the Guidance Manual as drafted currently. Our draft comments propose an annual, succinct, high-level report to domiciliary regulators from their insurers/insurance groups on how they are running their businesses.</i></p> <p><i>We believe that building an ORSA framework within the U.S. system of regulation will take time, for regulators and industry alike. Implementing it should be a staged process to allow for evolution of company practices as well as regulatory practices. We emphasize that, given the long-standing success of the U.S. regulatory framework, which has no concept of 'economic capital,' it is not possible or meaningful to try to construct an ORSA data analysis framework at this time.</i></p>

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August 24, 2011

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Re: NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual

Dear Director Huff and Mr. Saenz:

I write today on behalf of America's Health Insurance Plans (AHIP). AHIP is the nation's trade association representing health, managed care, long-term care, supplemental and disability carriers from across the country. We appreciate the opportunity to provide input and comment on the August 5 draft version of the NAIC's *Own Risk and Solvency Assessment (ORSA) Guidance Manual*. AHIP and its member companies have some significant concerns about the direction of this document and we look forward to discussing these with you in detail at the upcoming National Meeting.

General Comments

Timing. The concept of an *Own Risk and Solvency Assessment (ORSA)*, as noted in earlier industry comments, is complex and important. An ORSA, done correctly, will be a major undertaking for most carriers, particularly those that are smaller or mid-sized companies. This project must be undertaken carefully to avoid causing harm, rather than creating a strong regulatory framework. In order to ensure that there has been a careful consideration of all the possible consequences that may result from the ORSA project, we urge the Working Group to step back from the rigid and inflexible timeline that has been proposed. We suggest that the November, 2011 completion date, which is a mere ten weeks away, is an aggressive and unworkable goal that will require regulators to circumscribe vigorous and in-depth discussion with stakeholders. Rather, the goal should be to complete the ORSA project as expeditiously as

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possible, while providing adequate time and opportunity for stakeholder involvement, which has not been done to date.

Reporting Level. We urge the working group to include a clear statement that the carrier itself must be responsible for determining at what internal level the ORSA analysis takes place and that any reporting must comport with the manner in which the carrier regularly analyzes and manages its own risks.

Process. It also has not been made clear precisely what the expectations for the ORSA reporting mechanism actually are. We believe that the “ORSA” process itself is intended to be an assessment that a carrier makes of its own risks, and its own solvency, and is one that takes the company’s unique profile and risk appetite into account. It is not intended to be a prescribed report under which regulators set rigid guidelines for what must be or what may not be included in the internal analysis. To the extent that regulators will require reporting, they should only require a high level report that outlines the company’s process rather than demanding a filing that includes all the elements included in the manual, which could run to hundreds of pages.

As currently contemplated in the *Manual* document, the report will be overly expensive to produce, overly detailed in its reporting and not effective as a regulatory tool. Much of the information currently outlined will be impossible to include in a manageable document. For example, filing a report including all underwriting policies, claims processing policies, investment policies and stress testing will require hundreds, if not thousands of pages to report adequately but will not, under any circumstances, provide the regulators with workable information to assess overarching solvency. Instead of this rigid approach, the manual should contain only guiding principles and outline the expectation that the group will furnish evidence that the culture within the organization has adopted the process. An example of the overly prescriptive and intrusive language is in Section 2 which provides "*The regulator may provide input on the level of the measurement metric to use in the stressed condition or specify particular parameters...*"

Annual reporting. It remains unclear how the working group intends to require ORSA filings. We suggest that an annual report, due at a fixed date, containing all the elements discussed in the *Manual* is unnecessary, overly burdensome to both industry and regulator alike and provides no real benefit. To the extent an adequate internal process is in place, and that process has remained stable over time, there is no reason to require a full and detailed report explaining the details of that stable process. Companies should be required to certify to the stability of the process, and should be required to report in more detail when process or procedures change over time, but to go through the exercise of a full “ORSA” report as contemplated by the *Manual* is unnecessary, expensive and time consuming for no real reason. We also urge the working group to agree that carriers not be required to file annual reports or certifications on a prescribed date each year. In line with the ORSA concept, we ask that each carrier be provided flexibility to provide this information to regulators at the time of the year that the carrier is engaging in its own annual

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strategic planning, including completing its ORSA process and running stress tests for ORSAs or risk assessments to be filed with other U.S. or international regulators.

In addition, once there has been a determination regarding whether or how the states will receive ORSA filings, we urge that there be at a minimum a one year transition to permit carriers and regulators to understand the wide variety of ORSA reporting, interpretations and practices that currently exist.

Confidentiality. We recognize that there has been significant discussion regarding the confidentiality of this and other financial data over the past two years. Nevertheless, the nature of the information contained in a report of a group's ORSA is of such sensitivity that it is critical that all stakeholders – industry, regulators and legislators – have clear and uniform understandings that this information will not be made public. Any release of this kind of company-specific strategic thinking will create extremely serious disruptions to the market, and will harm the company whose strategic planning and thinking was revealed. This data is far more sensitive and confidential than the data normally provided to regulators, and hence, special care must be taken to safeguard it.

Implementation. We acknowledge that very large international groups of the type represented on the Chief Risk Officer (CRO) Council likely have been performing internal testing and assessments that closely resemble an “ORSA” process as contemplated by this *Manual*. There are many companies and groups, however, that have very distinct and unique measures of their own risk tolerances and profiles and that do not currently collect data as described in the *Manual*. These companies will need to analyze the new requirements against current practices, and then modify or create policies, processes, and infrastructure. This will take significant lead time, not only to work with regulators to secure the highest level of confidentiality, but to determine what, exactly, the regulators' expectations will be with regard to issues such as stress tests, and how they intend to use the new information, so that it can be appropriately designed for its specific uses. We repeat our suggestion, above, that the working group take the time necessary to ensure that whatever requirements it imposes do not unduly disadvantage significant market segments. Health carriers, for example, have significantly different issues both with regard to financial risk and diversity that have not been addressed in this manual at all.

In addition, we are concerned about the potential for each state to establish its own unique, and possibly confusing requirements for the type and frequency of reporting, what parameters and thresholds will need to be met for stress testing, what kinds of stress testing are being envisioned as appropriate, and how each regulator will assess the information that groups are being asked to provide.

Lead state. Throughout the *Manual*, there are references to “a commissioner” or “the commissioner” with respect to filing, granting waiver applications, and discretion to demand further or more detailed information, among other things. For companies and groups with multiple regulated entities, it is critical that each commissioner in every state not be granted unlimited authority to demand that the

group take specific actions, file specific documentation, or perform specific testing. The unbridled authority of a commissioner who is not a lead-state commissioner to demand that groups take this kind of action has the potential to create chaos among regulated entities. It is imperative, as we move toward a group, rather than individual legal entity manner of oversight that there be clear understanding that only the group, or lead-state supervisor is responsible for these exercises of discretion, if any are to be taken at all.

Specific comments

I. Introduction

The introductory language makes two troublesome assertions – first that the *Manual* is intended to provide guidance to companies regarding the ORSA performance “within the Form B Insurance Holding Company System Annual Registration Statement...” and that the ORSA “shall be completed at least annually.” As noted above, these statements presuppose that there will be a mandatory reporting, and that the reporting will be in the context of Form B. We strongly urge the working group to reconsider this suggestion, and first to be perfectly clear and comfortable with the contents of the report, the timing of the report and the filing of the report before deciding on where the statutory requirement for filing will lie. There are, certainly, some reasons for mandating that certain filings containing confidential financial data be made under the auspices of Form B. There are, however, many more good reasons for requiring a report on an ORSA review to be filed pursuant to other statutory or regulatory requirements. But until there is a clear and common understanding of what the “report” must look like and must contain, and when it should be filed, and the degree of flexibility that carriers will have regarding all of these factors, it is quite premature to decide upon the statutory basis for filing requirements.

We also suggest that the statement “the ORSA shall be completed at least annually” is again a premature statement. There is no common understanding between regulators and industry precisely what the regulatory expectations are with regard to a company’s internal risk and solvency assessment. Until there is, it is unclear that a mandate that this particular report “be completed at least annually” has any real meaning. We therefore urge the working group to remove both statements from the introduction.

II. Exemption

We suggest the language in the exemption section be amended thus:

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

In addition, the *Manual* should make clear that non-insurance, non-regulated business operations may be carved out of any reporting requirement, and should also make clear exactly what “unique circumstances” are contemplated under which a commissioner can exercise discretion to demand an ORSA from an otherwise exempt company or group. Given the tremendous financial and personnel costs involved in creating these types of analyses and reports, it is critical that companies and groups have a clear understanding when they may be required to undertake this exercise and be given the appropriate amount of time within which to prepare.

III. Application for Waiver

We suggest that the language regarding the application for a waiver be amended as follows to recognize that groups as well as individual carriers may be the subject of a waiver application:

An insurer and/or insurance group may make application to the commissioner for a waiver from the requirements of the ORSA based upon unique circumstances.

IV. General Guidance

The language in the introductory paragraph to the general guidance provisions is overly restrictive and prescriptive. As written, it indicates that all ORSA filings must have three sections. Of those three sections, Section 1 must be a description of the risk management policy, Section 2 must be a description of the quantitative Measurements of Risk Exposure in Normal and Stressed Environments and Section 3 must be Group Economic Capital and Prospective Solvency Assessment. This ignores the fact that every carrier’s ORSA process is going to be qualitatively and quantitatively unique as each will be based upon the circumstances of the insurance group conducting the assessment. In order to clearly recognize this, we suggest that the language read as follows:

While the ORSA is completed entirely by an insurance legal entity within an insurance group and/or the insurance group, and therefore represents its internal risk management assessment, the resulting ORSA filings should contain-address three major sections-areas as follows:

Section-Area 1 – Description of the Risk Management framework

Section-Area 2 – Quantitative Measurements of Risk Exposure in Normal and Stressed Environments

Section-Area 3 – Group Economic Capital and Prospective Solvency Assessment

However, the depth and detail is likely to be influenced by the nature and complexity of the insurer and/or insurance group.

V. Section I

We suggest that the title to this section should be the “Description of the Risk Management Framework, rather than the risk management “policy.”

We further suggest that the portion of section I devoted to the list of mandatory requirements for risk management policies is prescriptive and for many insurers will be inaccurate, or immaterial. This is precisely the one-size-fits-all format that are more than likely destined to lead to onerous reporting requirements that serve no real regulatory purpose. The carriers or insurance groups themselves should determine the elements that must be included in their *own* risk and solvency assessment. Section I does not describe a method for a company or insurance group to explain to its regulator how it has performed its risk and solvency assessment. Rather it is a mandated set of reporting elements by which the regulatory community is forcing carriers and groups into a uniform reporting platform. We therefore suggest that elements a – m be deleted. We believe that the principles set forth in bullet points at the top of page 5 of the draft *Manual*, informed by the CRO Council's presentation in Jacksonville, provide sufficient high-level regulatory expectations for the elements of a carrier's risk management framework.

Nevertheless, if the working group does not agree to delete elements a – m, we ask that the language be revised: (1) to provide carriers with discretion in determining whether some or all of these elements need to be included in their Own Risk and Solvency Assessment process and report; and (2) to confirm that the information sought in these elements be provided at an overview or summary level. We therefore ask that the introductory clause be revised to reinforce that a risk management framework may consider *some or all* of these elements. Further, the language of each element must be clear enough so that both the carriers and the regulators have a common understanding regarding the level of detail to be provided. By way of example, Section 1 (d) as currently drafted seeks "any underwriting policy." Our belief is that an ORSA would not contain underwriting detail on every product.

VI. Section II

The manual throughout has lost sight of a key point: The purpose of undertaking an ORSA review is for internal, not regulatory, decision-making. All through Section II we note again that the requirements are overly prescriptive, and, rather than creating a method for carriers to explain their own, internal, risk and solvency reviews to the insurance regulator, instead create a program under which regulators are encouraged to demand specific testing or review. Language such as "however the regulator may have input regarding the level of stress that company management should consider for each risk category" is not intended to encourage regulators to understand company internal assessments; rather, it is intended to assume control of those assessments.

What this section should include is a high-level discussion of regulatory expectations, recognizing that decisions regarding testing, particularly stress testing, involve significant amounts of internal business judgment. The appropriate regulatory response should be to understand how a company makes its testing decisions and to understand why a company makes the decisions that it does, rather than to substitute or overlay the regulator's judgments on management's.

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We also note that the intent of an “own risk and solvency assessment” is not to map risks down to each entity in the group. Rather it is to ensure that the collective enterprise has considered the sum of its risks and related capital needs and is advancing its business planning with the understanding of the variation in outcomes and its ability to meet its capital needs under each of those scenarios. Items such as Section 2 which includes the language: "*Although it is recognized that some stress tests for certain risks may be performed at the insurance group level, the regulator may request additional information to map the results to an individual insurance legal entity*" are not consistent with that intent and will obstruct the usefulness of the overall process.

The discussion of modeling results is quite unclear. As an initial comment on this issue, we note that providing this level of detail is overly burdensome, and will provide regulators with potentially thousands of pages of materials to review, few of which will provide significant regulatory oversight benefits. However, if that level of detail is to be required, then it is imperative that the NAIC outline its expectations clearly. For example with respect to stress test calibrations, an expected value can be stressed “a little” or “a lot” and unless the regulatory community is clear and precise in its expectations there will be a wide range of outcomes that will not be comparable one to another. It will also be important to determine and communicate in each situation whether the stressed values are before or after the effect of controls have been considered.

Finally, we ask that this section be revised to reflect the understanding that an ORSA report, as opposed to the ORSA process, would likely include only certain or high level summaries of stress test results. Some large carriers may run well over 100 stress tests as part of their ORSA process.

VII. Section III

Section III of the *Manual* has received the least amount of discussion by the working group to date, but is, we suggest, critical. The *Manual* in its current iteration provides overly prescriptive, rigid reporting requirements that ultimately may serve no valid regulatory purpose. This is most evident in Section III.

The *Manual* must make very clear that the company or group has sufficient flexibility to determine appropriate group-level liquidity. The U.S. system has a vibrant risk-based capital system for determining whether legal entities within a group are in need of regulatory intervention – the ORSA should not attempt to either supplant that system or layer otherwise unnecessary regulatory requirements on the group until there has been a clear discussion and agreement between both regulators and industry what the purpose of the reports will be. We note that the *Manual* claims that the “section is intended to help regulators understand insurers’ capital adequacy in relation to the risk profiles” but the extent of an appropriate regulatory response is unclear.

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The section contemplates an annual mandatory report for the “insurance holding company system” – a term which has not previously been defined in the context of the *Manual* -- that has at a minimum seven required sections including “definition of solvency;” “time horizon of risk exposure;” “risks to model” and several others. This is not a high-level description of a group’s *own* risk and solvency assessment; it is an outline of a prescriptive report that must be completed pursuant to a regulatory template. Again, the one-size-fits-all nature of this document belies any suggestion that this is an attempt by the regulatory community to understand internal company decisions, rather than to mandate a new annual report.

We thank you for the opportunity to provide comments and look forward to working with you closely as we develop the parameters of this extremely important project.

Sincerely,

MITCHELL, WILLIAMS, SELIG,
GATES & WOODYARD, P.L.L.C.

A handwritten signature in blue ink that reads "Randi Reichel". The signature is written in a cursive style.

By

Randi Reichel



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August 25, 2011

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Re: NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual – 8/5/11 Draft

Dear Mr. Saenz and Director Huff:

We appreciate the opportunity to provide commentary on the August 5, 2011 exposure draft of the NAIC's Own Risk and Solvency Assessment (ORSA) Guidance Manual (Guidance Manual). We continue to offer our support of this initiative and recognize the great deal of work and progress that has been made since the proposal's initial exposure period. As stated in our March 17, 2011 comment letter, we believe that an organization with a robust enterprise risk management (ERM) culture has a comprehensive understanding of the potential risks to its operations and, accordingly, is in a position to effectively manage those risks going forward. With this letter we would like to reiterate certain comments made in our March 17, 2011 comment letter which asked for clarification regarding the role of ERM in solvency regulation, as well as stressed the importance of ORSA requirements being applied consistently across international jurisdictions. Included with this letter is a copy of the Guidance Manual with suggested text changes which seek to address, to the extent possible, the high level comments made in this letter, as well as provide additional clarity and reduce the amount of prescriptive requirements ensuring that the assessment completed truly represents an insurer's "own" risk and solvency assessment.

The objective of the ORSA and how it fits into the existing U.S. regulatory structure remains unclear. We believe that ERM has a place in solvency regulation but that place must be defined and balanced with existing oversight. It is our belief (consistent with Insurance Core Principle 16, Enterprise Risk Management, paragraph 16.13.13) that the level of regulation should be adapted based upon how well an insurer manages its risk and capital. Currently the U.S. regulatory framework requires an annual independent statutory audit report, a general purpose financial statement audit for publically traded companies and a mandatory triennial risk-focused examination. Adding an ORSA requirement on top of this process in its current state would be

redundant and inefficient. Based on our research of the six largest insurance markets in the world, other jurisdictions do not mandate that an extensive statutory exam be conducted in addition to the information provided through an ORSA-type document. The U.K. FSA, for example, supervises insurers through a risk assessment framework called ARROW (Advanced, Risk-Responsive Operating Frame Work). The FSA is permitted to assess insurers at intervals of one to four years, but every two to three years would be typical, depending on the level of regulatory confidence. The FSA will usually write to the insurer requesting specific information and documents (including financial statements) at an early stage in the assessment, and is likely to subsequently make an on-site visit. During such visits the FSA usually interviews senior management members, focusing heavily on their responsibility to establish and ensure the operating effectiveness of regulatory compliance controls. Such a framework is consistent with that of other jurisdictions polled and seems very similar to how many are advocating the ORSA process should work in the U.S. That approach would eliminate the burden and cost of a risk-focused examination layered on top of ORSA. Therefore we strongly recommend that the examination model law be modified to contemplate ORSA and remove the mandatory requirement for on-site triennial examinations for those groups deemed to have a strong ERM process as documented by ORSA.

In addition to the need to ensure that the objective and role of ORSA is appropriately defined as discussed above, we also believe that there should be a sufficient level of international coordination to enable an insurer to complete one ORSA that will satisfy the requirements of all the jurisdictions in which it operates. We recognize that Section I.C. of the Guidance Manual implies that U.S. regulators will accept (with certain caveats) an ORSA provided to another jurisdiction who serves as the group-wide supervisor, but it does not address the compatibility of foreign ORSAs being provided in instances in which a U.S. jurisdiction is the group-wide supervisor. We believe that any internationally active insurance group should have the ability to complete one ORSA that can be provided to all relevant jurisdictions, regardless of whether the group-wide supervisor is the U.S. or some other foreign jurisdiction. This approach will be more efficient for both regulators and insurers.

Finally, we challenge the benefit that regulators will receive from enacting the ORSA requirements as currently drafted compared to the significant cost that will be incurred by insurers to comply with them. ERM standards and practices are evolving, and while many large insurance companies have robust ERM frameworks in place, there is a cost associated with compiling data in a specified manner that is not necessarily reflective of how management reviews information. For those insurers with less robust or perhaps no formal ERM function, the costs associated with complying with the ORSA requirements will be even more significant. These are factors that should be considered when specifying the level of detail required and is the basis of our rationale for suggesting the specific risk management policies referenced in Section 1 of the Guidance Manual be deleted.

As always, we appreciate the opportunity to provide feedback and look forward to continued dialogue on this very important topic.

Sincerely,



Jeffery C. Alton



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August 25, 2011

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Re: *AIA Comments on NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual (8/5/11 Draft)*

Dear Director Huff and Associate Commissioner Saenz:

Thank you for this opportunity to comment on the exposed draft Guidance Manual for implementing an ORSA requirement in the United States. AIA represents approximately 300 major insurance companies that provide all lines of property-casualty insurance and write more than \$117 billion annually in premiums. Our membership includes insurers with significant operations within the United States and around the world. They are very much interested in the work product of the Group Solvency Issues Working Group (GSIWG).

As requested by the GSIWG, AIA is submitting comments regarding the draft "Guidance Manual" document, which appears to require an annual report of an insurer's (or an insurance group's) Own Risk and Solvency Assessment, commonly referred to as ORSA. The GSIWG has repeatedly stated that it would like a full, robust discussion with industry. As this is the first opportunity for industry to comment on the proposed Guidance Manual, we would like to identify the significant problems the draft has. It raises so many fundamental issues that we cannot launch into a discussion of specific "fixes" to the document without first discussing certain fundamental concerns with the ORSA project. Accordingly, our comment letter is divided into two parts: (1) a summary of concerns with the proposed approach to ORSA and (2) specific suggestions for the document to address those concerns.

Part I: Summary of Overriding Concerns

Objective of ORSA

The Guidance Manual document never articulates a specific regulatory objective of an ORSA and as a result, appears to be disjointed throughout:

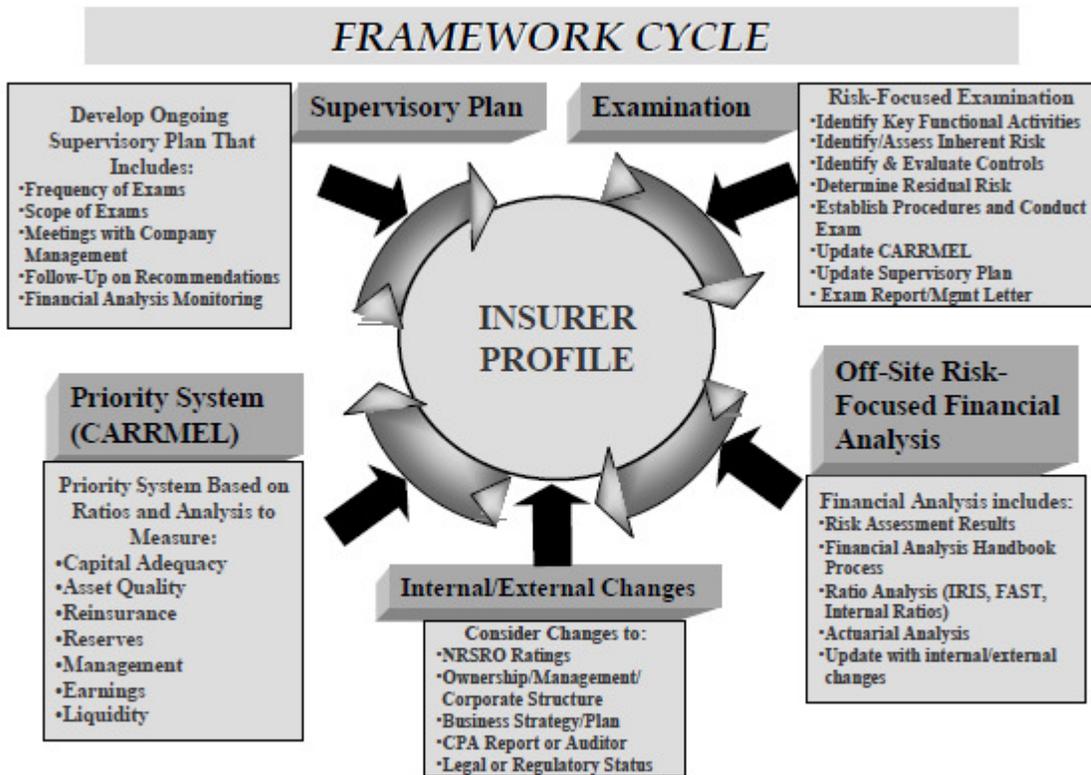
- Is the proposal a requirement **to report on** an insurer's risk management processes or is it a requirement **to engage in** risk management?
- Is the proposal a meaningful, integrated tool within the U.S. insurance solvency regulatory system or is it stand-alone compliance filing?
- Is the proposal intended for insurers or for regulators?

In our view, risk management is a process, not a report and likewise, it will take a process of engagement for regulators to properly review and understand a company's ERM/ORSA process.

Thus, our first fundamental concern is whether the regulatory purpose and desired benefit would be achieved through an ORSA filing requirement. Over the past two years of meetings and discussions, we have heard regulators state publicly and privately that an ORSA could be an effective tool for providing regulators with an enhanced understanding of how insurers manage their risks. Yet, we have also heard stated that ORSA will not be the primary tool used for measuring capital adequacy, and that the risk-based capital formula will remain the pillar of U.S. solvency and capital regulation. While we agree that regulators, in carrying out their prudential responsibilities, have a legitimate interest in understanding how an insurer views and manages its many risks, we are troubled by the continuing discussion of ORSA as though it is a new supervisory framework rather than an additional tool. For example, nowhere does the proposed Guidance Manual provide a linkage or reference to the existing Risk-Focused Surveillance Framework.

In 2004, the NAIC adopted the Risk-Focused Surveillance Framework and one of its stated objectives is to allow “. . . the assessment of risk management processes other than those that result in financial statement line item verifications including, for example, the board of director's effectiveness and corporate governance activities, thus providing a prospective look at the operations and quality of the risk management process of an insurer . . .”. The NAIC incorporated the concepts of the Risk-Focused Surveillance Framework into its 2006 amendment to the Financial Examiners Handbook, including requirements to make the new risk-focused examination process effective in 2010. So, the ERM review and ORSA, by virtue of it being an ERM process, already are key components of the Risk-Focused Surveillance Framework.

As opposed to the annual compliance filing indicated in the proposed Guidance Manual, the Risk-Focused Surveillance Framework document views solvency monitoring as a dynamic, on-going process, in which the financial examination is a key component, as reflected in the following diagram:



This Framework also anticipates that regulators would use an insurer’s own risk assessment in evaluating an insurer’s risk management environment. In the section covering risk-focused examinations, the Framework states: “The examiner may identify risks through various means such as leveraging off of the **insurer’s own risk assessment** (*emphasis added*), utilizing internal and external audit’s risk assessment, filing requirements of the SEC and the 2002 Sarbanes-Oxley Act (sections 302 and 404), 10Ks, interviews with management and any other source that may assist in identifying risk.” As we have earlier stated, we agree that regulators should enhance their understanding of insurer risk management processes; however, we strongly believe the existing Risk-Focused Surveillance Framework provides a more cohesive approach to achieving that regulatory objective. Consequently, any ORSA work product of the GSIWG should be developed within the Risk-Focused Surveillance Framework.

To address our earlier questions, regulators must be very careful that an ORSA requirement focuses on obtaining information about the insurer’s risk management processes, rather than mandating a specific risk management system; the latter is the responsibility of the directors and management of the insurer. The Risk-Focused Surveillance Framework is clear that the purpose of obtaining information about an insurer’s risk management system is to aid the regulator in calibrating the level of solvency monitoring that is appropriate for the insurer. The Framework does not mandate the nature or scope of a risk management system. However, there are aspects in the proposed Guidance Manual that appear to prescribe certain elements that must be in an insurer’s risk management system. Whether an insurer’s risk management system contains specific elements may be a factor that regulators consider when determining the scope and frequency of solvency monitoring. However, outside of a receivership, it is not the prerogative of a regulator to tell the insurer how to manage its business. Given the profusion of prescriptive detail contained in the proposed Guidance Manual, regulators should take greater care to

avoid over-stepping their regulatory role and inappropriately inserting their judgment into the management of the insurance enterprise.

ORSA is a process and is not a compliance filing. The use of the terms “ORSA” and “ORSA information” has caused some confusion in the discussion of the Guidance Manual. To be clearer on this point, we recommend moving away from the term “ORSA information” and instead recasting it as evidence of an insurer’s effective enterprise risk management process (ERM). ERM is defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as follows:

Enterprise risk management (ERM) is a process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.

The process of assessing risk is on-going, as reflected in the Risk-Focused Surveillance Framework diagram. Regulators and insurers should have the flexibility to determine the best protocol for communicating information about the insurer’s risk and solvency assessment process. We do not believe that a mandated annual filing would allow a regulator to perform a credible evaluation of an insurer’s risk and solvency assessment process – each situation will be unique and the form of communication should adjust accordingly. By prescribing the form and frequency of the communication between the insurer and regulator, the proposed Guidance Manual may encourage a simple compliance mindset on the part of both the insurer and regulator, and ultimately undermine the laudable goal of enhancing regulator understanding of the insurance enterprise. Instead, we urge that any ORSA guidance be incorporated into the Risk-Focused Surveillance Framework and let the process of assessing an insurer’s ERM process begin where it will be most productive – an onsite discussion between state financial examiners and the insurer’s management.

We will discuss the prescriptive elements of the proposed Guidance Manual in the second part of our comment letter. But the GSIWG may wish to consider whether the more prescriptive elements would be more suitable as guidance for regulators, particularly, the financial examiners and analysts. Instead of telling insurers they must have certain elements in their risk management system, we believe it would be more appropriate to ask regulators to look for evidence of an effective enterprise risk management system. The latter approach is more consistent with the Risk-Focused Surveillance Framework.

Risk Management vs. Solvency Assessment

Most of NAIC’s discussion about ORSA has focused on the risk management prong of the ORSA and very little has been said, so far, about the solvency prong. The U.S. regulatory system does not address economic capital, yet two-thirds of the proposed Guidance Manual is focused on the assessment of economic capital. U.S. regulators have consistently expressed support for continuing with the existing risk-based capital (RBC) system, so the GSIWG must clarify how additional information on an insurer’s economic capital model will be utilized for U.S. regulatory purposes. We agree that RBC should continue to be the “pillar” or primary regulatory standard for capital in the U.S. and believe that an ORSA should not become the “pillar” of U.S. capital standards. RBC is an approach that provides objective action levels at which regulators have statutory authority to intervene. The ORSA approach to capital standards is likely to impede regulators ability to take action against a company in the U.S. legal environment. Instead of being a “pillar”, the GSIWG should clearly acknowledge that a U.S. ORSA requirement will be used as a supplemental solvency tool, and should also indicate how this supplemental tool will be used to enhance solvency monitoring of the insurance industry. We note that

insurers already provide the results of the risk-based capital formula annually to their domestic regulator. We reiterate our belief that the more appropriate use of ORSA is to provide supplementary solvency information in the course of a financial examination process, rather than as part of an annual filing.

ORSA via the Model Holding Company Law

The NAIC should not incorporate an ORSA requirement into the model holding company law. Any review of a company's ORSA process should be incorporated through the NAIC's Risk-Focused Surveillance Framework. The NAIC has already invested significant resources in implementing the Framework by updating the examination process to be risk-focused, designing an exam process that includes a review of a company's enterprise risk management processes, developing applicable risk matrices, and training insurance department personnel on applying the new risk-based approach. The financial examination and financial analysis functions are the appropriate places for reviewing the supplementary risk and solvency information provided in an ORSA. Placing the ORSA requirement within the Risk-Focused Surveillance Framework also assures that the regulators with the most training and hands-on experience in evaluating companies under the risk-focused examination requirements will be the regulators reviewing an insurer's ERM process.

Also, re-opening the holding company model law process will reignite debates over a number of issues, such as the level of confidentiality applicable to ORSA data if it is shared with the NAIC. By contrast, the state financial examination and financial analyses processes provide the best possible protection from disclosure for the extremely sensitive information that will be included in an insurer's enterprise risk management process, including an ORSA, such as the prospective solvency assessment. It should be pointed out, however, that a large portion of Section 1 of the proposed ORSA Guidance Manual overlaps with or is redundant with the new enterprise risk report required under the new model holding company law. At some point, a limited review of the model holding company law may be necessary in order to eliminate redundancy with the NAIC's ORSA guidance, perhaps by eliminating the enterprise risk report from the holding company model law.

Confidentiality

We cannot over-emphasize the importance of preserving confidentiality for ORSA information and related documents. Forward-looking information, such as that required in the prospective solvency assessment and stress-testing results, is highly sensitive and proprietary. For stock companies, an ORSA is likely to include information subject to the Securities and Exchange Commission's Regulation FD. This is the type of information that should be reviewed only on-site at an insurer's headquarters. This information should not be subjected to the risk of disclosure that accompanies any compliance filing, including risks of inadvertent disclosure related to the transport, transmission and storage of such documents outside of the insurance company's control.

Remember the "OWN" in ORSA

We cannot over-emphasize the importance that an ORSA must be an insurer's OWN assessment. Different companies and groups will naturally develop their own ways of identifying, quantifying, and managing their risk and solvency standards and requirements. Any ORSA guidelines for insurers should be at a high-level and should not be overly prescriptive. Where companies manage risk on a group basis, it is appropriate that the ORSA be evaluated on a group basis.

Timing

The importance of the ORSA work stream dictates a thoughtful, critical analysis of the implications – to regulators and insurers – of an ORSA requirement. We appreciate the openness of the GSIWG in allowing interested parties to hear the discussion among regulators. To allow for the robust discussion that the GSIWG has promised, sufficient time must be provided to allow for a full interactive exchange of ideas and concerns between regulators and interested parties. However, the time period for concluding the ORSA project by the end of 2011 seems rushed and could result in short circuiting a thoughtful consideration of all aspects of the proposal.

Part II: Specific Edits to the Draft Guidance Manual

The basic gist of our detailed comments and edits is that a U.S. ORSA requirement should be effectuated through the financial examination and financial analysis processes, as originally envisioned by the NAIC with the adoption of its Risk-Focused Surveillance Framework. We believe that mandating a regulatory filing with respect to a company's ORSA would ultimately become just another compliance exercise that would not necessarily provide much substantive value to regulators.

Comments on the INTRODUCTION.

The GSIWG should consider re-working this manual to provide guidance to regulators for the purpose of conducting risk-focused exams. That re-write should include a statement of the regulatory purpose of an ORSA, i.e., enhancing regulator understanding of insurers' risk and solvency management. Thus, the opening paragraph could state something to the following effect:

The ORSA shall be evaluated by the regulator pursuant to the financial examination and financial analysis laws of the jurisdiction, in a manner and at such frequency as the regulator may request, consistent with both applicable law and the examination process. The format of the ORSA information that is to be provided to the regulator may vary depending upon a myriad of factors, such as the nature and complexity of the insurance enterprise, its financial position, prioritization of the insurer/group for heightened financial surveillance, prior discussions with the insurer/group's management, the economic environment considerations, and other factors that are consistent with the NAIC's Risk Focused Surveillance Framework.

Introduction, Section C, General Guidance: The provisions in this subsection are overly prescriptive and inherently at odds with an ORSA, which is supposed to be management's own internal assessment; thus, the specifics of the insurer's own assessment should not be dictated by an outside party. Also, we fundamentally disagree with the notion that an ORSA is a filed document. A general statement that "information about an insurer's ORSA should be available during the course of an examination" should be sufficient. All insurer documents are normally available for review by regulators under current law and regulations, so this section is not necessary. To the extent an ORSA filing is required, whether the ORSA filing will be done on a legal entity or group basis depends solely on the framework and structure of the insurer's risk management function. Additionally, an internationally active insurance group that has provided an ORSA to another jurisdiction should be able to satisfy U.S. regulatory expectations by providing that ORSA to the appropriate U.S. insurance regulator.

Comments on II. SECTION 1 of the ORSA Filing – DESCRIPTION OF THE RISK MANAGEMENT POLICY

We again state our objection to a mandated ORSA filing. Because this manual is premised upon an actual filing, we are providing comments accordingly. But we believe a regulatory filing is inconsistent

with the more dynamic solvency monitoring framework that the NAIC has already created through its Risk-Focused Surveillance Framework. Assuming a filing, however, there should be a general statement of what should be included in this section. The last paragraph of this portion of the manual may be suitable:

The ORSA should disclose insurer/group information, management processes, and 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. The ORSA should also 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.

In the manual, preceding the listing of broad risk categories, there is a statement about “an effective Enterprise Risk Management Framework”. The scope and variety of enterprise risk management systems among insurers logically dictates that there is no one, predetermined checklist of factors for determining “effectiveness” of an ERM process. It should not be the goal of this manual to determine or dictate the elements that will produce an effective ERM system. Such statements should be removed from the guidance. We suggest the following language instead: “In reporting on its ORSA, an insurer may wish to consider the following key principles, as applicable: ”.

The next portion of the manual provides for an extensive list of elements that should be included in the five risk categories that were carried over into this proposed manual from the presentation of the North America Chief Risk Officers Council during the July 21st ERM Symposium. However, that list is too prescriptive. We suggest the following wording in this portion of the manual:

“The summary of risk management policies should identify all relevant, material risk categories and describe how those risk categories are managed on a day-to-day operational basis as the insurer/group executes its business strategy.”

The rest of the list, items “b” through “m” should be removed from the proposed Guidance Manual and possibly included in specific guidance to examiners and analysts as potential components of an effective ERM process.

Comments on III. SECTION 2 of the ORSA Filing - QUANTITATIVE MEASUREMENTS OF RISK EXPOSURE IN NORMAL AND STRESSED ENVIRONMENTS

We repeat our objection to a mandated regulatory filing for an insurer’s ORSA, but provide you with the following comments with respect to the manual’s requirement to include a section on quantitative measures in the ORSA filing. There should be an initial section that describes the purpose and benefit of quantitative measurements and how information about quantitative measurements should be appropriately used by insurance regulators.

The manual’s requirement for information on an insurer’s own stress testing would be too voluminous for a statutory filing. The manual should provide sufficient flexibility for the regulator and insurer to determine the most effective and efficient method of sharing the results of the insurer’s stress testing – for example, a comprehensive presentation provided in person.

The examples of relevant material risk categories should be moved forward to the *Description* section of the manual and should be coordinated with the risk categories that already exist in the Risk-Focused Surveillance Framework to avoid inconsistencies.

This section of the manual refers to examples in the appendix of possible risk outcomes of risk measurement that a regulator may wish to see. However, including these examples in regulatory guidance has the effect of saying that the risk categories included in the example must also be included in the insurer's own assessment, regardless of the insurer's actual assessment of the risks that pertain to its business. We recommend that this language be deleted from this section, as well as the accompanying examples in the appendix.

The section beginning with "Because the risk profile of each insurer/group is unique . . ." should be deleted in its entirety and moved to the financial examiners or financial analysts handbook, as necessary, because it provides guidance that regulators should consider in their review of an insurer's ERM and solvency."

The last sentence within this section is unclear, possibly due to missing language. We made some assumptions about the intended wording to come up with the following language:

By identifying each material risk category independently and reporting notional amounts and expected amounts in both normal and stressed conditions, the insurer/insurance group and the regulator are in a much better position to evaluate certain risk combinations that could cause an insurer/insurance group to fail. One of the most difficult exercises in modeling insurer/insurance group 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.

If this is the intended wording, the manual should be adjusted accordingly. Some thought should be given to whether such a statement would be more suitable in guidance for regulators.

Comments on IV. SECTION 3 of the ORSA Filing – GROUP ECONOMIC CAPITAL AND PROSPECTIVE SOLVENCY ASSESSMENT

There should be an opening paragraph to explain the benefit of this section and how regulators intend to use information gathered pursuant to this section. In addition, the last paragraph of this section could be moved forward to the beginning of this section to provide more guidance as to the material that should be included in this section:

The ORSA should disclose insurer/group information, management processes, and 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. The ORSA should also 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.

Legal authority is also problematic since insurance regulators might not have authority over the entire holding company group.

The section on group economic capital should be moved from this manual and into regulatory guidance. Also, the terminology "group economic capital assessment" is not a part of the U.S. capital framework

and is undefined. It is imperative that the NAIC identify sources of legal authority for making such a requirement, especially since it is contrary to the existing regulatory framework. It is troubling that the NAIC would proceed with developing “guidance” without first addressing legal authority issues.

The language in the section addressing prospective solvency assessment is cumbersome and awkward; the intended meaning is unclear. Words may be missing and/or there may be incorrect punctuation. We also suggest the GSIWG review this section to ensure it is conveying the desired meaning. Also, we recommend that references to “2-5 year” business should be replaced with “multi-year”, to allow for the fact that insurers may have differing time horizons.

In summary, we believe a mandatory filing is not necessary in implementing an ORSA requirement because the existing Risk-Focused Surveillance Framework, which is still relatively new, is designed to provide regulators with a comprehensive review of an insurer’s approach to managing its risks, and to provide that review within a confidential setting. Any regulatory requirement to conduct an assessment of an insurer’s own risk and solvency condition should be provided within the context of that established Framework. Mandating a regulatory filing creates an unnecessary compliance burden without providing an incremental benefit over the existing Risk-Focused Surveillance Framework. In fact, we believe that an annual filing requirement will be counterproductive, as evaluating an insurer’s ORSA process will itself require a process, not a report. We would be happy to work with the GSIWG and other regulators to ensure that any ORSA requirement is properly integrated within the Risk-Focused Surveillance Framework.

We look forward to a full discussion of our concerns at the summer national meeting in Philadelphia. If you have any questions prior to that meeting, please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script that reads "Phillip L. Carson". The signature is written in dark ink and is positioned above the typed name and title.

Phillip L. Carson
Assistant General Counsel



August 25, 2011

Director John M. Huff, Missouri Department of Insurance
Danny Saenz, Texas Department of Insurance
Co-Chairs, Group Solvency Issues Working Group
c/o National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, Missouri 64108-2662

Re: Comments on Own Risk and Solvency Assessment Guidance Manual

Dear Sirs:

On behalf of the 39 independent members of the Blue Cross Blue Shield Association (BCBSA), who collectively provide health insurance benefits to nearly 100 million Americans, we appreciate the opportunity to provide comments to the Group Solvency Issues Working Group (Working Group) of the Solvency Modernization Initiative (SMI) Task Force regarding the draft of the NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual dated August 5, 2011.

As we understand it, the NAIC's goal of the ORSA initiative is to incorporate international standards as appropriate into the U.S. system. Given that, we want to emphasize that health insurance markets and insurers do not exist internationally as they do in the U.S. As a result, most international standards do not account for the unique characteristics of health insurers. We also have several concerns regarding whether the manual will be interpreted as suggestive guidance or additional requirements, especially given that the current solvency system is functioning well. Adding requirements onto a well-functioning system is not likely to manifest better results, but rather increases overhead expenses, which are ultimately charged to consumers in the form of higher premiums.

Comments on Applicability to Health Insurers and HMOs

During the recent Working Group conference calls, several regulators commented on the desire to not impose additional reporting requirements on insurers, but rather to leverage work currently performed and/or shared with rating agencies. We certainly agree with this approach and want to ensure that regulators understand that current ERM and capital management practices can vary widely according to the enterprise's assessment of its risk profile.

The Working Group obtained critical input on industry practices from the CRO Council. It should be noted, however, that not a single health insurer is represented on the CRO Council. This is likely because health insurers' risks, and therefore the management of those risks, are quite different from either life or P&C insurers.

The most significant line of business for Blue Cross and Blue Shield Plans is comprehensive major medical insurance, which is typically one-year policies that renew annually with the opportunity to re-price. Major medical claims and payments are typically made within a relatively short period from the incurral date, and therefore, it is considered a "short-tail" coverage. In contrast, other insurance lines, such as life or liability coverages, are deemed to be "long-tail" because payments occur over longer periods with high volatility in the amounts. Therefore, these coverages are much more difficult to simulate and assess. Also, many "long-tail" coverages are subject to material delays in the reporting of claims to the insurer.

We strongly recommend that any documents, whether model laws, guidance manuals or other, be clear in stating that the actual risk profile of the enterprise should drive the structure of the management program employed.

General Comments on Guidance Manual

While it is difficult to truly assess the completeness and validity of the guidance manual without an understanding of where it would reside within the regulatory structure, we present some general comments below. The Working Group discussed the regulatory structure options of amending the Holding Company Act or including an ORSA requirement within the statutory examination laws. These two options have differing legal implications and could necessitate changes to the guidance. We recommend that the decision be made on the regulatory structure prior to finalizing the guidance manual to ensure the two are properly aligned.

1. One of our primary concerns is assuring the confidentiality and sensitivity of the supplied data, especially with respect to exposing risk modeling results. While the typical, general risks that insurers are subject to are common to many, there are some specific risk scenarios which may be modeled that are privileged and confidential trade secrets. The Working Group acknowledged this concern, but has not yet resolved it.
2. The Working Group determined that the ORSA should be performed at the enterprise group level, and even performed a market impact analysis at the group level. However, there are still references to legal entities in the manual.
3. Since the basis is to be at the enterprise group level, consistency of guidance across all states is vital to an efficient and effective program. We are aware of at least one state that appears to be moving along a different path than the NAIC. We recommend that the NAIC strongly encourage all its members to adhere to consistent ORSA guidance.

Specific Comments by Section of Manual

Section 1 – Description of the Risk Management Policy:

4. The purpose of the manual as defined is to provide guidance to the enterprise performing the ORSA. However, the initial sentence of Section 1 states that an effective ERM Framework should at a minimum include a list of several aspects, which suggests requirements rather than guidance. We recommend that the wording be clarified to indicate that these are guidelines or suggestions rather than requirements.

Section 2 – Quantitative Measurements of Risk Exposure in Normal and Stressed Environments:

5. The initial sentence states that the ORSA should document the quantitative measurements of risk exposure in both normal and stressed environments for each risk category identified in Section 1. However, many risks are not easily quantifiable or require significant assumptions, such as regulatory risks, reputational risks and operational risks. We recommend the wording be altered to allow for qualitative analysis in lieu of quantitative as appropriate.
6. Due to the short-tailed nature of major medical insurance, regulators should not expect that most Blue Cross and Blue Shield Plans are currently performing stochastic modeling on many risks.

Section 3 – Group Economic Capital and Prospective Solvency Assessment:

7. Similar to our comments on Section 2, because of the short-tail coverages, many Blue Cross and Blue Shield Plans do not currently perform the detailed modeling as suggested in the manual. Many are performing some level of capital modeling, but may differ in intensity and definition from the description in Section 3.

Thank you for your consideration of these comments. We look forward to participating in the continuing discussions of this issue during the NAIC Summer National Meeting. Please contact me at 312.297.6093 if I can be of assistance in the interim.

Sincerely yours,



Shari Westerfield
Brand Protection & Financial Services

cc: David Vacca, NAIC Staff
Kim Holland, BCBSA

NAIC OWN RISK AND SOLVENCY ASSESSMENT (ORSA) GUIDANCE MANUAL

DRAFT (8/5/11)

**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 to provide guidance to insurers and/or the insurance groups on performing 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). The ORSA shall be completed at least annually to assess the adequacy of its risk management and current, and likely future, solvency position.~~ Lead state regulators shall be provided with a high level summary of the ORSA processes and results on an annual basis. Supporting materials need not be provided annually, but rather made available upon request. ~~However, w~~Whether the lead state 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.

The ORSA process is subject to review and the results of such review shall determine the frequency and scope of subsequent risk-focused examinations. Insurers and / or insurance groups with ERM frameworks deemed to be robust may not require risk-focused examinations as periodically as those with less robust ERM functions.

A. Exemption

An insurer and/or insurance group 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 assumed premium including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program and excluding affiliated reinsurance premium is less than \$1,000,000,000.

An insurer may be required to provide an ORSA 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 and/or an insurer within the insurance group 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, volume of business written, availability of qualified board members, or the ownership or organizational structure of the entity.

C. General Guidance

The ORSA may be completed on an insurance legal entity and / or insurance group basis (“insurer” or “insurers”). As it represents an individual insurer’s internal risk assessment, each ORSA will be unique, customized to reflect the

~~individual insurer's approach to risk management. Recognizing that no two ORSAs will be alike, it is expected to be broken down into the following three broad categories: While the ORSA is completed entirely by an insurance legal entity within an insurance group and/or the insurance group, and therefore represents its internal risk management assessment, the resulting ORSA filing should contain three major sections as follows:~~

- Section 1** - Description of the Risk Management Policy
- Section 2** - Quantitative Measurements of Risk Exposure in Normal and Stressed Environments
- Section 3** – Group Economic 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 and/or insurance group. Additionally, in order to avoid excessive volumes of detail or supporting documents for complex insurance groups, an insurer ~~and/or insurance group~~ may simply reference other explanatory documents within the ORSA, as long as those documents are available to the regulator upon request. If the referencing of other detailed documentation is performed, a summary index is requested.

An ~~internationally active insurance group~~insurer required to file an ORSA, may be able to satisfy the NAIC filing requirement by providing an ORSA that has been ~~provided to another jurisdiction who serves as the group wide supervisor~~completed for the purposes of satisfying ComFrame and / or other jurisdictional requirements. This ORSA will be reviewed in relation to Insurance Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) 16 Enterprise Risk Management (ERM) and 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.

D. Extensions

An extension for the ~~due date of~~ submission of the ORSA filing or a partial ORSA (i.e. specific sections) may be granted at the discretion of the Commissioner.

II. SECTION 1 – DESCRIPTION OF THE RISK MANAGEMENT POLICY

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 should ~~document~~ provide a high level summary of the aforementioned ERM Framework principles, if present, as well as ~~summarize or references~~ (e.g. in an appendix) to the insurer/~~group~~'s risk management ~~materials/policies~~. The risk management policies high-level summary should:-

- ~~a. Identify~~ should identify all relevant and material risk categories and describe how those risk categories are managed on a day-to-day operational basis as the insurer/group executes its business strategy. The high level summary should –
- ~~b. Describe~~ Describe any processes and methods used for monitoring risk and should include any risk tolerance statements and describe the relationship between any risk tolerance statements and capital requirements, both regulatory and economic. The high-level summary may also include reference to other applicable risk management policies such as those related to investments, underwriting, claims, asset-liability matching, counterparty and operational risks.
- ~~c. Include the insurer/group's investment policy which should specify the nature, role and extent of the insurer's investment activities, how the investment policy complies with the solvency regime investment requirements and specifies explicit risk management procedures regarding more complex and less transparent classes of assets and investments in markets or instruments that may be subject to less governance or regulation. The investment policy should address credit risk, market risk, liquidity risk and any counterparty risk that may be associated with any hedging programs. The ORSA should provide the insurer/group's own internal analysis processes used to identify such risks and not rely exclusively on investment managers or rating agencies and their use of diversification to mitigate such risks.~~
- ~~d. Include any underwriting policy used by the insurer/group to manage underwriting risk and describe the relationship of the underwriting policy to product design and product pricing.~~
- ~~e. Include any claims underwriting or claims processing policies implemented by the insurer/group to manage any risks associated with determining whether claims are covered under the contract and how claim amounts are determined.~~
- ~~f. Include a description of any anti-fraud policies that have been implemented to detect fraud in filing of claims.~~
- ~~g. Include a description of any asset liability management (ALM) activities which clearly specifies the nature, role and extent of ALM activities and the relationship with product development, pricing and investment management functions.~~

- ~~h. Include a description of any retention or conservation policy or program designed to retain assets, policies in force or market share. Such programs may include multiple coverage discounts, extra interest credits or other policyholder options.~~
- ~~i. Include a description of any reinsurance counterparty policy related to any reinsurance programs the company has in effect.~~
- ~~j. Include, if applicable, any management activities or policy related to processes of identifying, assessing, measuring, monitoring, controlling and mitigating risks associated with group membership.~~
- ~~k. Include any activity related to mergers or acquisitions of business including a description of the policy or program for completing due diligence on the transaction.~~
- ~~l. Include a description of how compensation and incentives are assessed and considered within the ERM Framework.~~
- ~~m. Include a description of any other management activity, policy or program designed to assess enterprise risk not already described in a category above.~~

~~-~~

~~The ORSA should also disclose how the insurer/group's management uses its risk management policy including any tolerance statements and limits in its day to day operations as it executes its business strategy. The ORSA should disclose insurer/group information, management processes, and 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. The ORSA should also 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.~~

III. SECTION 2 - QUANTITATIVE MEASUREMENTS OF RISK EXPOSURE IN NORMAL AND STRESSED ENVIRONMENTS

Section 2 of the ORSA should document the quantitative measurements of risk exposure in both normal and stressed environments for each risk category identified in Section 1. This quantitative measurement process should require a quantification of risks under a range of outcomes using risk measurement techniques that are appropriate to the nature, scale and complexity of the risks. Section 2 should include detailed descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made and outcomes of any plausible adverse scenarios that are run. Examples of relevant material risk categories may include, but not be limited to, credit, market, liquidity, cash flow mismatch, underwriting, claim, expense, operational and risks associated with group membership.

~~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. In instances in which it is feasible and relevant. Although it is recognized that some stress tests for certain risks may be performed at the insurance group level,~~ 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.~~

Within the Appendix are three examples that illustrate the types of outcomes of risk measurement a regulator may desire to observe for risk categories identified within a life insurance company (attachment 1), a property casualty company (attachment 2) and a health insurance company (attachment 3). These examples are not intended to be used as prescribed templates.

Because the risk profile of each insurer/~~group~~ is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer/~~group~~ should run, however the regulator may ~~have input~~make recommendations regarding the level of stress that company management should consider for each risk category. Unless a particular assumption is stochastically modeled, the ~~group~~insurer's management will be setting ~~their~~its 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 ~~also provide input~~make recommendations to an insurer/~~group~~'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~~make recommendations 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~~recommendations made by regulators will likely occur during ~~either the financial analysis process and/or the financial examination process~~ the ORSA review process.

~~By identifying each material risk category independently and reporting notional amounts, expected amounts in both normal and stressed conditions, insurer/group management and the regulator are in a much better position to evaluate certain risk combinations that could cause a insurer/group to fail. One of the most difficult exercises in modeling insurer/group 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 ECONOMIC CAPITAL AND PROSPECTIVE SOLVENCY ASSESSMENT

Section 3 of the ORSA should document how the ~~company-insurer~~ combines the qualitative elements of its risk management ~~policyframework~~ and the quantitative measures of risk exposure in determining the level of financial resources it needs to manage its business over the longer term business cycle such as the next 2-5 years.

Group Economic Capital

Insurers ~~and/or holding company systems~~ 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. This section is intended to help regulators understand ~~an~~ insurer's² capital adequacy in relation to ~~the-its~~ risk profiles.

On an annual basis, the insurer ~~and/or insurance holding company system subject to this filing~~ should provide a group economic capital assessment within ~~their/its~~ ORSA for the previous period year-end. ~~This information may also be requested by a Commissioner throughout the year, if needed.~~

The figure representing the group economic capital must be accompanied with a narrative describing the following:

1. **Definition of required capital ~~solvency~~** – Describe how the insurer ~~and/or group~~ defines ~~solvency~~required capital (e.g. Cash flow basis, balance sheet basis, etc.). If on a balance sheet basis, what basis of accounting is used.
2. **Time horizon of risk exposure** – Describe the time horizon modeled, such as one year, lifetime, etc.
3. **Risks to model** – Describe high-level risks and materiality (e.g. immaterial or material).
4. **How risks are quantified** – Describe the stress tests, stochastic modeling or factors utilized in the quantification, as well as, the methodology for allocating the group capital across insurance legal entities.
5. **Measurement metric** – Describe the measurement metric, such as value at risk in percentile (quantifies the capital needed to withstand a loss at a certain probability), tail value at risk (quantifies the capital needed to withstand average losses above a certain probability), probability to ruin (quantifies the probability of ruin given the capital held), etc.
6. **Target level of capital** – Describe the target capital for the insurer and/or holding company system's business objectives.
7. **Reflecting diversification** – Describe any diversification benefits and amount that is being used to spread around the risks to which the group is exposed.

The approach and assessment of group-wide capital adequacy should also consider the following:

- Eliminate intra-group transactions and consequently double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities.
- Take account of the level of leverage, if any, resulting from holding company debt.

- Clearly identify diversification credits and adequately address 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.
- Reflect the effects of contagion risk, concentration risk and complexity risk in their group capital assessment.

The goal of the assessment is to provide an overall determination of economic capital needs for the insurer ~~and/or holding company system~~, based upon the nature, scale and complexity of ~~its risks within the group~~. Group economic capital should not be perceived as the minimum amount of capital before regulatory action will result (e.g. US risk-based capital for insurance legal entities); rather, it should be recognized that this is the capital needed within an insurance group to achieve ~~the group's~~ business objectives.

Prospective Solvency Assessment

Most ~~insurer companies~~, as part of their strategic planning process, compile a 2-5 year business plan. Section 3 of the ORSA should contain an analysis demonstration and documentation that; ~~given the current capital requirements both economic and regulatory, the quality of that capital, the current risk management policy consisting of its current risk tolerance limits, current risk exposure amounts in both a normal and stressed environments and the projected 2-5 year business plan; the company has of~~ the financial resources necessary to execute its 2-5 year business plan. If the insurer/~~group~~ does not have the necessary financial capital or quality of capital to execute ~~the~~its 2-5 year business plan, the insurer/~~group~~ should describe the management actions it will take or describe any modifications to the business plan it has made to resolve the adequacy of its financial capital, including potential other resources of capital.

The prospective solvency assessment is in effect a feedback loop. The insurer/~~group~~ 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 2-5 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 consider any constraints on group capital or the movement of group capital to legal entities.

V. APPENDIX

Below are three examples that illustrate how the types of outcomes of risk measurement a regulator may desire to observe for risk categories identified within a life insurance company (attachment 1), a property casualty company (attachment 2) and a health insurance company (attachment 3). For each risk category identified, the minimum quantitative elements that could be reported are the notional amount of risk which identifies the total exposure the insurer has to that particular risk, the expected value of that risk under normal conditions which identifies the amount of expected payment under normal conditions due to that risk over the next year and the expected value of that risk under stressed conditions which identifies the amount of expected payment under stressed conditions due to that risk over the next year. The regulator may also desire to observe for each risk category a reverse stress test which would identify, given the insurer's current economic capital, the level of the stress factor which would have to unfold to cause the insurer to fail. Reverse stress testing can be helpful in identifying the risks that are most likely to cause an insurer to fail. These examples are not intended to be used as prescribed templates.



335 Madison Avenue
New York, NY 10017-4605

August 25, 2011

Director John M. Huff
Missouri Department of Insurance
Co-Chair, NAIC Group Solvency Issues Working Group

Sr. Associate Commissioner Danny Saenz
Texas Department of Insurance
Co-Chair, NAIC Group Solvency Issues Working Group

Mr. David Vacca
National Association of Insurance Commissioners
2301 McGee Street
Kansas City, Missouri 64108

Re: U.S. Own Risk Solvency Assessment (ORSA) Guidance Manual Comments

Dear Messrs Huff, Saenz and Vacca:

The North American CRO Council ("CRO Council," "Council," or "we") is a professional association of Chief Risk Officers of leading insurers based in the United States, Bermuda, and Canada. Member CROs represent 11 of the 15 largest Life insurers and 12 of the 15 largest Property & Casualty insurers in North America. The Council seeks to develop and promote leading practices in risk management throughout the insurance industry and provide thought leadership and direction on the advancement of risk-based solvency and liquidity assessments.

The Council appreciates the opportunity to comment on the U.S. Own Risk and Solvency Assessment ("ORSA") Guidance Manual, which was exposed for public comment by the National Association of Insurance Commissioners ("NAIC") on August 5, 2011. Our comments are organized into two parts: (i) this letter, which provides high-level comments; and (ii) specific suggested text edits to the Manual. The high-level comments address the conceptual and regulatory framework that is being used to support the ORSA requirement. The text edits provide specific suggestions to modify the language in the Manual and align it with our high-level comments. The goal of our comments is to be constructive and we look forward to continued dialogue on the ORSA requirement.

The following themes supplement and reinforce points made in a Council comment letter to the NAIC on March 18, 2011 and the ERM Education Session presented to state regulators in Jacksonville on July 21, 2011.

Clarity of the goals of the ORSA examination

The Council recognizes the progress that the NAIC has made on the development of the ORSA Guidance Manual. To further this development, we believe that the NAIC should articulate a clearer description of the overarching goals of the ORSA requirement and how it fits with the risk-focused examination process. In our view, the most appropriate role for a regulator in the review of a company's ORSA is to assure that the company has established a robust set of risk management systems, processes, and controls; and that these are used in management's understanding of risk and decision making. The ORSA review is a qualitative assessment, and its results should be one component of the new risk-focused examination

process. We suggest the NAIC consider strengthening its stated objectives for the ORSA review along these lines, and include a more focused explanation of how the ORSA fits into the risk-focused examination process.

ORSA should not be a prescribed filing requirement

The Council strongly believes in the principles of a sound risk management framework (see “Enterprise Risk and Solvency Management” presented to the NAIC/regulators on July 21, 2011). We also generally agree that each insurer should perform an assessment of its own risk and solvency and periodically share a summary of this process with regulators.

However, the Council believes that the ORSA is an internal process and should not be a prescribed mandatory filing requirement. A mandatory filing requirement is inconsistent with the purpose and intent of an ORSA — it will shift the insurer’s focus to producing materials that meet regulatory requirements and divert attention from the strategic purpose of the exercise. Each insurer should conduct the ORSA as a self-directed exercise within its strategic planning and enterprise risk management processes and tailor the approach to company culture and risk profile. We feel that the best way to encourage this is to state that the NAIC expects insurers to regularly perform an ORSA and be prepared to discuss the process. Regulators may choose to review an insurer’s internal materials as part of the risk-focused examination process.

We strongly believe that the submission of documents related to the ORSA should be limited to a high-level summary report of the ORSA process, with supporting materials available for review at the insurer’s office. This summary report would provide regulators with an overview of the ORSA, and a roadmap for further inquiry at the time of the examination. We have taken this approach in editing the Manual.

Emphasis on flexibility and principles-based ORSA requirements

The Council recognizes that the NAIC would like to provide state regulators with a framework for evaluating the efficacy of each insurer’s internal risk and capital management processes. In presenting this framework, it is important to differentiate between fundamental and supporting risk management practices. While “having procedures in place for material and relevant risks” is fundamental to a risk management framework, we suggest that the specific supporting details will depend on each company’s self-assessment of risks and strategy. For this reason, we reiterate that there is no one-size-fits-all approach to an ORSA and company risk policies, procedures and management actions should differ according to the business strategy and risks. As such, we suggest that the NAIC’s Guidance Manual provide clear language indicating that each insurer’s risk management, policies and procedures will vary based on the self-assessment of material and relevant risks.

We also believe that it is important to maintain flexibility and broader interpretation for this new requirement. Both the companies and the regulators will have a much better understanding of the ORSA after a few years of experience with it. In particular, regulators and examiners will become familiar with sound risk management frameworks and practices. After “piloting” the ORSA process for a period of time, the parties can assess whether and where greater specificity in requirements might be helpful.

Confidentiality is essential to the ORSA review process

Limiting the ORSA filing requirement to a high-level summary has another key benefit — preserving confidentiality. ORSA data and analyses are proprietary, strategic and highly confidential and represent trade secrets that form the basis for decision making and competitive advantage in the marketplace. Releasing this information to outside parties presents two significant risks: (i) leakage and (ii) misinterpretation. While we appreciate the NAIC’s acknowledgement of the importance of confidentiality in its ORSA review process, and acknowledge that some Form B disclosures include confidentiality protections, we note that transmission, storage and review of these documents still present significant

risks. Further, we strongly believe that documentation alone is not sufficient to fully assess the insurer's risk management processes, nor understand its ORSA results. Dialogue between the company and the regulator will be necessary to supplement and elaborate on the points presented in the ORSA summary report.

We generally agree that an ORSA should be conducted and documented, but suggest that these documents remain as "internal" working documents of the company. These internal working documents will remain on site at each insurer's location and can readily be shared with the regulator as part of the examination process.

Due consideration for the cost of meeting prescribed regulatory standards

The CRO Council represents the views of many of the largest life and property casualty insurers in North America. However, we also are interested in promoting industry risk management practices that are sensible to the insurance industry as a whole. In developing an ORSA regulatory framework, it is important to balance the recommended approach with due consideration for costs and complexities of implementation. We note that the Guidance Manual in its current form suggests changes that will be costly and complex for the majority of U.S. insurers. Moreover, the benefits derived from several of the suggested changes may not warrant the associated cost. For example, we do not believe that each insurer needs to achieve the depth of detail provided for all risk policies specified in Section 1 of the Guidance Manual. Rather, each insurer should spend time (and money) on strengthening and tailoring policies and procedures to risk areas that are material and relevant. The NAIC should consider adding language that makes this point clear.

Economic Capital is one supplementary tool for capital assessment

The Council strongly supports the concept of regular risk measurement and quantification. An Economic Capital Model (ECM) can be an effective tool to achieve this goal. However, significant variation exists between company ECM methodologies and definitions, and as such, each insurer's model will be constructed and used differently in managing the business. Finally, we note that insurers are in different stages of developing ECM and some may choose other measurement tools to assess capital and risk. We recommend that the Guidance Manual recognize that each insurer has the ability to select the measurement methodology that it feels is most appropriate for its own risks and organizational culture. We have reflected this view in our edits to the Manual.

The Council appreciates the opportunity to work with the NAIC on developing a sound and sensible approach to the ORSA requirement. We look forward to continuing the dialogue with the NAIC on its ORSA Guidance Manual and encourage you to continue to use the Council as a resource.

Sincerely,



Michael W. Mahaffey, Chair
North American CRO Council



Lizabeth Zlatkus, Chair
U.S. Regulatory Developments Committee

NAIC OWN RISK AND
SOLVENCY
ASSESSMENT (ORSA)
GUIDANCE
MANUAL

DRAFT (8/5/11)

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 to provide guidance to insurers and/or insurance groups (herein referred to as “insurer” or “insurers”) on performing an own risk and solvency assessment (ORSA). As described more fully below, an insurer who is subject to the ORSA requirement will be expected to regularly conduct an ORSA, internally document the process and results, and provide a high-level summary report to the domiciliary regulator. The domiciliary regulator may conduct on-site reviews of the ORSA process with the insurer, who will make supporting materials available for review. Such ORSA reviews will take place as part of the risk-focused examination process, or at the request of the commissioner. Whether the domiciliary regulator chooses to conduct a review of the insurer’s ORSA 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. If a regulatory ORSA review is conducted, all information shared with the domiciliary regulator or examiner shall be under the strictest confidentiality and conducted on-site at the insurer’s location.

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Exemption

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

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- a. The individual insurer’s annual direct written and 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 assumed premium including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program and excluding affiliated reinsurance premium is less than \$1,000,000,000.

An insurer that is otherwise exempt may be required to provide an ORSA 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.

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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.

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Regulatory Purpose of the ORSA Requirement

The ORSA is 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 NAIC's introduction of an ORSA regulatory requirement has two 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.

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An insurer that is subject to the ORSA requirement should consider the general guidance provided in this Manual when conducting its ORSA. The NAIC expects that each insurer will produce a high-level summary of the ORSA process, and internally document the results to facilitate periodic examination review.

General Guidance

The ORSA process is one element of an insurer's broader Enterprise Risk Management 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 enterprise risk management. 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.

The ORSA summary report should be organized into three major sections:

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

An internationally active insurer that completes its ORSA for a group-wide supervisor in a foreign jurisdiction, may be able to satisfy the NAIC's filing requirement by providing that ORSA report. One of the NAIC's goals is to avoid creating duplicate regulatory requirements for internationally active insurers.

Extensions

An extension for the completion of the ORSA review or a partial ORSA (i.e. specific sections) may be granted at the discretion of the domiciliary commissioner.

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II. SECTION 1— DESCRIPTION OF THE INSURER'S RISK MANAGEMENT FRAMEWORK

An effective Enterprise Risk Management (ERM) Framework would likely incorporate, in some manner, the following objectives and criteria:

- **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 facilitates 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 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 internal capital. 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 examination, the examiner 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.

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Identify all relevant and material risk categories and describe how those risk categories are managed on a day-to-day operational basis as the insurer/group executes its business strategy.¶

Describe any processes and methods used for monitoring risk and should include any risk tolerance statements and describe the relationship between any risk tolerance statements and capital requirements both regulatory and economic.¶

Include the insurer/group's investment policy which should specify the nature, role and extent of the insurer's investment activities, how the investment policy complies with the solvency regime investment requirements and specifies explicit risk management procedures regarding more complex and less transparent classes of assets and investments in markets or instruments that may be subject to less governance or regulation. The investment policy should address credit risk, market risk, liquidity risk and any counterparty risk that may be associated with any hedging programs. The ORSA should provide the insurer/group's own internal analysis processes used to identify such risks and not rely exclusively on investment managers or rating agencies and their use of diversification to mitigate such risks.¶

Include any underwriting policy used by the insurer/group to manage underwriting risk and describe the relationship of the underwriting policy to product design and product pricing.¶

Include any claims underwriting or claims processing policies implemented by the insurer/group to manage any risks associated with determining whether claims are covered under the contract and how claim amounts are determined.¶

Include a description of any anti-fraud policies that have been implemented to detect fraud in filing of claims.¶

Include a description of any asset-liability management (ALM) activities wh ... [1]

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III. SECTION 2 - INSURER ASSESSMENT OF RISK EXPOSURES

Section 2 of the ORSA report should summarize the assessment of risk exposures identified in Section 1. This process should consider quantification of risks under a range of outcomes using risk measurement techniques that are appropriate to the nature, scale and complexity of the risks. Stress tests may include both moderate and extreme scenarios, to provide a range of results.

The risk analysis should be conducted primarily at the group level. Within the group, risk portfolios should be organized for quantitative measurement in a way that is consistent with the way the business is managed, which may reflect a market rather than a legal entity orientation. Where useful and relevant to the management of the business, some of the group-level stresses may be mapped into legal entities.

Supporting materials referenced in Section 2 may include detailed descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made and outcomes of plausible adverse scenarios that are run. Examples of relevant material risk categories might include, but not be limited to, credit, market, liquidity, cash flow mismatch, underwriting, claim, expense, operational and risks associated with group membership. 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. The insurer's management will be setting its assumptions regarding the expected values based on current anticipated experience studies, current models and what is expected to unfold over the next year.

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IV. SECTION 3 — INTERNAL CAPITAL AND PROSPECTIVE SOLVENCY ASSESSMENT

The ORSA should address how the insurer combines the qualitative elements of its risk management framework and the quantitative assessment of risk exposure in determining the level of financial resources it needs to manage its business over a period, such as the next 2-5 years.

Internal Capital

The insurer should have sound processes for assessing capital adequacy in relation to risk profile and the process should be integrated into its management and decision making culture. Section 3 is intended to help the regulator understand the insurer's capital adequacy in relation to its risk profile.

On an annual basis, the insurer should include a group capital assessment within its ORSA for the previous period year-end. This information may also be reviewed by an examiner or the Commissioner during the financial analysis or examination process.

The ORSA summary report should provide information on the group capital assessment, including the following:

1. **Definition of internal capital** — Describe how the insurer defines internal capital (e.g. Cash flow basis, balance sheet basis, etc.). If balance sheet basis, what basis of accounting is used.
2. **Target level of capital** — Describe the target capital for the insurer's business objectives.
3. **Time horizon of risk exposure** — Describe the time horizon modeled, such as one year, lifetime, etc.
4. **Risks to model** — Describe high-level risks and materiality (e.g. immaterial or material).
5. **How risks are quantified** — Describe the stress tests, stochastic modeling or factors utilized in the quantification, as well as, the methodology for allocating the group capital across insurance legal entities.
6. **Measurement metric** — Describe the measurement metric, such as value at risk in percentile (quantifies the capital needed to withstand a loss at a certain probability), tail value at risk (quantifies the capital needed to withstand average losses above a certain probability), probability to ruin (quantifies the probability of ruin given the capital held), etc.
7. **Reflecting diversification** — Describe any diversification benefits and amount that is being used to spread around the risks to which the group is exposed.

The approach and assessment of group-wide capital adequacy should also consider the following:

- Intra-group transactions and consequently 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 insurer group debt.
- Diversification credits and restrictions on the fungibility of capital within the insurer group, including the availability and transferability of surplus resources created by insurer group level diversification benefits.
- The affects of contagion risk and concentration risk in the group capital assessment.

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The goal of the assessment is to provide an overall determination of internal capital needs for the insurer, based upon the nature, scale and complexity of risk within its operations. Internal capital should not be perceived as the minimum amount of capital before regulatory action will result (e.g. U.S. risk-based capital for insurance legal entities); rather, it should be recognized that this is the capital needed within an insurer group to achieve its business objectives.

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Prospective Solvency Assessment

Most companies, as part of their strategic planning process, compile a 2-5 year business plan. The ORSA review should contain a prospective solvency assessment that addresses the company's self assessment of the financial resources necessary to execute its 2-5 year business plan.

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If the insurer does not have the necessary financial capital or quality of capital to execute its 2-5 year business plan, it should describe the management actions it will take or describe any modifications to the business plan it has made to resolve the adequacy of its financial capital, including potential other resources of capital.

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The prospective solvency assessment is in effect a feedback loop. The insurer should project its future financial position including its projected internal 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 2-5 year business plan. If the prospective solvency assessment is performed for each individual insurance company legal entity, then 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 consider any constraints on group capital or the movement of group capital to legal entities.

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August 24, 2011

Danny Sanz
John Huff
Co-chairs
NAIC Group Solvency Working Group

Dear Co-Chairmen Huff and Sanz:

The Group of North American Insurance Enterprises (GNAIE) wishes to thank you for the opportunity to respond to the consultation document on Own Risk and Solvency Assessment (ORSA) Guidance Manual.

We wish to raise our concerns with the timing of the consultation on this draft. While we understand that there will be additional time to comment on the Guidance, the three weeks provided for this consultation in mid-summer made it very difficult to perform the necessary analysis and develop appropriate commentary. The addition of the ERM and ORSA requirements are major changes to the current solvency system and the review and consultation process should be commensurate with the importance of such changes. As such, these comments should be viewed in light of this limited review process and we reserve the right to alter these comments as additional analysis and internal consultation continues.

As we said in earlier consultations on the ORSA, GNAIE believes that consideration of the scope and effectiveness of an insurer's risk management framework should be an integral part of the supervisor's assessment of an insurer's solvency. We recommend a clear definition of the goals of the ORSA requirement be stated. We believe the analysis of an insurer/insurer group's ERM processes and capital adequacy is best accomplished through the use of the existing Risk Focused examination process.

A vital part of an ERM program is a process often described as an Own Risk and Solvency Assessment (ORSA). An ORSA is only part of the ERM. We believe the Guidance Manual, as drafted, confuses the ERM and ORSA. We think it is important to begin with a requirement for an ERM program and then an ORSA as a specific piece of that program. We have proposed specific editorial suggestions to unravel these two procedures and would urge the Working Group to look carefully at the draft in this light.

Regardless of the mechanism chosen for evaluation of insurers' ERM programs, it is important that the legal requirement for the ERM and ORSA and subsequent documentation, if any, be based upon a clear statement of objectives for and intended use of the documentation. In addition, before any documentation is required, a review of existing documentation such as Form F of the Model Holding Company Act should be made so that there are no duplicative requirements.

Douglas Wm. Barnert
Executive Director

Jerry M. de St. Paer
Executive Chair

We would also like to stress that both ERM and ORSA are internal processes. Neither is a report, although some pieces of the process can and should be documented in writing. Confusion between the ERM/ORSA process and the documentation exists throughout the Guidance Manual. The guidance should make clear what is suggested for inclusion in a company's ERM and ORSA processes versus what is intended to be filed with the regulator on a periodic basis to facilitate their review and evaluation. We have offered some suggestions for disentangling the process from the documentation, but much more work is needed to clarify the differences.

The process for reviewing the documentation also needs to be clarified. A review of the ERM or ORSA processes, particularly when performed on a group basis, should be coordinated with the lead state or under the leadership of the group supervisor. It would be very burdensome to have separate reviews of this material by multiple supervisors. Likewise, it would seem that the ORSA documentation, if any, should be filed with the lead state or group supervisor and made available on request to regulators in other jurisdictions in which group members are domiciled.

Section 1

We believe it is the intent of the Working Group that Section 1 of the ORSA filing contain a high level summary of an insurer's risk management policy with the entire policy being available for review upon examination. Filing of any documentation should be limited since regulators could make a special request or perform a targeted or limited scope examination if concerns arise from the initial reporting. Because of the confusion between the description of the process and the documentation, we do not believe that the required documentation is clear and that the submission based on the current written description would be much lengthier than the report verbally described by the Working Group. We have offered some suggestions to clarify the Section 1 filing.

The draft Guidance Manual suggests an annual submission of the ORSA documentation with updates, as requested by the regulator, throughout the year if necessary. We believe that much of the information in the proposed Section 1 of the ORSA documentation will not change on an annual basis. To the extent interim information regarding a company's enterprise risk is necessary, we would suggest an annual update requirement focus on changes to the company's enterprise risks or ERM program. Such interim reporting would simply build on the more detailed information collected during the previous examination. Alternatively, the use of an Annual Statement general interrogatory identifying when significant ERM changes are made (which could trigger further review) should also be considered.

We also applaud the Working Group for developing a process by which the ORSA documentation filed in other international jurisdictions could be leveraged to meet the requirement for Section 1, and possibly other sections of the ORSA requirement. We would urge that the NAIC make its requirements as compatible as possible with global standards so that the enterprise-wide ORSA documentation does not have to be significantly adjusted for NAIC review purposes.

Section 2

We support the Working Group's recommendation that Section 2 of the ORSA documentation reflect a company's own view of its risk and that no specific template or stress tests will be required.

We believe this section confuses the ERM and ORSA process and would urge a careful restructuring of the Manual to separate these processes. We have suggested beginning changes.

In the examples, we do not think notional value is relevant or useful for non-life companies.

Section 3

GNAIE supports an analysis of the group's financial condition and risks as a means to review the holding company system's capital position. GNAIE agrees with the SMI Task Force's view that capital requirements should continue to be based on Risk Based Capital (RBC) methodology, focused on minimum capital levels at the legal entity basis and that a separate group capital requirement will not be added. We agree the economic or target capital of an enterprise should not be perceived as the minimum amount of capital before regulatory action will result, but it should be assessed as the capital needed within a holding company system.

We think the ORSA documentation suggested is confusing in its reference to time frame, at one point referring to the past year and at other times looking at 2-5 years in the future. Target capital is a prospective evaluation so the reference to the past year should be dropped as we have suggested in our comments on the text. We also feel that 2-5 years may not be appropriate for non-life companies as projections greater than 2 years may not be reliable for such purposes.

It is also not clear what the Working Group expects the documentation on needed capital to be. Companies have different ways of assessing capital needs and the use of specific amounts may not always be used. The assessment of capital needs must be considered in light of how the companies view and manage themselves.

We look forward to continuing discussions with you on the development of the Guidance Manual.

Sincerely,

William R. Sergeant, CPA, CPCU, CLU, ChFC, FLMI
Chair, GNAIE Solvency Committee

Submitted by email to David Vacca at dvacca@naic.org

NAIC OWN RISK AND SOLVENCY ASSESSMENT (ORSA)

GUIDANCE **MANUAL**_[MEF1]

DRAFT (8/5/11)

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 to provide guidance to insurer and/or the insurance group on performing 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). This paper provides guidance to supervisors as to what to expect from, and how to analyze and evaluate a company's or group's ORSA. An ORSA results from the application of a company's/group's internal processes designed to define risk, appetite for risk, quantification of risk, and interrelationships of risk. The purpose of such processes and their results, i.e., the ORSA, is to manage risk exposure and to evaluate the company's/group's capital adequacy in terms of defined risk appetite parameters.

Dependent upon the size, nature and complexity of the company or group, a supervisor should expect an ORSA to be completed on a regular period basis (possibly annually). The supervisor should also expect that the ORSA contains a forward looking approach that denotes an assessment that is not only current, but that also includes an assessment of future solvency positions. Thus, the supervisor should be aware that an ORSA is likely to include proprietary information requiring a high degree of confidentiality protection. In analyzing an ORSA, the supervisor should expect that the ORSA represents a work product of the enterprise risk management processes that are well thought out and that include all of the risks to which a company or group is exposed.

The ORSA ~~shall be completed at least~~ is normally completed annually to assess the adequacy of its risk management and current, and likely future, solvency position.

Enterprises vary in the way each conducts its risk management. Many groups choose to manage risks on an enterprise wide basis. Others may separate the functions by pools and in a few cases some may use a legal entity basis. Any regulatory review should not require the enterprise to alter the level at which the risk management and ORSA is performed. If the enterprise performs an ORSA on a group-wide basis, an ORSA should not be required on a legal entity basis.

As part of its examination and oversight function it is important for the regulators to verify that the enterprise has completed an ORSA and has in place the principal components of a risk management system. A regulator should understand the ORSA as developed by the enterprise. This is best undertaken as part of the examination process since these are complex and dynamic procedures. Since the risk focused exam is normally conducted only every five years, regulators may wish to be provided with verification that the ORSA process is in place and is being updated annually. In order to assure himself that the review is in place, the regulator may wish to request brief written documentation of the process. This documentation is described in Section 1.

However, whether the 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.

A. Exemption

An insurer and/or insurance group 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 assumed premium including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program and excluding affiliated reinsurance premium is less than \$1,000,000,000.

An insurer may be required to provide an ORSA 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 and/or an insurer within the insurance group 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, volume of business written, availability of qualified board members, or the ownership or organizational structure of the entity.

C. General Guidance

~~While the ORSA is completed entirely by an insurance legal entity within an insurance group and/or the insurance group, and therefore represents its internal risk management assessment, the resulting ORSA filing should contain three major sections as follows:~~

Insurance regulators may wish to require documentation that its ORSA process is in place and has been reviewed at least annually. Such documentation should be a brief written document describing in narrative the following:

. Section 1 - Description of the Risk Management Policy

- . Section 2 - Quantitative Measurements of Risk Exposure in Normal and Stressed Environments
- . Section 3 – Group Economic 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 and/or insurance group. ~~Additionally, in order to avoid excessive volumes of detail or supporting documents for complex insurance groups, an insurer and/or insurance group may simply reference other explanatory documents linked to within the ORSA, as long as those documents are available to the regulator upon request. If the referencing of other detailed documentation is performed, a summary index is requested.~~ request. This exhibit should be a listing of documents available for review^[MEF4].

~~An internationally~~^[MEF5] ~~active insurance group required to file an~~^[MEF6] ~~ORSA, may be able to satisfy the filing requirement by providing an ORSA that has been provided to another~~^[MEF7] ~~jurisdiction who serves as the group-wide supervisor. An insurer required to file an ORSA may be able to satisfy the NAIC filing requirement by providing an ORSA report that has been completed for the purposes of satisfying ComFrame and/or other jurisdictional requirements.~~ This ORSA documentation will be reviewed in relation to Insurance Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) 16 Enterprise Risk Management (ERM) and 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^[MEF8].

D. Extensions

An extension for the due date of submission of all or part of the ORSA documentation ~~filing or a partial ORSA (i.e. specific sections)~~ may be granted at the discretion of the Commissioner^[MEF9].

II. SECTION 1 – DESCRIPTION OF THE RISK MANAGEMENT POLICY

An effective Enterprise Risk Management (ERM) Framework^[MEF10] 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 should document the aforementioned ERM Framework principles, if present, as well as summarize or reference (e.g. in an appendix) the insurer/group's risk management policies.~~

The^[MEF11] risk management ~~policies-process~~ should^[MEF12]:

- a. Identify all relevant and material risk categories and describe how those risk categories are managed on a day-to-day operational basis as the insurer/group executes its business strategy^[MEF13].
- b. Describe any processes and methods used for monitoring risk and should include any risk tolerance statements and describe the relationship between any risk tolerance statements and capital requirements both regulatory and economic.
- c. Include the insurer/group's investment policy which should specify the nature, role and extent of the insurer's investment activities, how the investment policy complies with the solvency regime investment requirements and specifies explicit risk management procedures regarding more complex and less transparent classes of assets and investments in markets or instruments that may be subject to less governance or regulation. The investment policy should address credit risk, market risk, liquidity risk and any counterparty risk that may be associated with any hedging programs. The ~~ORSA should provide the insurer/group's company should use its~~ own^[MEF14] internal analysis processes ~~used~~ to identify such risks and not rely exclusively on investment managers or rating agencies and their use of diversification to mitigate such risks.
- d. Include any underwriting policy used by the insurer/group to manage underwriting risk and describe the relationship of the underwriting policy to product design and product pricing.

- e. Include any claims underwriting or claims processing policies implemented by the insurer/group to manage any risks associated with determining whether claims are covered under the contract and how claim amounts are determined.
- f. Include a description of any anti-fraud policies that have been implemented to detect fraud in filing of claims.
- g. Include a description of any asset-liability management (ALM) activities which clearly specifies the nature, role and extent of ALM activities and the relationship with product development, pricing and investment management functions.
- h. Include a description of any retention or conservation policy or program designed to retain assets, policies in force or market share. Such programs may include multiple coverage discounts, extra interest credits or other policyholder options.
- i. Include a description of any reinsurance counterparty policy related to any reinsurance programs the company has in effect.
- j. Include, if applicable, any management activities or policy related to processes of identifying, assessing, measuring, monitoring, controlling and mitigating risks associated with group membership.
- k. Include any activity related to mergers or acquisitions of business including a description of the policy or program for completing due diligence on the transaction.
- l. Include a description of how compensation and incentives are assessed and considered within the ERM Framework.
- m. Include a description of any other management activity, policy or program designed to assess enterprise risk not already described in a category above.

The ORSA^[MEF15] is part of the risk management ~~should~~ process. The purpose of the ORSA is to assess the adequacy of its risk management and current, and likely future, solvency position (ICP 16).

Section 1 of the documentation that the ORSA has been undertaken should include:

- ~~also disclose~~ how the insurer/group's management uses its risk management policies~~y~~ including any tolerance statements and limits in its day-to-day operations as it executes its business strategy. The ORSA should disclose
- describe insurer/group information, management processes~~;~~ and 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. The ORSA should also
- 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.

III. SECTION 2 - QUANTITATIVE MEASUREMENTS OF RISK EXPOSURE IN NORMAL AND STRESSED ENVIRONMENTS

Section 2 of the ORSA The ORSA should ~~asses~~document the quantitative measurements of risk exposure in both normal and stressed environments for each risk category identified ~~in Section 1.~~by the company or group. This quantitative measurement process ~~should require~~requires a quantification of risks under a range of outcomes using risk measurement techniques that are appropriate to the nature, scale and complexity of the risks.

Examples of relevant material risk categories may include, but not be limited to, credit, market, liquidity, cash flow mismatch, underwriting, claim, expense, operational and risks associated with group membership. Although it is recognized that some stress tests for certain risks may be performed at the insurance group level, the regulator may request additional information to map the results to an individual insurance legal entity.

By identifying each material risk category independently and reporting notional amounts, expected amounts in both normal and stressed conditions, insurer/group management and the regulator are in a much better position to evaluate certain risk combinations that could cause an insurer/group to fail. One of the most difficult exercises in modeling insurer/group 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.

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^[MEF16].

Because the risk profile of each insurer/group is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer/group should run, however the regulator may have input regarding the level of stress that company management should consider for each risk category. 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/group'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.

The regulator may also desire to observe for each risk category a reverse stress test which would identify, given the insurer's current economic capital, the level of the stress factor which would have to unfold to cause the insurer to fail. Reverse stress testing can be helpful in identifying the risks that are most likely to cause an insurer to fail.

~~By identifying each material risk category independently and reporting notional amounts, expected amounts in both normal and stressed conditions, insurer/group management and the regulator are in a much better position to evaluate certain risk combinations that could cause an insurer/group to fail. One of the most difficult exercises in modeling insurer/group 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.~~

The ORSA documentation^[MEF17] in Section 2 should include detailed descriptions^[MEF18] and explanations of the risks identified, the measurement approaches used, key assumptions made and outcomes of any plausible adverse scenarios that are run. ~~Examples of relevant material risk categories may include, but not be limited to, credit, market, liquidity, cash flow mismatch, underwriting, claim, expense, operational and risks associated with group membership. Although it is recognized that some stress tests for certain risks may be performed at the insurance group level, 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.~~

Within the Appendix are three examples that illustrate the types of documentation outcomes of risk measurement a regulator may desire to observe for risk categories identified within a life insurance company (attachment 1), a property casualty company (attachment 2) and a health insurance company (attachment 3). These examples are not intended to be used as prescribed templates.

~~Because the risk profile of each insurer/group is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer/group should run, however the regulator may have input regarding the level of stress that company management should consider for each risk category. 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/group'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 notional amounts, expected amounts in both normal and stressed conditions, insurer/group management and the regulator are in a much better position to evaluate certain risk combinations that could cause an insurer/group to fail. One of the most difficult exercises in modeling insurer/group 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 ECONOMIC CAPITAL AND PROSPECTIVE SOLVENCY ASSESSMENT

~~Section 3 of the ORSA 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 business over the longer term business cycle such as the next 2-5 years.~~

Group Economic Capital

Insurers and/or holding company systems 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. ~~- Annually, the insurer and/or insurance holding company system subject to this filing should conduct a group economic capital assessment~~

~~This section is intended to help regulators understand insurers' capital adequacy in relation to the risk profiles.~~

The approach and assessment of group-wide capital adequacy should also consider the following:

. Eliminate intra-group transactions and consequently double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities.

. Take account of the level of leverage, if any, resulting from holding company debt.

. Clearly identify diversification credits and adequately address 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.

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

The goal of the assessment is to provide an overall determination of economic capital needs for the insurer and/or holding company system, based upon the nature, scale and complexity of risk within the group. Group capital should not be perceived as the minimum amount of capital before regulatory action will result (e.g. US risk-based capital 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.

~~Section 3 of the ORSA documentation is intended to help regulators understand insurers' capital adequacy in relation to the risk profiles. On an annual basis, the insurer and/or insurance holding company system subject to this filing should document that it has completed ~~provide~~ a group economic capital ~~assessment~~ assessment and should provide its calculation of economic capital needed for the chosen time ~~within period within~~ their ORSA for the previous period year-end. [MEF19]~~

This information may also be requested by a Commissioner throughout the year, if ~~needed~~ [MEF20].

The figure representing the group economic capital must be accompanied with a narrative describing the following:

1. Definition of solvency – Describe how the insurer and/or group defines solvency (e.g. Cash flow basis, balance sheet basis, etc.). If balance sheet basis, what basis of accounting is used?
2. Time horizon of risk exposure – Describe the time horizon modeled, such as one year, lifetime, etc.
3. Risks to model – Describe high-level risks and materiality (e.g. immaterial or material^[MEF21]).
4. How risks are quantified – Describe the stress tests, stochastic modeling or factors utilized in the quantification, as well as, the methodology for allocating the group capital across insurance legal entities^[MEF22].
5. Measurement metric – Describe the measurement metric, such as value at risk in percentile (quantifies the capital needed to withstand a loss at a certain probability),⁷ tail value at risk (quantifies the capital needed to withstand average losses above a certain probability), probability to ruin (quantifies the probability of ruin given the capital held), etc.
6. Target level of capital – Describe the target capital for the insurer and/or holding company system's business objectives^[MEF23].
7. Reflecting diversification – Describe any diversification benefits and amount that is being used to spread around the risks to which the group is exposed.

~~The approach and assessment of group-wide capital adequacy should also consider the following:~~

~~–Eliminate intra-group transactions and consequently double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities.~~

~~–Take account of the level of leverage, if any, resulting from holding company debt.~~

~~–Clearly identify diversification credits and adequately address 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.~~

~~–Reflect the effects of contagion risk, concentration risk and complexity risk in their group capital assessment.~~

~~The goal of the assessment is to provide an overall determination of economic capital needs for the insurer and/or holding company system, based upon the nature, scale and complexity of risk within the group. Group capital should not be perceived as the minimum amount of capital before regulatory action will result (e.g. US risk-based capital 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

Most companies, as part of their strategic planning process, compile a 2-5 year business plan^[MEF24]. The ORSA should examine its financial resources over a prospective time period.

The prospective solvency assessment is in effect a feedback loop. The insurer/group 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 2-5 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 consider any constraints on group capital or the movement of group capital to legal entities.

Section 3 of the ORSA documentation should demonstrate 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 business over the longer term business cycle such as the next 2-5 years.

Section 3 of the ~~ORSA-ORSA filing~~ should also contain ~~a demonstration and~~ documentation that; ~~given the current capital requirements both economic and regulatory, the quality of that capital, the current risk management policy consisting of its current risk tolerance limits, current risk exposure amounts in both a normal and stressed environments and the projected 2-5 year business plan;~~ ~~the~~ that the^[MEF25] company has the financial resources necessary to execute its 2-5 year business plan. If the insurer/group does not have the necessary financial capital or quality of capital to execute the 2-5 year business plan, the insurer/group should describe the management actions it will take or describe any modifications to the business plan it has made to resolve the adequacy of its ~~financial~~ capital, including potential other ~~resources~~ of capital.

~~The prospective solvency assessment is in effect a feedback loop. The insurer/group 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 2-5 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 consider any constraints on group capital or the movement of group capital to legal entities.~~

V. APPENDIX

Below are three examples that illustrate how the types of outcomes of risk measurement a regulator may desire to observe for risk categories identified within a life insurance company (attachment 1), a property casualty company (attachment 2) and a health insurance company (attachment 3). For each risk category identified, the minimum quantitative elements that could be reported are the notional^[MEF26] amount of risk which identifies the total exposure the insurer has to that particular risk, the expected value of that risk under normal conditions which identifies the amount of expected payment under normal conditions due to that risk over the next year and the expected value of that risk under stressed conditions which identifies the amount of expected payment under stressed conditions due to that risk over the next year. ~~The regulator may also desire to observe for each risk category a reverse stress test which would identify, given the insurer's current economic capital, the level of the stress factor which would have to unfold to cause the insurer to fail. Reverse stress testing can be helpful in identifying the risks that are most likely to cause an insurer to fail. These examples are not intended to be used as prescribed templates^[MEF27].~~

~~These examples are not intended to be used as prescribed templates^[MEF28].~~

August 25, 2011

The Honorable John M. Huff and Danny Saenz
Co-Chairs, Group Solvency Issues (EX) Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108
By E-Mail
Attn.: David Vacca

Dear Chairmen Huff and Saenz:

NAMIC is a trade association comprising approximately 1,300 mutual property/casualty member insurers domiciled in the United States and another 100 in Canada. The 1,300 members domiciled in the United States write approximately 37 percent of the annual property/casualty premium in this country. On behalf of those members, NAMIC provides the following comments on the latest version of the NAIC's Own-Risk and Solvency Assessment (ORSA).

In accordance with the request from the working group, attached are NAMIC's proposed wording changes to the current ORSA draft and the following sets forth the basis for those proposed changes. However, the modification of the ORSA draft for these changes does not address all of our comments. We understand the working group intends to address proposed wording changes first, but we believe it prudent for regulators to step back and consider how the information will be used before finalizing the ORSA draft.

Form of Authorization

NAMIC understands regulators desire to create authority for the ORSA filing and to create some specifics regarding that authority. We encourage the working group to adopt limited changes (e.g. confidentiality, exemptions, application for waiver) to statute/regulation to provide these specifics. NAMIC believes that regulators have expressed their beliefs that insurers' ORSAs will evolve over time, and lessons will be learned and consequently, any change in regulation should be limited.

Form of ORSA

NAMIC does not believe the ORSA should be a new regulatory filing but should represent information made available to the regulator through existing processes. NAMIC believes the ORSA paper being drafted should represent what regulators expect to observe and obtain during an examination of such information (all sections) or analysis of specific aspects (Sections 2 and 3). Although the current introduction includes language that could be interpreted in this manner, we have proposed wording changes in the August 5 Exposure makes this more explicit, the following describes the basis for our suggestion in more detail.

The NAIC Financial Examiners Handbook requires the state examiner to obtain an understanding of the company and separately requires the examiner to assess risks, including those other than financial reporting risks. This includes among other things, interviews of senior management, which provides an excellent opportunity to address current and prospective risk in the same manner as addressed in the ORSA. We would suggest that reviewing the ORSA during an examination is better than a filing because

it gives the regulator a face to face opportunity to query senior management and ask more questions. Regardless, the expectation is that the examiner is already reviewing aspects of the insurer's risk management processes. This, along with information obtained by the state analyst through the detailed annual and quarterly statement filings, as well as any communication with the insurer, allows the state insurance department to assess the risks within the company, which is ultimately used to make decisions regarding the ongoing prioritization and supervisory plan for the insurer. Many insurance departments meet with their domestic companies annually to discuss various issues, NAMIC suggests this may represent an ideal opportunity to discuss section 2 and 3 of the ORSA. Regardless, the U.S. system already contemplates that insurers with weaker than expected risk management processes will receive greater regulatory scrutiny. NAMIC suggests that regulators build upon the existing U.S. Solvency Framework that supports this notion, and we have proposed wording for inclusion in the August 5 Exposure that addresses this fact. We believe the additional wording also helps to address some concerns insurers may have regarding specificity, as discussed below.

Specific Requirements of an ORSA

We have concerns with some of the specific requirements of the ORSA that, in our mind, go beyond best practices and strive to set a bar higher than what insurers have set for themselves for commercial reasons. In fact, many of the requirements seem to be closer to practices that only the largest and most sophisticated companies utilize. We do not believe U.S. regulators desire an approach requiring insurers to spend millions of dollars on new processes and systems that may or may not be appropriate for their business model. NAMIC makes this comment in light of the fact that U.S. regulators have made it very clear throughout the Solvency Modernization Initiative project that they would like to adopt best practices from international regulators that enhance the U.S. system, but only where such practices make sense for the U.S. system. Separately, U.S. regulators have indicated that, unlike other countries' systems, the U.S. system is not designed for the regulator to act on behalf of management and make decisions unless the protection of policyholders is at risk (e.g. a troubled company). We believe such approaches are consistent with the way businesses have always been regulated in the U.S. What is appropriate, however, is that insurers/insurance groups be judged and prioritized by regulators based upon the extent to which their risk management systems are appropriate for their risks. Consequently, we have proposed wording to the August 5 Exposure making this more clear. Again, we believe this addresses some of the concerns with the specificity of the current ORSA, but we believe additional time may be needed for insurers to develop more specific suggestions.

Specific Changes Needed as a Result of the ORSA

Although NAMIC believes the NAIC has already developed a regulatory process that considers enterprise risk management, we believe changes are needed to the NAIC Financial Analysis Handbook and NAIC Financial Condition Examiners Handbook, regardless of the final form of the ORSA document. Specific to the Financial Condition Examiners Handbook, we would propose a new exhibit, similar to Exhibit M for Corporate Governance, which sets forth a mechanism for the examiner to identify and assess this information from the ORSA. We would expect similar changes to be made to the Financial Analysis Handbook, but which should only focus on Sections 1 and 2. We would also propose adding three interrogatories to the NAIC Annual Statement. The first would ask if the insurer or group of insurers is subject to the requirements of an ORSA. The second would ask if the insurer or group of insurers has made any material changes to its risk management policies (Section 1 of the ORSA) since last being examined. The third would ask the insurer to provide a brief description of such changes, or request the regulator to contact the insurer for a description, which would be designed to determine if a limited scope examination on such changes was necessary. We believe proposals to incorporate such changes should be developed simultaneously with the finalizing of this document, thus the primary reason for the recommendation for regulators to take a more deliberate approach with this project.

Other Concerns

As we have also commented in the past, we are concerned about the resources necessary for regulators to review and analyze the ORSA. We believe the working group's decision to exclude insurers/insurance groups below a predefined threshold is an appropriate decision, in part because the demands on insurers, but also because of the demands this ORSA will place on regulators. It is for this reason that we suggest that the working group take its time on this project to determine exactly how this will be rolled out to insurers. It is also for this reason that we suggest that state regulators roll this out as a pilot program before finalizing the ORSA. Although the presentations to the working group in Jacksonville were well received, states need to determine exactly how helpful this information is, how it will be used, and the amount of resources it will take to review before finalizing these requirements. Once this is done, we suggest finalizing the ORSA, and then at that time, the new Examination Coordination (E) Working Group to develop a schedule for when the examinations of section 1 will be rolled out to all other groups subject to the ORSA. Once the schedule is determined, the lead states can notify the insurers/insurance groups, and regulators and insurance groups can begin to prepare for the ORSA. The development of a schedule will also facilitate an ongoing staggering of such reviews, with the understanding that limited scope examinations may be necessary on some insurers/insurance groups that were not originally expected.

Closing Comments

Finally, we reiterate our comments from our March 18 letter, where we remind the working group that insurers have survived the current financial crisis rather well without the potentially monumental filing addressed herein. Consequently, any ORSA requirements should consider that fact and simply make greater way for regulators to enhance their current processes with information already utilized by insurers.

Respectfully,



Dan Daveline

Financial Regulation Manager

NAIC OWN RISK AND SOLVENCY
ASSESSMENT (ORSA)
GUIDANCE MANUAL

DRAFT (8/5/11)

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

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Introduction

The purpose of this Manual is to provide guidance to insurer and/or the insurance group on the expectations of U.S. regulators on their performing its own risk and solvency assessment (ORSA) as required outlined within the Form B—the Insurance Holding Company System Annual Registration Statement of the NAIC’s Insurance Holding Company System Regulatory Regulation (#450). The determination as to whether the ORSA information is done at the legal insurer or insurance group level shall be made by the insurance group based upon how it manages its own risk. The ORSA consists of three sections as discussed below, for which sections 2 and 3 shall be completed at least annually, and section 1 as deemed appropriate by the insurer and/or the insurance group. to assess the adequacy. The purpose of the ORSA is to make information available to the regulator that demonstrates how the insurer and/or insurance group manages its risk, as well as it’s current and likely solvency position. of its risk management and current, and likely future, solvency position. should be completed. The ORSA is not intended to be a regulatory filing, but rather the accumulation of information that the insurer or insurance group makes available to the regulator upon their request. It is the expectation of U.S. regulators that section 1 of the ORSA will be reviewed during a full scope examination while sections 2 and 3 may be reviewed at the same time, and/or discussed with the state analyst on an annual basis, or at least a more periodic basis than the examination. However, whether the regulator chooses to request the information be made available at a particular point in time 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. However, the general expectation is that unless there are major changes to the insurer and/or insurance group risk management policies, or unless the regulator has specific concerns with the insurer/insurance group, the regulator will request section 1 to be reviewed during an on-site examination once every 3 to 5 years. Major changes to an insurer/insurance group’s risk management policies, or specific concerns from a regulator regarding the insurer/insurance group may result in the state calling a targeted examination to review section 1 more periodically. The general expectation is that the state analyst will request that management discuss sections 2 and 3 with them annually, but the analyst should only request a hard copy of the information from these sections if they intend a full review of such information and if it’s expected to impact the ongoing supervisory plan.

A. Exemption

An insurance and/or insurance group shall be exempt from the requirement 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, ~~and excluding affiliated reinsurance premium~~ is less than \$1,000,000,000.

An insurer may be required to provide an ORSA based on unique circumstances at the discretion of the Commissioner including, but not limited to, the type of business written, federal agency requests, international supervisory requests.

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

B. Application for Waiver

An insurer may also 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, volume of business written, availability of qualified board members, or the ownership or organizational structure of the entity.

C. General Guidance

While the ORSA ~~is completed entirely by an insurance legal entity within an insurance group and/or the insurance group, and therefore~~ represents the insurer and/or the insurance groups its own internal risk management assessment, the resulting ORSA filing documentation should provide information on the insurer or insurance groups processes or results related to ~~contain the~~ three major sections as follows:

- **Section 1** - Description of the Risk Management Policy
- **Section 2** - Quantitative Measurements of Risk Exposure in Normal and Stressed Environments
- **Section 3** – Group Economic Target 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 and/or insurance group. As noted above, sections 2 and 3 of the ORSA are expected to be updated annually for the insurer and/or insurer group and highlights of such results may need to be presented by management on a private conference call with the state analyst, or a face to face meeting. Consequently, sections 2 and 3 must be capable of being provided to the regulator in a condensed format. However, for some insurers/insurance groups, 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/insurance group. This is because its up to the insurer/insurance group to determine how best to communicate its processes designed to manage its risks. This could be done through a combination of summary documents, presentations, interviews and walkthroughs. Each insurer/group of insurers is best equipped to determine how best to communicate the totality of its systems and processes to the regulator, which includes not only the level of detail included in the summary, but how it explains the totality of the system and the extent to which its embedded in its structure.

~~Additionally, in order to avoid excessive volumes of detail or supporting documents for complex insurance groups, an insurer and/or insurance group may simply reference other explanatory documents within the ORSA, as long as those documents are available to the regulator upon request. If the referencing of other detailed documentation is performed, a summary index is requested.~~

An internationally active insurance group required to file an ORSA, may be able to satisfy the filing requirements by providing an ORSA that has been provided to another jurisdiction who serves as the group wide supervisor. This ORSA will be reviewed in relation to Insurance Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) 16 Enterprise Risk Management (ERM) and 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.

D. Extensions

~~An extension for the due date of submission of the ORSA filing or a partial ORSA (i.e. specific section) may be granted at the discretion of the Commissioner.~~

Section 1 – Description of the Risk Management Policy

An effective Enterprise Risk Management (ERM) Framework should at a minimum consider 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.

The manner and depth in which the insurer/insurance group 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/insurance group. Similarly, the extent to which the insurer/insurance group processes address the below will also be considered in that ongoing supervisory plan. However, the below policies, unlike the principles, are not expected minimum thresholds, and should not be used in a “checklist manner” by the examiner. Rather, the regulator should consider the entirety of the risk management program and its appropriateness for the unique risks of the insurer/insurance group.

Section 1 of the ORSA requires the insurer/insurance group to make ~~should~~ documentation available to the regulator regarding the aforementioned ERM Framework principles, if present, as well as the insurer/group’s risk management policies. The risk management policies should demonstrate that the insurer/group:

- a. Identifies all relevant and material risk categories and describe how those risk categories are managed on a day-to-day operational basis as the insurer/group executes its business strategy.
- b. identifies ~~Describe~~ any processes and methods used for monitoring risk and should include any risk tolerance statements (if applicable) or limits and describe the relationship between such any risk tolerance ~~statements/limits~~ and target and regulatory capital requirements ~~both regulatory and economic~~.
- c. Has ~~Include the insurer/group’s an~~ investment policy which should specifies ~~the nature, role and extent of how~~ the insurer’s conducts its investment activities, how the investment policy complies with the solvency regime investment requirements and specifies explicit risk management procedures regarding more complex and less transparent classes of assets and investments in markets or instruments that may be subject to less governance or regulation. The investment policy should address credit risk, market risk, liquidity risk and any counterparty risk that may be associated with any hedging programs. The ORSA should provide the insurer/group’s own internal analysis processes used to identify such risks and not rely exclusively on investment managers or rating agencies and their use of diversification to mitigate such risks.

- d. Identifies ~~Include any~~ underwriting policies used by the insurer/group to manage underwriting risk and describe the relationship of the underwriting policy to product design and product pricing.
- e. Identifies ~~Include~~ any claims underwriting or claims processing policies implemented by the insurer/group to manage any risks associated with determining whether claims are covered under the contract and how claim amounts are determined.
- f. Identifies ~~Include a description of~~ any anti-fraud policies that have been implemented to detect fraud in filing of claims.
- g. Identifies ~~Include~~ a description of any asset-liability management (ALM) activities which clearly specifies the nature, role and extent of ALM activities and the relationship with product development, pricing and investment management functions.
- h. Identifies ~~Include a description of~~ any retention or conservation policy or program designed to retain assets, policies in force or market share. Such programs may include multiple coverage discounts, extra interest credits or other policyholder options.
- i. Identifies ~~Include a description of~~ any reinsurance counterparty policy related to any reinsurance programs the company has in effect.
- j. Identifies ~~Include, if applicable,~~ any management activities or policy related to processes of identifying, assessing, measuring, monitoring, controlling and mitigating risks associated with group membership.
- k. Identifies ~~Include~~ any activity related to mergers or acquisitions of business including a description of the policy or program for completing due diligence on the transaction.
- l. Identifies ~~Include a description of~~ any other management activity, policy or program designed to assess enterprise risk not already described in a category above.
- m. Identifies ~~Includes a description of~~ how compensation and incentives are assessed and considered within the ERM framework.

The ORSA should also identify ~~disclose~~ how the insurer/group's management uses its risk management policy including any tolerance statements and limits in its day-to-day operations (if any) as it executes its business strategy. The ORSA should make available ~~disclose~~ insurer/group's information, management processes, and 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. The ORSA should also allow the regulator to understand ~~disclose~~ how the risk management policy is related and tied to the determination of the amount and quality of its economic target capital and regulatory capital.

Section 2 - Quantitative Measurements of Risk Exposure in Normal and Stressed Environments

Section 2 of the ORSA should summarize the most relevant~~document the~~ quantitative measurements of risk exposure in both normal and stressed environments for material~~each~~ risks category~~category~~ identified in Section 1. This quantitative measurement process should require a quantification of risks under a range of outcomes using risk measurement techniques that are appropriate to the nature, scale and complexity of the risks. Information should be available upon request that describes~~Section 2 should include detailed descriptions and explanations of the risks identified, the measurement approaches used,~~ key assumptions made and outcomes of any~~the most~~ plausible adverse scenarios that are run. Examples of relevant material risk categories may include, but not be limited to, credit, market, liquidity, cash flow mismatch, underwriting, claim, expense, operational and risks associated with group membership. Although it is recognized that some stress tests for certain risks may be performed at the insurance group level, the regulator may request additional information to determine the estimated impact~~map the results~~ to an individual insurance legal entity, but only to the extent the risk identified is material to the overall prioritization of the insurer.

Any risk tolerance statements (if applicable) 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.

Within the Appendix are three examples that illustrate the types of outcomes of risk measurement a regulator may desire to observe for risk categories identified within a life insurance company (attachment 1), a property casualty company (attachment 2) and a health insurance company (attachment 3). These examples are not intended to be used as prescribed templates.

Because the risk profile of each insurer/group is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer/group should run, however the regulator may have input regarding the level of stress that company management should consider for each risk category. 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 a group'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 notional amounts, expected amounts in both normal and stressed conditions, insurer/group management and the regulator are in a much better position to evaluate certain risk combinations that could cause an insurer/group to fail. One of the most difficult exercises in modeling insurer/group 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.

Consistent with section 1, the manner and depth in which the insurer/insurance group quantitative measurement process addresses these expectations of this section will have a bearing on the regulators ongoing supervisory plan of the insurer/insurance group. However, the expectations described above should not be used in a "checklist manner" by the analyst/examiner. Instead, the regulator should consider the entirety of the quantitative measurement process and its appropriateness for the unique risks of the insurer/insurance group.

Section 3 – Group ~~Economic-Target~~ Capital and Prospective Solvency Assessment

Section 3 of the ORSA 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 business over the longer term business cycle such as the next 12-5 years where more sophisticated techniques completed over longer periods of time are encouraged, but will vary from insurer to insurer depending upon the processes they deem appropriate for commercial purposes.

Group ~~Economic-Target~~ Capital

Insurers and/or holding company systems should have sound processes for assessing capital adequacy in relation to risk profile and the process should be integrated into its management and decision making culture. This section is intended to help the regulator understand how the insurance group^{insurers'} views their capital adequacy in relation to their risk profiles.

On an annual basis, the ~~insurer and/or insurance group~~holding company system subject to this filing should provide a group ~~economic-target~~ capital assessment within their ORSA for the previous period year-end. This information may also be requested by a Commissioner throughout the year, if material changes in the macroeconomic environment and/or microeconomic facts and circumstances suggest its needed for the ongoing supervisory plan~~needed.~~

The figure representing the group ~~economic-target~~ capital must be accompanied with a short narrative describing the following:

1. **Definition of solvency** – Describe how the insurer and/or group defines solvency (e.g. Cash flow basis, balance sheet basis, etc.). If balance sheet basis, what basis of accounting is used.
2. **Time horizon of risk exposure** – Describe the time horizon modeled, such as one year, lifetime, etc.
3. **Risks to model** – Describe high-level risks and materiality (e.g. immaterial or material).
4. **How risks are quantified** – Describe the stress tests, stochastic modeling or factors utilized in the quantification, as well as, the methodology for allocating the group capital across insurance legal entities.
5. **Measurement metric** – Describe the measurement metric, such as value at risk in percentile (quantifies the capital needed to withstand a loss at a certain probability), tail value at risk (quantifies the capital needed to withstand average losses above a certain probability), probability to ruin (quantifies the probability of ruin given the capital held), etc.
6. **Target level of capital** – Describe the target capital for the insurer and/or holding company system's business objectives.
7. **Reflecting diversification** – Describe any diversification benefits and amount that is being used to spread around the risks to which the group is exposed.

The approach and assessment of group-wide capital adequacy should also consider the following:

- Eliminate intra-group transactions and consequently double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities.
- Take account of the level of leverage, if any, resulting from holding company debt.
- Clearly identify diversification credits and adequately address 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.

- Reflect the affects of contagion risk, concentration risk and complexity risk in their group capital assessment.

The goal of the assessment is to provide the regulator with information regarding the insurance groups an overall determination of its economietarget capital needs for the insurer and/or holding company system, based upon the nature, scale and complexity of risk within the group. Group capital should not be perceived as the minimum amount of capital before regulatory action will result (e.g. US risk-based capital for insurance legal entities); rather, it should be recognized that this is the amount of capital that the insurance group believes is needed within a holding company system to achieve the group's business objectives.

Prospective Solvency Assessment

Most companies, as part of their strategic planning process, compile a 12-5 year business plan. Section 3 of the ORSA should contain a demonstration and documentation that; given the current capital requirements both eeconomietarget and regulatory, the quality of that capital, the current risk management policy consisting of its current risk tolerance limits, current risk exposure amounts in both a normal and stressed environments and the projected 21-5 year business plan; the insurer/group has the financial resources necessary to execute its 21-5 year business plan. If the company does not have the necessary financial capital or quality of capital to execute the 21-5 year business plan, the insurer/group should describe the management actions it will take or describe any modifications to the business plan it has made to resolve the adequacy of its financial capital, including potential other resources of capital.

The prospective solvency assessment is in effect a feedback loop. The insurer/group should project its future financial position including its projected eeconomietarget 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 21-5 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 consider any constraints on group capital or the movement of group capital to legal entities.

Consistent with sections 1 and 2, the sophistication of processes used by the insurance groups target capital and prospective solvency assessment to address these expectations of this section will have a bearing on the regulators ongoing supervisory plan of the insurer/insurance group. However, the expectations described above should not be used in a “checklist manner” by the analyst/examiner. Instead, the regulator should consider the entirety of the group target capital and prospective solvency assessment for the unique risks of the insurance group.



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Via E-Mail

August 25, 2011

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Senior Associate Commissioner Danny Saenz, Co-Chair
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Re: RAA Comments on NAIC ORSA Guidance Manual

Dear Co-Chairmen Huff and Saenz:

The RAA appreciates the opportunity to comment on the NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual (the guidance manual) dated August 5. We appreciate the considerable effort involved in drafting the proposal and support the development of an appropriately designed U.S. ORSA requirement.

The RAA is the leading trade association of property and casualty reinsurers and life reinsurers doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross border basis. RAA members maintain sophisticated enterprise risk management (ERM) systems and many are, or will be subject to ORSA requirements in other jurisdictions.

General Observations

The RAA believes that an appropriately designed ORSA requirement will encourage the improvement of ERM processes among U.S. insurance enterprises, will enhance regulators' understanding of how insurers evaluate and manage their risks and will help to ensure that the existing high quality standard of U.S. regulation is recognized by other jurisdictions. We believe that the most important and basic element of a properly designed ORSA requirement is that it be principles-based and flexible so that compliance is a logical extension of an entity's or group's existing ERM processes.

ICP 16 recognizes that different approaches to ERM are appropriate depending on the nature scale and complexity of an insurer's risks as well as the availability of reliable data. To be effective, an insurance enterprise's ERM framework must be tailored to its business model so that it is integrated into its overall business strategy and its day-to-day operations. An appropriate ORSA requirement must not be overly prescriptive and instead, should reflect how the insurance enterprise measures, evaluates and responds to its risks.

As large, well capitalized and internationally active reinsurers, RAA members have a relatively long history of well developed and sophisticated ERM processes including the use of advanced internal models. Effective ERM is a critical prerequisite for participating in the global reinsurance market and is a characteristic that has been demonstrated to rating agencies and investment analysts. We welcome the corresponding modernization of the U.S. and international solvency regimes that include more focus on ERM as a way to differentiate regulated entities and improve the allocation of regulatory resources.

Unfortunately, despite our strong support for a U.S. ORSA requirement, we believe that the NAIC is unnecessarily rushing to complete the guidance manual without giving due consideration to many important elements that are necessary to integrate the requirement into the existing U.S. solvency framework. We further believe that despite the recent statements by members of the working group that the ORSA filing is not intended to result in a great deal of new and additional documentation requirements, the language of the manual will require exactly that. If adopted in any close approximation of its current form, the guidance manual will require lengthy and overly prescriptive new filing requirement that will not be reflective of how (re)insurers manage their risk and thus will not provide useful information to regulators.

Overall Concerns:

While the RAA and its members remain fully supportive of the addition of a U.S. ORSA requirement, we have several concerns about the project that we feel must be addressed before the guidance manual is finalized.

- The working group should abandon its unnecessary deadline of completing the guidance manual by November 2011 and instead ensure that the guidance meets regulatory objectives while not causing unnecessary compliance burdens for the industry;
- The working group has more work to do to define the regulatory objectives of the ORSA and to integrate this potentially powerful new regulatory tool into the overall U.S. regulatory framework;
- The working group must decide on the appropriate statutory vehicle to require the ORSA and one which addresses how the information will be integrated into the financial examination and financial analysis processes;
- Explicit statutory guidance is needed to ensure the confidentiality of the proprietary ERM documentation of (re)insurers and to limit the sharing of this information with others.
- The working group should not make any final decisions on whether the ORSA will be an explicit annual filing or specify the level of detail of that filing until after determining how the ORSA documentation will be used in the examination, analysis or other supplementary NAIC processes.
- The working group needs to reconcile its' public statements and the NAIC's staff's private advice about the nature of the ORSA requirements with what is required by the language of the guidance manual. We continue to believe that the language of the manual contains unnecessarily prescriptive guidance that will result in a costly and voluminous filing and unnecessary internal documentation that is unlikely to meet the regulators' as yet undefined objectives for the ORSA.
- If the ORSA must comprise an explicit annual filing, then the level of prescribed detail should be limited to the type of information that will prove useful in a "desk audit" environment. In our view, an ORSA filing should provide high level summary information about the reporting organization's risk environment and ERM processes. Such a document would provide information that can be used to prioritize supervisory activity and to guide and enhance the on-site risk focused examination process.

Integration of ORSA into the U.S. Solvency Framework and NAIC Timeline

The RAA views the addition of the ORSA and state regulators' focus on ERM as the most significant potential improvement to U.S. regulation since the introduction of Risk-Based Capital. A change in the focus of solvency regulation of this magnitude requires considerably more thought regarding how the new requirements will be integrated into the U.S. solvency framework. The ORSA is a concept that derives from Solvency II, which is intended as an integrated solvency framework based on an economic measure of capital for the entire organization. Since the U.S. has a much different legal system and an existing comprehensive regulatory system based on different principles, much care is needed to ensure the ORSA is designed to work effectively without placing unnecessary burdens on the industry. While Solvency II provides regulatory capital relief to (re)insurers that have effective ERM, sophisticated internal models and risk diversification across the enterprise, the U.S. system does not.

The proposed guidance manual does not address any issues beyond the strict requirements for the annual ORSA filing. Before the guidance manual is adopted, full consideration of many other related questions must be addressed such as:

- What will be the source of the statutory authority to require the ORSA filing?
- How can states assure the confidentiality of the ORSA information? What protections are necessary to prevent sharing of this proprietary information with the NAIC, other U.S. state regulators and other insurance supervisors unless confidentiality can be assured?
- Will the ORSA filing or its internal documentation be reviewed only by the lead state of the insurance group? How can duplication of filings and regulatory reviews of the ORSA be avoided?
- What is the purpose of an annual filing when the requisite thorough understanding of a (re)insurers ERM processes can only be gained from on-site discussions with management?
- How will the information gained through the ORSA process (or filing) be used by regulators? What guidance is necessary in the Financial Examiner's or Analyst's Handbooks?
- What training of examiners and analysts or other resources are necessary to implement the ORSA requirement?
- How will the information be used in the Financial Analysis Working Group, Financial Surveillance Working Group or Examiner Team and can the information be shared with other state regulators without violating confidentiality protections?
- Will the information with respect to the group economic capital and prospective solvency assessment be collected by the NAIC? How it will be used?
- What are the regulatory benefits to (re)insurers of maintaining effective ERM processes? Solvency II grants regulatory capital relief. What about the U.S. system? One potential answer could be a new optional risk-focused financial exam approach for certain entities, where on-site exams are less frequent or only include periodic targeted procedures primarily aimed at verifying the ongoing effectiveness of ERM processes.

We do not suggest that all of these issues must be fully resolved prior to issuing a guidance manual. However, we believe that the working group should develop a more comprehensive plan for integrating the ORSA requirement into U.S. regulation before finalizing the guidance manual. During the July 8 conference call of the working group, NAIC legal staff raised several decision points that need to be resolved before finalizing the substance of the ORSA guidance and before determining the appropriate location of the ORSA authority. To date, few of these decision points have been resolved and fewer are clear in the guidance manual.

The ORSA guidance manual should not be finalized until more of these issues are clarified. Otherwise, it is certain that either the substance of the ORSA guidance will have to change or that the information obtained in the ORSA will not be useful to meet regulatory objectives. We strongly urge that the NAIC abandon the unnecessary deadline of completing the guidance manual this year.

Annual Filing

The introduction and Section 1.C. of the guidance manual makes clear that the ORSA requires an annual hardcopy filing that addresses all three sections of the ORSA. However, the proposed guidance manual is not clear on what level of detail must be included in the proposed annual filing. While Section 1 suggests that the reporting entity should *summarize or reference* (emphasis added) risk management policies, Sections 2 and 3 contain no similar language and require highly prescriptive and detailed reports that may not be summarized in the annual filing. Given the very detailed risk management policy requirements described in Section 1 items a. through m., even simple references to risk management policies in this level of prescribed detail will likely be a long list. We seriously question whether such a voluminous annual filing as contemplated in this entire guidance manual would be useful to regulators, when it will be impossible to understand complex risks and ERM processes solely by reference to a written document.

The working group should give more consideration to exactly how an annual filing will be used before requiring this level of detail. At most, the annual filing will provide a superficial snapshot of an entity or group's ERM practices and solvency position at a point in time. Such a view of the organization could be effectively used to prioritize examinations or the application of other regulatory resources. However the same objective could be achieved through a much less detailed written filing.

We suggest that the most effective and efficient way for insurance regulators to gain the necessary thorough understanding of insurers ERM processes is through meetings with management supplemented by review of internal documentation during an on-site financial examination. We believe that the NAIC's stated objectives for the recently developed risk-focused examination correspond precisely with the description of the ORSA in ICP 16 and consequently, the on-site examination is the only appropriate vehicle to implement the regulators' review of ERM.

Prescriptive Requirements

The requirements of all three sections of the ORSA guidance manual remain overly prescriptive. In recent conference calls and during the Jacksonville symposium working group members stated that their intention was that the filings be summary in nature and that much of the compliance requirements should be met by internal documentation of existing ERM processes. However, the guidance manual contains very specific guidance on the type of ERM analysis and the level of documentation required. We do not believe that the substance of the guidance manual is consistent with the stated intentions of the working group members.

We strongly believe that the most important element of a properly designed ORSA requirement is that it be principles-based and flexible so that compliance is a logical extension of an entity's or group's existing ERM processes. Prescriptive guidance will not provide regulators with useful information about a (re)insurers actual ERM processes that are necessarily customized to meet the reporting entity's specific commercial purposes. Thus an ORSA filing should include only high level summary information about the reporting organization's risk environment and ERM processes. Such a document would provide valuable information to the regulator that can be used to prioritize examinations and to guide and enhance the on-site risk focused examination.

Specific Comments on the NAIC Draft Guidance Manual

Introduction – Page 3

- The guidance manual is only intended to provide compliance information to reporting entities. However we believe it is premature to finalize the guidance for the industry until more thought is given to exactly how the information in the proposed filing is to be used. Ultimately, guidance will need to be added to the examiners' and analysts' handbooks and perhaps for other supplementary NAIC processes that will be impacted as well.
- The ORSA must be completed annually but the written report may not be requested each year. This provision appears well intentioned, but provides little benefit as long as the requirements for the written documentation remain detailed and prescriptive. The burden on industry will be producing the prescribed written documentation annually, rather than whether or not it is filed.
- While the manual is designed as guidance for the industry, it would be helpful to include more documentation as to its intended purpose and expected use by regulators. For example, the purpose might be described as "to obtain insight into the organization's risks, risk management practices and current solvency position to better allocate limited regulatory resources and to improve the risk focused examination process." This could and should be expanded, including addressing how the ORSA will be used and will enhance financial analysis and perhaps other NAIC support processes.
- The introduction would be an appropriate location to describe the overall scope of the ORSA filing and related documentation. As an example, it could describe that the expected level of ERM processes and related level of detail in the ORSA should be commensurate with the nature scope and complexity of the reporting entity's risk and operations. It would be beneficial if the introduction stated more clearly what documentation is required in the written ORSA versus what information can be summarized, referenced or should be included in an appendix. This idea is partially addressed in the first paragraph on page 4, but should be expanded.

Exemption and Waiver – Page 3

- The draft guidance manual provides the commissioner discretion to either require or waive an ORSA filing. The draft describes examples of unique circumstances for each. It strikes us as odd that the examples are different for each case. For example would not the type of business written be an equally relevant reason to grant a waiver as it would be to require an ORSA filing? We believe the rationale for either requiring an ORSA for an exempt organization or waiving the ORSA for a non-exempt organization should be based on similar characteristics.
- We are unsure what is intended by the example criteria of "availability of qualified board members" as a rationale to grant a waiver. The absence of highly qualified board members would increase regulatory risk and does not seem an appropriate rationale to waive an ORSA. Neither would this characteristic be a valid rationale for requiring an ORSA since the absence of qualified directors would likely be a symptom of overall weak ERM processes.

Item C. General Guidance – Page 3

- We appreciate that the working group has agreed that the ORSA may be filed on a group basis as most insurance organizations perform risk management processes that are applicable across their entire organization.
- This section requires an explicit filing of an ORSA that includes a report on all three major sections of the ORSA. As stated above, we do not believe that an annual filing of the level of detail prescribed will be useful to U.S. regulators. Such an annual filing would be a major additional compliance burden for the industry. We urge the working group to both make clear that the ORSA report filing will be a much higher level summary document and that the review of the ORSA documentation and related ERM processes is expected to be performed during the on-site, risk-focused examination.

- Section 3 should be re-titled “Economic Capital and Prospective Solvency Assessment.” The title implies that Section 3 is only applicable to groups when it is intended to apply to both groups and individual legal entities.

Filing Detail - Page 4

- This guidance, which suggests that not all of the supporting detail must be included in the annual ORSA filing, is helpful. However, because we believe that a thorough understanding of risks and ERM practices can only be gained through on-site discussions with management coupled with simultaneous review of supporting documentation, the requirement that “all of this information be available for submission to the department” is unnecessary and inappropriate. The ORSA filing should be completed at a much higher level than contemplated in this document.

Internationally Active Insurance Groups – Page 4

- The RAA appreciates the addition of this guidance which would allow a group ORSA filing submitted to a non-US home jurisdiction to satisfy the US ORSA requirement. This will be particularly helpful provision for RAA members, many of which have U.S. subsidiaries of groups domiciled in other major insurance jurisdictions.
- The alternative of filing separate unique ORSA’s in every jurisdiction would be unnecessarily burdensome and is contrary to the objectives of the IAIS standards and the FSAP program. U.S. acceptance of offshore group ORSA filings should encourage other jurisdictions to accept appropriately designed U.S. ORSA filings to meet their requirements, which will similarly benefit U.S. based insurance groups that operate globally.
- We do not believe that it is necessary for U.S. regulators to review these ORSA filings in relation to their compliance with ICP 16. This is unnecessary and would place individual states in the position of evaluating other jurisdictions’ compliance with international standards. This is the role of the FSAP program, not of state regulators. Instead, U.S. regulators receiving such an ORSA filing should evaluate it only with respect to its compliance with their own state’s ORSA filing requirements. If it is the judgment of the U.S. group regulator that more information is needed, that information could be obtained during the course of an on-site examination of the U.S. entities in the group as it is for every other ORSA filing.

Extension – Page 4

- Commissioner discretion regarding a possible time extension for filing the ORSA document is a necessary and welcome provision in the guidance manual. However, the proposed filing deadline should also be included in the guidance manual. Since the ORSA filing is representative of an ongoing process rather than a point in time evaluation, the due date should not be particularly time sensitive and should be timed to avoid other statutory filing and audit deadlines.

Risk Management Policy – Pages 5 & 6

- We support the descriptions and guidance provided in the key principles.
- The level of prescribed detail for documenting risk management policies is unjustifiably high. Examples from this section that we consider too detailed include:
 - a. Identify all relevant and material risk categories
 - b. Describe any processes and methods
 - b. Describe the relationship between any risk tolerance statements and capital requirements both regulatory and economic
 - The prescriptive list of specific risk policies and individual subsidiary risks described in subsections c. through m.

- We believe that such a requirement will result in unnecessarily detailed documentation of policies that in most instances will not reflect the actual policies used to manage the reporting organization's risks.
- Rather than require this level of prescribed detail, this section should include only a general requirement that the reporting organization report an overview of its major risk policies that it uses in its own ERM processes. An open and more free form requirement will provide more useful information on the comprehensiveness of the organization's actual policies and practices and will allow regulators to judge whether the organization should be prioritized for further evaluation during an on-site risk-focused examination.
- We also question whether an annual filing of risk management policies is necessary. After the initial filing, it should only be necessary to annually provide a description of material changes in any significant risk management policies or practices.

Quantitative Measurement of Risk Exposure – Page 7

- We believe that this section is similarly too detailed and prescriptive because it requires quantitative measurements of exposure for each of the many prescribed risk categories required in Section 1.
- The guidance manual also requires this detailed analysis for each of these risk categories in both normal and stressed conditions. It goes on to require detailed descriptions and explanations of the risks identified, measurement approaches used, key assumptions, and outcomes of any plausible adverse scenarios. This level of detail is unlikely to be useful in any regulatory process other than an on-site exam, so it should not be included in the annual ORSA filing except in very high level summary form.
- The suggestion that the regulator may require mapping of stress test results down to the legal entity is not appropriate. Often stress tests are not mapped down to the individual entity level and the requirement is not in line with the spirit of the ORSA, which should reflect management's own systems and processes.
- For the same reasons, the regulator should not have input into the level of stress that should be considered for each risk category, which stress factors should be applied, which assumptions or parameters should be used, etc. In our opinion, these requirements cross the line between regulation and management of the enterprise.

Group Economic Capital – pages 8 & 9

- The reference to group economic capital in the title is confusing. In other section of the document it states that ORSA's may be prepared on a legal entity basis. Similarly, the first sentence should replace the word "company" which implies legal entity with "organization" or "enterprise," which could mean either legal entity or group.
- Requiring a single group economic capital number as of the prior year-end date is problematic without understanding how the information will be collected and used by the NAIC or individual state regulators. This information will be highly subjective and will not be comparable to other organizations' economic capital measures, given the obvious differences in the nature of risks, methods, assumptions, stresses, etc. used for determining the target capital level.
- The value in this section for regulators appears to reside in gaining an understanding of how an organization combines the elements of its ERM processes and quantitative projections in its own evaluation of its internal capital requirements over a (management determined) time horizon, rather than defining a single entity or group capital amount.
- The narrative description proposed in the draft guidance manual seems like the appropriate level of detail to provide regulators the necessary insight into this process. This insight should give regulators sufficient information to evaluate whether an insurer or group should be subject to more thorough review on an examination.

- The additional factors listed in the bullet points at the bottom of page 8 and top of page 9 are unnecessary and overly prescriptive. These considerations should be incorporated at the discretion of management and documented in the summary narrative description.

Prospective Solvency Assessment – Page 9

- This section should be simplified to reduce the regulatory burden and reflect the reporting entity's own internal processes. We do not believe it should be necessary to document that the organization will meet its regulatory and economic capital requirements over a defined 2 to 5 year time horizon. Instead the target capital used for this purpose should be the organization's own internal target capital, whether that is economic, regulatory, rating agency or some other measure.
- We agree that the prospective solvency assessment should consider normal and stressed environments. However, this prospective assessment requires a very complex and intensive process including sophisticated internal models that may not exist at all enterprises. We believe that the guidance manual should recognize this section as more aspirational in nature than other sections of the ORSA.

Thank you for the opportunity to comment on the draft NAIC ORSA Guidance Manual. We look forward to working with the NAIC to develop an appropriate U.S. ORSA requirement. Should you have comments or questions about this letter, please contact me.

Sincerely,



Joseph B. Sieverling
Senior Vice President

cc: David Vacca, NAIC



D. Keith Bell

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August 25, 2011

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Mr. Danny Saenz, Co-Chairman
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Via E-mail: Dvacca@naic.org

Re: NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual

Dear Co-Chairs Huff and Saenz:

Travelers appreciates the opportunity to comment on the NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual. Travelers has an extensive Enterprise Risk Management (ERM) process that includes the assessment of risk and determination of target capital levels. We encourage the promulgation of sound ERM practices and believe there are significant benefits to be gained by a company's stakeholders from an effective ERM process.

We believe that ERM is recognized in the NAIC Financial Condition Examiners Handbook and are very supportive of making ERM an explicit requirement. We are also very supportive of having a requirement that will assist regulators in understanding the risks within insurers/insurance groups and how those risks are being evaluated and mitigated, and how the appropriate capital level is being determined as part of the analysis. However, we are very concerned that the ORSA Guidance Manual (Manual) as drafted requires a static, voluminous document as opposed to evidence of an ongoing ERM process that includes an own risk and solvency assessment. We believe that this concern, along with a lack of an objective and guiding principles and the prescriptive nature of the Manual, will not lead to information that is useful to regulators.

Objective

We believe that the first step in developing an ERM/ORSA requirement should be to determine the purpose of the requirement. Through the open meetings we have heard two different objectives, first is the ability of the NAIC to assert compliance with the International Association of Insurance Supervisors ICP 16 - *Enterprise Risk Management* (ICP 16), and the second is to give regulators insight on how insurers assess and mitigate risk and determine the "right size" of

capital. These two concepts are not necessarily mutually exclusive as achieving the second objective should allow the NAIC to assert compliance with the first objective using an outcomes-based approach. However, meeting the first objective without meeting the second produces results that are much more compliance based without providing useful information to regulators.

We recommend that the NAIC include the following objective in requiring ERM: Require insurers to have an ongoing ERM/ORSA process and be able to provide sufficient evidence of that process to regulators during the course of the financial examination process. The evidence of the ERM process will assist regulators in understanding how insurer(s) continually evaluate and mitigate risk and determine the appropriate capital level for retained risk. In addition, through the NAIC Financial Condition Examiners Handbook, regulators should be responsible for the review of sufficient evidence to have an understanding of the insurer/insurance group's risk management and capital management in order to determine the appropriate examination scope.

Prescriptive Nature

The proposed filing (Section 1 of the Manual) is extremely prescriptive, requiring that Section 1 of the ORSA summarize or reference the following:

- ✓ All relevant and material risk categories,
- ✓ all processes and methods for monitoring risk,
- ✓ all underwriting policies,
- ✓ all claims underwriting or claims processing policies implemented to manage "any" risk,
- ✓ all anti-fraud policies,
- ✓ all asset-liability management activities,
- ✓ all policies or programs for retaining customers,
- ✓ all activity related to mergers, and
- ✓ all other management activity designed to assess enterprise risk not in the above.

The result of documenting all of the required items would be a document so large that the volume of information that would have to be provided would make it nearly impossible for the regulators to find it useful. Simply producing a listing of all of the underwriting, claim management, anti-fraud and customer retention policies would create a voluminous document. The listing of underwriting policies for a property and casualty insurer/insurance group alone would be unwieldy as each type of product has many different underwriting policies dependent upon the type of account. For example, workers compensation would have different policies for each different job category and/or industry.

We are also troubled by the prescriptive nature of Section 2 and Section 3 as well as the Appendix for property and casualty insurers. An assessment of risk should be through the eyes of management and not based on what "a regulator may desire to observe". We note that while the Appendix is intended as an example, its inclusion in the Manual may indicate to regulators that insurers are expected to complete it or something similar. We also note that the risks listed are inconsistent with the risks in the NAIC Financial Condition Examiners Handbook and some of the risks are not meaningful or quantifiable in a property and casualty context.

Travelers believes that there should be a proper integration of ERM into the business decision process that creates value and generates acceptable returns for investors. That process should reflect a company's unique culture and must support the achievement of each company's mission and objectives. Travelers believes that a company needs to develop its own strategies, plans,

practices, tools and methodologies to pursue its own mission and objectives while taking into consideration regulatory and rating agency constraints. Therefore, what companies need most are guiding principles rather than prescriptive rules or documentation requirements.

For a more detailed discussion of specific concerns with the Manual, please see the attached Appendix.

Conclusion

We believe that the evaluation of one's own risks is a necessary part of managing an on-going enterprise, insurer or otherwise. However, there is a significant difference between an evaluation of the process and the documentation of the process. We believe that the proposed Manual would convert a key facet of good management into an overly detailed documentation exercise that would require significant resources with added costs for insurers.

We also are extremely skeptical that any static summarized document could provide useful information to regulators in understanding how a company addresses risk on a daily basis. In fact, many of the presentations that have been given to rating agencies and regulators include well over 100 slides and consist of documents generated for the purposes of managing risk internally, not for purposes of the presentations. In addition, we believe that for property and casualty insurers, any required summary document has the significant risk in being stale shortly after it's filed. The specific content varies from quarter to quarter, just as the risk environment changes from quarter to quarter.

Travelers Recommendation

Travelers is supportive of the NAIC developing a requirement that insurers must have a functioning and effective ERM process. Additionally, we note that an insurer's ERM process is already recognized and currently used in setting the scope of regulatory financial examinations. Considering this, we do not feel that a prescriptive manual is necessary to require ERM, but instead believe the requirement could be added to an existing law or regulation. For confidentiality reasons, we believe that any requirement to make available an insurers/insurance group's ERM information to regulators should be done as part of the financial examination process and included in the NAIC Financial Condition Examiners Handbook.

Based on the concerns described in this letter, we do not recommend a prescribed filing. A more effective alternative would be to require annual or biennial meetings (or more frequent, as appropriate) between the domiciliary regulator and the insurer to discuss the insurer's ERM process and latest results. This is similar to the rating agency approach and we believe this interaction would provide regulators meaningful insight as to how insurers evaluate and mitigate risk. Insurers should also be required to notify the domiciliary regulator if a material change in risks or mitigation strategies has occurred.

We believe that these suggestions would allow regulators to gain meaningful insight to insurers/insurance groups ERM process while allowing the NAIC to assert compliance with ICP 16 on an outcomes-based approach.

Thank for you the opportunity to comment. We would be very pleased to discuss our views at the upcoming meeting in Philadelphia.

Group Solvency Issues Working Group
August 25, 2011
Page 4

Sincerely,

A handwritten signature in black ink that reads "D. Keith Bell". The signature is written in a cursive style with a large, prominent initial "D".

Keith Bell

dkb1128.doc

cc: Bill Hannon
Larry Mills
David Vacca, NAIC staff

APPENDIX

Section 1

This section requires that the “*ORSA should document ... the insurer/group’s risk management policies.*” It then states that these policies should identify a list of items, many of which include the phrase “*any*”. In this case, “any” implies “all”. There is no mention of materiality in any other than the first item of this list. We understand that one interpretation is that the intent of this requirement is for a 2 to 3 page document, yet just listing all the items that are requested by these bullet points would take up more than those 2 or 3 pages. If the resulting output is intended to be only a few pages, then **we recommend a major rewrite be undertaken of this section with that goal in mind**. In particular, we strongly recommend that this section clearly split the requirement to perform an ORSA from the summary report that the NAIC may be requesting.

Section 2

This section requires that the ORSA “*document*” the resulting assessment for each risk category identified in Section 1. We assume this refers only to the first bullet in Section 1, where the words “*all relevant and material*” are used. We recommend that the wording be changed to “*reasonably foreseeable and relevant material*” to be consistent with ICP 16. It is not always possible to predict which risks will be material – e.g., the risk of a coordinated terrorist attack on major places of business with jet airliners.

Additionally, the manual states that “*Section 2 should include detailed descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made and outcomes of any plausible adverse scenarios that are run*”. The use of the word “detailed” will lead to long explanations of risks, measurement approaches, key assumptions and plausible scenarios run. This requirement for “detailed” documentation may also discourage the running of many scenarios, due to the overhead costs that this documentation requirement adds to those efforts.

The phrase “experience studies” is not used in property/casualty insurance. We suggest that it be deleted, as it does not seem to be needed in the current wording. In general, we note that the request for expected values does not need to discuss stochastic versus other approaches – merely stating the reporting objective should be sufficient.

Regarding stress scenarios for stochastically modeled risks, we caution against relying too heavily on a set percentile, VaR or TVaR for selecting a stress “event”. The recent financial crisis resulted in outcomes that were considered nearly impossible according to some firms’ stochastic model assumptions. Hence, such stochastic modeling is not always sufficiently reliable for stress testing. It may be desirable to instead allow for scenario testing in all cases, or reverse stress testing – evaluating the scenarios or situations that would cause a failure – and then evaluating the likelihood or the series of events that would lead to that scenario.

Section 3

This section requires the documentation of a company’s capital management strategy over the “longer term business cycle such as the next 2-5 years”. We caution that this requirement needs to be consistent with the underlying products that are sold. For short-duration policies that are re-

underwritten and re-priced every 6 to 12 months, longer term planning on a detailed basis is typically unreliable.

We advise against the inclusion of the current Attachment 2, a “sample” output from a property/casualty insurer’s ORSA. It assumes the same format for assessing all risk items, which we have found to be ill-advised in practice. It also includes “expense” as a risk expected to be “material”, contrary to what is normally found for property/casualty. If a sample is desired, we recommend that the NAIC use as examples excerpts from various disclosures by publicly traded insurers in their annual 10-K filings with the SEC.

Stephen W. Broadie
Vice President, Financial Policy

August 26, 2011

Director John M. Huff
Missouri Department of Insurance
Co-chair, NAIC Group Solvency Issues (EX) Working Group

Senior Associate Commissioner Danny Saenz
Texas Department of Insurance
Co-chair, NAIC Group Solvency Issues (EX) Working Group

Re: Proposed NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual

Dear Director Huff and Commissioner Saenz:

Attached is the Property Casualty Insurers Association of America's (PCI) response to the Working Group's draft of an Own Risk and Solvency Assessment (ORSA) Guidance Manual ("Manual"). PCI's 1,000 member property/casualty insurers write \$180 billion annual direct written premium, 38.3 percent of the U.S. property/casualty insurance market.

As the Working Group has asked, PCI has proposed revisions to the draft Manual. These proposed revisions, however, along with the other submissions the Working Group will receive, should not be viewed as final comments refining a document that is near completion. Rather they should be viewed as another important step in a process that, if continued with the deliberation that has characterized the Working Group's work to this point, promises to result in an ORSA process that will add value for both insurers and regulators and enhance U.S. regulators' leading role in international insurance supervision.

We cannot state too strongly, however, our concern about the current timeline for this process, which we believe is driving it toward a premature conclusion risking adverse impacts on U.S. insurers, regulators and policyholders. The diversity of the comments the Working Group will receive from industry and other interested parties should illustrate the need for additional time. As PCI and seven other industry associations commented to the Working Group several weeks ago:

The self-imposed deadline of late 2011 for completion of this proposal suggests an urgency that is likely to be detrimental to the final product. Although we understand the basis for this proposal comes in part from International Association of Insurance Supervisors' Insurance Core Principle (ICP) 16, it is our understanding that the US will not be subject to ICP 16 as part of the FSAP review process until at least 2015. Also, ICP 16 explicitly states that it is not a compulsory set of requirements. Rather, it is an aspirational document, and the goals of ICP 16 can be achieved over time. Consequently, there is time to take a more deliberate approach in developing a final proposal and, in particular, to consider how insurers and regulators will implement this proposal as there are resource implications associated with both. We strongly recommend that the ORSA development timeline be expanded to allow creation of a work product that reflects existing ERM practices and other jurisdictions' views of the ORSA. ORSA also needs to be harmonized with the US legal system, existing regulatory requirements, and developing capabilities of the US industry and regulators.

We understand that IAIS members will be asked to begin self-assessments using the ICPs in the near future. We emphasize, however, that no other jurisdiction yet imposes an ORSA. In fact, the Solvency II ORSA requirement in the European Union continues to undergo revision and Solvency II itself is not yet in effect. In any case, the NAIC is making good progress toward an ORSA requirement. In developing a regulatory tool

that could either promote good risk management or encumber it with conflicting or excessive guidance, it is of paramount importance to get it right, rather than to get it done fast.

PCI believes it is entirely possible for the Working Group to develop a revised schedule for completion of the ORSA project that complies with the Solvency Modernization Initiative Roadmap's goal that all major SMI policy decisions be completed by the end of 2012, while taking the time necessary to develop a solid ORSA requirement that will enhance insurer risk management and that regulators can appropriately use. We strongly urge the Working Group to do so, and we pledge our best efforts to assist you in this endeavor.

If you have any questions, please feel free to contact me at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "Step W Broadie". The signature is fluid and cursive, with a prominent initial "S" and a long, sweeping underline.

Stephen W. Broadie

NAIC OWN RISK AND SOLVENCY ASSESSMENT (ORSA) GUIDANCE MANUAL

DRAFT (8/5/11)

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 to provide guidance to insurers and/or insurance groups on performing their own risk and solvency assessments (ORSA) as required by (the NAIC's Model Law on Examinations?). The ORSA shall be completed at least annually in order for the insurer/group and the regulator to assess the adequacy of the insurer's risk management and current, and likely future, solvency position. A full ORSA, including a brief confidential summary report ("ORSA Report"), should be required during the year of a state financial examination (or, in the case of a group, the year in which the lead state of the group begins its examination). The ORSA should be reviewed as part of the standard examination work. If material changes occur in an insurer's/group's risk profile during the interim period between examinations, the insurer/group shall be required to file a brief confidential written update ("ORSA Report Update") of the ORSA Report with the lead state regulator limited to such material changes in the risk profile.

In the case of an insurance group, the ORSA shall be performed at the same level within the group at which the group performs its risk management. If the group performs its risk management at a level other than the legal entity level, separate ORSAs will not be required at the legal entity level.

A. Exemption

An insurer and/or group 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 assumed premium including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program and excluding affiliated reinsurance premium, is less than \$1,000,000,000.

A commissioner has authority to require an ORSA Report Update if the insurer and/or an insurer within the insurance group 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/group 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

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Comment [TL1]: We are concerned that the Model Holding Company Regulation does not provide authority for a state to impose the ORSA requirement.

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not limited to, the type of business entity, volume of business written, availability of qualified board members, or the ownership or organizational structure of the entity.

C. General Guidance

~~The ORSA is an insurer's/ group's "own" risk and solvency assessment, based upon the manner in which the insurer performs its own risk management. The ORSA Report should be a brief written document describing in narrative the following:~~

- . Section 1 - Description of the Risk Management Policy
- . Section 2 - Quantitative Measurements of Risk Exposure in Normal and Stressed Environments
- . Section 3 – Group Economic Capital and Prospective Solvency Assessment

Guidance for completing each section is noted below. ~~In order to avoid excessive volumes of detail or supporting documents for complex insurance groups, an insurer may simply reference other explanatory documents within the ORSA Report, as long as those documents are available to the regulator upon request. If the referencing of other detailed documentation is performed, a summary index is requested.~~

~~An insurance group writing international business that is required to file documentation of its ORSA with another jurisdiction may be able to satisfy the filing requirement by providing documentation of the ORSA that has been provided to another jurisdiction who serves as the group-wide supervisor. This ORSA documentation will be reviewed in relation to the U.S. NAIC ORSA Guidance Manual to determine if additional information is needed.~~

D. Extensions

An extension for the due date of submission of the ORSA ~~Report~~ may be granted at the discretion of the Commissioner.

II. SECTION 1 – DESCRIPTION OF THE RISK MANAGEMENT POLICY

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.

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Deleted: the resulting ORSA filing should contain three major sections as follows

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Deleted: Insurance Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) 16 Enterprise Risk Management (ERM) and

Deleted: The U.S. state regulator might also review and consider the applicable jurisdiction's FSAP and IAIS Self-Assessment in relation to ICP 16.

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- . 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/group; 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.

The risk management process should:

- Identify all relevant and material risk categories and describe how those risk categories are managed on a day-to-day operational basis as the insurer/group executes its business strategy.
- Describe any processes and methods used for monitoring risk and should include any risk tolerance statements and describe the relationship between any risk tolerance statements and capital requirements, both regulatory and economic.
- Include the insurer's/group's investment policy, which should specify the nature, role and extent of the insurer's/group's investment activities, how the investment policy complies with the solvency regime's investment requirements and specifies explicit risk management procedures regarding more complex and less transparent classes of assets and investments in markets or instruments that may be subject to less governance or regulation. The investment policy should address credit risk, market risk, liquidity risk and any counterparty risk that may be associated with any hedging programs. The ORSA Report should summarize the insurer's/group's own internal analysis processes used to identify such risks.
- Include any underwriting policy used by the insurer/group to manage underwriting risk that is material at the level at which the insurer/group performs its ERM.
- Include a description of any asset-liability management (ALM) activities which clearly specifies the nature, role and extent of ALM activities and the relationship with product development, pricing and investment management functions.
- Include a description of any reinsurance counterparty policy related to any reinsurance programs the insurer/group has in effect.
- Include, if applicable, any management activities or policy related to processes of identifying, assessing, measuring, monitoring, controlling and mitigating risks associated with group membership.
- Include a description of how compensation and incentives are assessed and considered within the ERM Framework.
- Include a description of any other management activity, policy or program designed to assess enterprise risk not already described in a category above.

Deleted: Section 1 of the ORSA should document the aforementioned ERM Framework principles, if present, as well as summarize or reference (e.g. in an appendix) the insurer/group's risk management policies.

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Comment [TL2]: The deleted language here is an ERM or investment risk requirement, not part of the ORSA.

Deleted: and not rely exclusively on investment managers or rating agencies and their use of diversification to mitigate such risks

Deleted: and describe the relationship of the underwriting policy to product design and product pricing.

Deleted: e. Include any claims underwriting or claims processing policies implemented by the insurer/group to manage any risks associated with determining whether claims are covered under the contract and how claim amounts are determined. ¶
f. Include a description of any anti-fraud policies that have been implemented to detect fraud in filing of claims. ¶

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Deleted: h. Include a description of any retention or conservation policy or program designed to retain assets, policies in force or market share. Such programs may include multiple coverage discounts, extra interest credits or other policyholder options. ¶
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Deleted: k. Include any activity related to mergers or acquisitions of business including a description of the policy or program for completing due diligence on the transaction. ¶
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The ORSA Report should summarize how the insurer's/group's management uses its risk management policy, including a summary of risk tolerance statements and limits used in its day-to-day operations as it executes its business strategy. The ORSA Report should discuss information, management processes, and assessment tools (feedback loops) used to monitor and respond to any changes in the insurer's/group's risk profile due to economic changes, operational changes, or changes in its business strategy. The ORSA Report should also disclose how the risk management policy is related and tied to the determination of the amount and quality of the insurer's/group's economic capital and regulatory capital.

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III. SECTION 2 - QUANTITATIVE MEASUREMENTS OF RISK EXPOSURE IN NORMAL AND STRESSED ENVIRONMENTS

Section 2 of the ORSA Report should document quantitative measurements of risk exposure in both normal and stressed environments for each risk category identified in Section 1. This quantitative measurement process should require a quantification of risks under a range of outcomes using risk measurement techniques that are appropriate to the nature, scale and complexity of the risks. Examples of relevant material risk categories may include, but not be limited to, credit, market, liquidity, cash flow mismatch, underwriting, claim, expense, operational and risks associated with group membership. Although it is recognized that some stress tests for certain risks may be performed at the insurance group level, the regulator may request additional information to map the results to an individual insurer, 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.

Because the risk profile of each insurer/group is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer/group should run, however the regulator may have input regarding the level of stress that company management should consider for each risk category. Unless a particular assumption is stochastically modeled, the group's management will be setting its assumptions regarding the expected values based on its current anticipated experience studies and what it expects to unfold over the next year. The regulator may provide input to an insurer/group'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.

IV. SECTION 3 – GROUP ECONOMIC CAPITAL AND PROSPECTIVE SOLVENCY ASSESSMENT

Section 3 of the ORSA Report should document how the insurer/group 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 business over a prospective time period of at least two years.

Group Economic Capital

Insurance groups 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. This

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Deleted: Section 2 should include detailed descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made and outcomes of any plausible adverse scenarios that are run.

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Comment [TL3]: We recommend deletion of the risk tolerance paragraph because the language is ERM guidance that is far too detailed to be summarized in the ORSA Report. The risk tolerance statements should be reviewed in the risk-focused examination.

Deleted: 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.

¶ Within the Appendix are three examples that illustrate the types of outcomes of risk measurement a regulator may desire to observe for risk categories identified within a life insurance company (attachment 1), a property casualty company (attachment 2) and a health insurance company (attachment 3). These examples are not intended to be used as prescribed templates. ¶

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Comment [TL4]: Many P/C companies do not project results in sufficient detail five years forward.

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section is intended to help regulators understand insurers' capital adequacy in relation to the risk profiles.

On an annual basis, the group should conduct a group economic capital assessment, and include it within its ORSA Report upon examination. During interim periods, this information may also be requested by the commissioner in an ORSA Report Update if needed.

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The figure representing the group economic capital should be supported with a narrative briefly summarizing the following:

1. Definition of solvency – Describe how the insurer and/or group defines solvency (e.g. Cash flow basis, balance sheet basis, etc.). If balance sheet basis, what basis of accounting is used?
2. Time horizon of risk exposure – Describe the time horizon modeled, such as one year, lifetime, etc.
3. Risks to model – Describe high-level risks and materiality (e.g. immaterial or material).
4. How risks are quantified – Describe the stress tests, stochastic modeling or factors utilized in the quantification, as well as, the methodology for allocating the group capital across insurance legal entities.
5. Measurement metric – Describe the measurement metric, such as value at risk in percentile (quantifies the capital needed to withstand a loss at a certain probability), tail value at risk (quantifies the capital needed to withstand average losses above a certain probability), probability to ruin (quantifies the probability of ruin given the capital held), etc.
6. Target level of capital – Describe the target capital for the group's business objectives.
7. Reflecting diversification – Describe any diversification benefits and amount that is being used to spread around the risks to which the group is exposed.

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The approach and assessment of group economic capital should also consider the following:

Deleted: -wide capital adequacy

- . Eliminate intra-group transactions and consequently double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities.
- . Take account of the level of leverage, if any, resulting from holding company debt.
- . Clearly identify diversification credits and adequately address 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.
- . Reflect the effects of contagion risk, concentration risk and complexity risk in their group capital assessment.

The goal of the assessment is for management to provide an overall determination of group economic capital, based upon the nature, scale and complexity of risk within the group. Group capital should not be perceived as the minimum amount of capital before regulatory action will result (e.g. US risk-based

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capital 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

Most insurers/groups, as part of their strategic planning process, compile a prospective business plan. The ORSA Report should include an assessment of the insurer’s/group’s financial resources over a time period of at least two years.

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- Deleted: 2-5
- Deleted: year
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- Comment [TL5]: See comment 4.

The prospective solvency assessment is in effect a feedback loop. The insurer/group 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 business plan. The prospective solvency assessment should also consider both normal and stressed environments.

Section 3 of the ORSA documentation should demonstrate how the insurer/group 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 business over the longer term business cycle.

Deleted: Section 3 of the ORSA should contain a demonstration and documentation that; given the current capital requirements both economic and regulatory, the quality of that capital, the current risk management policy consisting of its current risk tolerance limits, current risk exposure amounts in both a normal and stressed environments and the projected 2-5 year business plan; the company has the financial resources necessary to execute its 2-5 year business plan. If the insurer/group does not have the necessary financial capital or quality of capital to execute the 2-5 year business plan, the insurer/group should describe the management actions it will take or describe any modifications to the business plan it has made to resolve the adequacy of its financial capital, including potential other resources of capital. ¶
¶
The prospective solvency assessment is in effect a feedback loop. The insurer/group 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 2-5 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 insurer, 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 consider any constraints on group capital or the movement of group capital to legal entities.

- Deleted: insurance
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¶
Below are three examples that illustrate how the types of outcomes of risk measurement a regulator may desire to observe for risk categories identified within a life insurance company (attachment 1), a property casualty company (attachment 2) and a health insurance company (attachment 3). For each risk category identified, the minimum quantitative elements that could be reported are the notional amount of risk which identifies the total exposure the insurer has to that particular risk, the expected value of that risk under normal conditions which identifies the amount of expected payment under normal conditions due to that risk over the next year and the expected value of that risk under stressed conditions which identifies the amount of expected payment under stressed conditions due to that risk over the next year. The regulator may also desire to observe for each risk category a reverse stress test which would identify, given the insurer's current economic capital, the level of the stress factor which would have to unfold to cause the insurer to fail. Reverse stress testing can be helpful in identifying the risks that are most likely to cause an insurer to fail. These examples are not intended to be used as prescribed templates. ¶

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¶
Risk Category Notional ¶
Amount ¶
Expected Value ¶
Normal Expected Value ¶
Stressed Reverse Stress ¶
Test ¶
Measurement ¶
Type Mortality (NAR)¶
Longevity Lapse Non-forfeiture Interest
RateMarketUnderwritingExpenseCreditP
re-paymentOperationalCounter-
partyRisk Category Notional ¶
Amount ¶
Expected Value ¶
Normal Expected Value ¶
Stressed Reverse Stress ¶
Test ¶
Measurement ¶
TypeReservingUnderwritingExpenseCata
stropheCreditOperationalCounter-
partyRisk Category Notional ¶
Amount ¶
Expected Value ¶
Normal Expected Value ¶
Stressed Reverse Stress ¶
Test ¶
Measurement ¶

By identifying each material risk category independently and reporting notional amounts, expected amounts in both normal and stressed conditions, insurer/group management and the regulator are in a much better position to evaluate certain risk combinations that could cause an insurer/group to fail. One of the most difficult exercises in modeling insurer/group 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.

V. APPENDIX

Below are three examples that illustrate how the types of outcomes of risk measurement a regulator may desire to observe for risk categories identified within a life insurance company (attachment 1), a property casualty company (attachment 2) and a health insurance company (attachment 3). For each risk category identified, the minimum quantitative elements that could be reported are the notional amount of risk which identifies the total exposure the insurer has to that particular risk, the expected value of that risk under normal conditions which identifies the amount of expected payment under normal conditions due to that risk over the next year and the expected value of that risk under stressed conditions which identifies the amount of expected payment under stressed conditions due to that risk over the next year. The regulator may also desire to observe for each risk category a reverse stress test which would identify, given the insurer's current economic capital, the level of the stress factor which would have to unfold to cause the insurer to fail. Reverse stress testing can be helpful in identifying the risks that are most likely to cause an insurer to fail. These examples are not intended to be used as prescribed templates.

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Risk Category Notional

Amount

Expected Value

Normal Expected Value

Stressed Reverse Stress

Test

Measurement

Type Mortality (NAR)

Longevity Lapse Non-forfeiture Interest RateMarketUnderwritingExpenseCreditPre-

paymentOperationalCounter-partyRisk Category Notional

Amount

Expected Value

Normal Expected Value
Stressed Reverse Stress
Test
Measurement
TypeReservingUnderwritingExpenseCatastropheCreditOperationalCounter-partyRisk Category
Notional
Amount
Expected Value
Normal Expected Value
Stressed Reverse Stress
Test
Measurement
TypeMorbidityMortalityLapseNon-forfeitureInflationUnderwritingClaimExpenseCreditPre-
paymentOperationalCounter-party

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Attachment 3 - ExampleHealth Insurance Company

Attachment 1 - ExampleLife Insurance Company

Attachment 2 - ExampleProperty/Casualty Insurance Company