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HOW TO REVIEW AN ORSA

Co-Sponsoring Organizations:

Four C's for Reviewing an ORSA Report

By Joonghee Huh

The primary goals of ORSA are to foster an effective level of enterprise risk management as well as to provide a group-level perspective on risk and capital to supplement the existing legal entity view. An ideal ORSA report should evidence that these two goals are adequately met through the ORSA process. Depending on the nature of the businesses of the company, the ORSA report will be inevitably varying substantially from one company to another in terms of contents and structure. However, there are general common attributes that a good ORSA report should reflect and a reviewer should look for. These attributes can be summarized as four C's: Comprehensiveness, Consistency, Comparability, and Consumability.

Comprehensiveness

An ORSA report should depict a comprehensive picture of the company's risk profile, and this can be achieved by addressing following three key components: (i) risk factor coverage, (ii) source of risk, and (iii) manifestation of risk in the company's financials. The report should cover all relevant risk factors, such as credit risk, market risk, insurance risk, operational risk, and strategic risk. In order to provide insight into the source of these risks, the report should outline the composition of asset portfolios as well as characteristics of product liabilities, describe how these risks may be realized from these asset/liability portfolios, and comment on possible interplay between multiple risk factors. As an example, for universal life products, presence of guaranteed minimum rates can be a source of interest rate risk, and possibly contribute toward policyholder behavior risk by causing persistent lower lapses under a prolonged low interest rate environment. Then the report should also comment on how these risks manifest itself in the company's financials from various lenses including economic capital, GAAP, statutory, etc. The discussion should identify timing of risk emergence under stress events, and demonstrate how the company will cope with these risks and their consequences in the company's financials.

Qualitative description of the risk management process should also be complete, covering all the components of the risk management cycle ranging from risk identification, measurement, management, and reporting.

A comprehensive report will help strengthen creditability of the content of the ORSA report as well the ERM program of the company.

Consistency

In all three sections of an ORSA report (i.e. Section I: Risk management policy, Section II: Insurer's assessment of risk exposure, and Section III: Group risk capital and prospective solvency assessment), the description of risk identification, measurement, and assessment of capital adequacy should be a coherent narrative across the three sections of the report. Here are some examples of consistency that should be maintained in the ORSA report:

- Any material risk factors identified in Section I of the report should be quantified in Section II. Similarly, quantification approaches used in Section II should be coherent to the quantitative measures used to determine capital adequacy in Section III.

- Results of risk quantification in Section II should support and comply with the risk appetite, tolerances, and limits defined in Section I. Moreover, for the capital and solvency assessment in Section III, the report needs to demonstrate that the risk profile, under normal and stress scenarios, remains within the bounds of the risk policies as defined in Section I; otherwise, there should be a clear remediation strategy to cure violations of these policies.

- Normal and stress scenarios used throughout three sections should be chosen consistently with appropriate rationales. Moreover, all modeling assumptions should be applied consistently to all the risk and capital analysis throughout the report.

A consistent report will make evident that different components of risk and capital management processes such as risk policy, risk management, and capital planning, are well coordinated, and, therefore, will help adding credibility to its content.

Comparability

Open-ended nature of the ORSA report poses an inherent challenge for a reviewer to compare one company's report with others'. Unless a common set of stress scenarios are defined by the regulators, direct quantitative comparison, similar to what is done for Federal Reserve's Comprehensive Capital Analysis and Review (a.k.a. CCAR) testing for bank holding companies, across the industry cannot be easily done. However, an ideal ORSA report should nevertheless strive to facilitate qualitative and quantitative comparison across the industry, and this comparison can be supported by transparency and ample granularity of the report.

For qualitative measures, the description of the risk management process and governance structure should be sufficiently thorough and clear for a reviewer to assess and determine qualitative ratings. For quantitative measures such as risk quantification, all the underlying assumptions (e.g. risk factor scenarios and modeling assumptions) should be provided in detail, so that appropriate adjustments can be applied in comparing results from several related companies.

A comparable report will increase transparency of the analysis supported by details, and facilitate peer comparison to gauge the company's practice relative to the industry best practice.

Consumability

The intent of ORSA should not be just a regulatory exercise, but to be embedded in the company's risk management culture and processes to further promote effective ERM within the organization. The ORSA report should be prepared to be read not only by regulators, but also by various stakeholders. These stakeholders could include internal personnel who contribute toward the risk management process and also others such as the board and possibly rating agencies who want to gain better insight into and evaluate the ERM practice of the company.

In order for the ORSA report to be consumable, the report should delineate capital and risk management processes currently used by the management today rather than a theoretic framework. For example, capital and risk measures used in the report should be the metrics that are actually used for business decisions such as capital allocation and performance measurements. Also, the capital forecast should be in sync with the company's annual financial and capital planning processes, and the remediation plan under stress scenarios should be consistent to expectations of senior management and the board.

Moreover, the report should be prepared in collaboration with, and well supported by various constituencies including finance, actuarial, and portfolio management, not simply by ERM as a silo. A collaborative work will naturally lead to a consumable report.

A reviewer should determine consumability of the ORSA report based on informativeness of the content as well as the way the report was prepared. A consumable report will help cultivate good risk culture within the organization and promote effective ERM with a company-wide support.

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Conclusion

The four C's highlighted in this paper are not meant to be an exhaustive list of attributes that a reviewer should look for in an ORSA report. Depending on different businesses that insurers are involved in, the ORSA report will likely have numerous idiosyncratic components specific to each company, and these would need to be reviewed with various other considerations. However, these four C's are common key attributes that every ideal ORSA report should have, since they are good indicators of whether ORSA process and the ORSA report are accomplishing their intended goals.

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