JOINT RISK MANAGEMENT SECTION
Canadian Institute of Actuaries
Casualty Actuarial Society
Society of Actuaries

HOW TO REVIEW AN ORSA

Co-Sponsoring Organizations:

Regulatory Review of ORSA Framework

By Laura A. Maxwell

Own Risk Solvency Assessment (ORSA) reports are an important way for regulators to ensure that insurance companies are managing their enterprise-wide risks. Each company's report will need to be appropriate for the nature, scale and complexity of the company's risks. Although the details will vary significantly between companies, the list of items to be discussed should be similar. Section 1 of the NAIC ORSA Guidance Manual provides five key principles for an effective Enterprise Risk Management (ERM) framework. Companies' ORSA reports will need to demonstrate how their programs meet the five key principals. In addition to the principles, companies may want to include items from the NAIC's report on their pilot programs. Each principle is discussed below as well as items that regulators will need to consider during their assessments.

Risk Culture & Governance

NAIC key principle: "Governance structure that clearly defines and articulates roles, responsibilities and accountabilities; and a risk culture that supports accountability in risk-based decision making." [1]

The NAIC suggested that insurers consider including a table identifying the risk owners, the assigned risk, their role and responsibility, and to which committee/department/chief officer they report on their risk management and a flow chart explaining control processes.[2] The table and flow chart are a good start to articulate roles, responsibilities and accountabilities. The regulator will need additional detail on the company's risk culture. Some items to discuss include:

- What is risk management's role? Is this a purely advisory role or does risk management have authority to execute its mandate?
- Is there regular interaction with the Board?
- Are risk management objectives coordinated with business goals?
- Does company incentive compensation support risk management objectives?
- Are risk management policies well documented and distributed throughout the company?[3]

The regulator will need to review these items and make sure roles are clearly defined, risk management is not simply a compliance function and that the entire company is involved with risk management.

Risk Identification & Prioritization

NAIC key principle: "Risk identification and prioritization process that is key to the organization; responsibility for this activity is clear; the risk management function is responsible for ensuring that the process is appropriate and functioning properly at all organizational levels."[4]

Standard & Poor's lists the following as important risks currently facing insurers.

- Reserve risk—risk that reserves will develop adversely
- Catastrophe risk—both natural and man-made
- Reinsurance-recoverable risk (i.e., counterparty credit risk)
- Equity risk arising from embedded guarantees in insurance products

1 NAIC Own Risk Solvency Assessment (ORSA) Guidance Manual as of March 2014, page 6.

2 NAIC Own Risk and Solvency Assessment (ORSA) Feedback Pilot Projects Observations of the ORSA (E) Subgroup 2012-2013 Feedback to Industry, page 3.

3 Standard & Poor's Evaluating The Enterprise Risk Management Practices of Insurance Companies, pages 5-6.

4 NAIC Own Risk Solvency Assessment (ORSA) Guidance Manual as of March 2014, page 6.

- Interest rate risk, which stems from historically low interest rate environments and could add significant risk if rates rise or fall
- Insurance concentration and event risks
- Underwriting cycle management
- Corporate governance
- IT data security risk[5]

The NAIC suggests that companies discuss risks associated with intercompany dependencies and identify priority ranking of the material risks.[6] Responsibility for risk identification should be discussed as part of the risk culture and governance discussion. Regulators need to review that the list of risks is comprehensive for the nature, scale and complexity of the company's risks. The ranking of the risks will also vary significantly by company.

Risk Appetite, Tolerances & Limits

NAIC key principle: "A formal risk appetite statement, and associated risk tolerances and limits are foundational elements of risk management for an insurer; understanding of the risk appetite statement ensures alignment with risk strategy by the board of directors."[7]

For each of the risks identified, insurance companies will need to provide the corresponding risk tolerance statement and limit. Risk tolerance statements need to provide overall quantitative and qualitative tolerance levels. The tolerance statements should reflect the company's strategy and business plan and should be determined for the same time horizon as the corporate strategic plan. The regulator will need to review

- Do risk tolerance statements set boundaries for how much risk the organization is prepared to accept?
- Is risk tolerance determined in line with the company's long-term strategic plan?
- Is the risk appetite set by the Board?
- Are tolerance statements clearly defined?[8,9]

Regulators will also need to review explanations of any changes that have occurred in risk limits, appetites and tolerances as well as who approved the change and the decision process for implementing the change.[10]

Risk Management & Controls

NAIC key principle: "Managing risk is an ongoing ERM activity, operating at many levels within the organization."[11] The NAIC suggests that risk mitigation be discussed in addition to risk monitoring.[12] An ERM framework needs to be able to adjust for change. A feedback loop needs to be established to formally review incidents and support a culture of learning and continuous improvement.[13] Regulators will need to review

5 Standard & Poor's Evaluating The Enterprise Risk Management Practices of Insurance Companies, page 7.

6 NAIC Own Risk and Solvency Assessment (ORSA) Feedback Pilot Projects Observations of the ORSA (E) Subgroup 2012-2013 Feedback to Industry, page 4.

7 NAIC Own Risk Solvency Assessment (ORSA) Guidance Manual as of March 2014, page 6.

8 International Actuarial Association, Practice Note on Enterprise Risk Management for Capital and Solvency Purposes, August 11, 2008, page 68.

9 Standard & Poor's Evaluating The Enterprise Risk Management Practices of Insurance Companies, page 5.

10 NAIC Own Risk and Solvency Assessment (ORSA) Feedback Pilot Projects Observations of the ORSA (E) Subgroup 2012-2013 Feedback to Industry, page 2.

11 NAIC Own Risk Solvency Assessment (ORSA) Guidance Manual as of March 2014, page 6.

12 NAIC Own Risk and Solvency Assessment (ORSA) Feedback Pilot Projects Observations of the ORSA (E) Subgroup 2012-2013 Feedback to Industry, page 2.

13 International Actuarial Association, Practice Note on Enterprise Risk Management for Capital and Solvency Purposes, August 11, 2008, page 36.

- Does the company monitor significant risks on a regular basis?
- Is there a clear process for managing risk or is it ad hoc?
- Is the risk monitoring process accurate?
- Are there consequences for exceeding risk limits?
- What is the review process after a loss situation?[14]

Regulators will need to determine if the process allows the insurance company to react quickly to any risk limits being approached as well as the ability to continually refine and improve their ERM program.

Risk Reporting & Communication

NAIC key principle: "Provides key constituents with transparency into the risk-management processes and facilitate active, informal decisions on risk-taking and management."[15]

The regulator will need to review the effectiveness of the feedback loop.

- Is there an establishment of thresholds for reporting significant issues/incidents?
- Is there a process for escalation of issues to various levels of management?[16]

Lack of common terminology can undermine the effectiveness of the ERM program. The regulator will need to confirm that key constituents understand each other.

- Is there a universally understood risk rating system that defines high risks versus low risks?
- Are there standard templates for use across the insurance company?[17]

Another item to review is how information is distributed to the key constituents. Companies should provide an easy to review concise report with supporting information as needed. Company reports may start with a top ten list of residuals, a table of key risk indicators, heat maps or significant progress reports.[18]

Regulatory review of a company's framework is not going to be a simple checklist, however the items and questions provided above will cover much of the review. Regulators will need to determine if the ORSA report discussion of the items listed above demonstrates a framework that is appropriate for the nature, scale and complexity of the company's risks.

Laura A. Maxwell, FCAS, MAAA is a Consulting Actuary at Pinnacle Actuarial Resources, Inc. She can be reached at *LMaxwell@pinnacleactuaries.com.*

[14] Standard & Poor's Evaluating The Enterprise Risk Management Practices of Insurance Companies, page 7.

[15] NAIC Own Risk Solvency Assessment (ORSA) Guidance Manual as of March 2014, page 6.

[16] International Actuarial Association, Practice Note on Enterprise Risk Management for Capital and Solvency Purposes, August 11, 2008, page 36.

[17] International Actuarial Association, Practice Note on Enterprise Risk Management for Capital and Solvency Purposes, August 11, 2008, page 19.

[18] International Actuarial Association, Practice Note on Enterprise Risk Management for Capital and Solvency Purposes, August 11, 2008, page 27.