Session 102PD, The Alphabet Soup of Risk Protection - ORSA & ERM

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The Alphabet Soup of Risk Protection - ORSA & ERM

Session 102
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SOCIETY OF ACTUARIES
Introductions
Our Panelists

• Chris Merkel, Lewis & Ellis, Moderator
• Chris Slaybaugh, Axene
• Kristi Bohn, State of Minnesota
• James Morris, Baker Tilly
Background on ERM & ORSA
Background on ERM

SOA Enterprise Risk Management (ERM) Definition

“ERM is the discipline by which an organization in any industry assesses, controls, exploits, finances and monitors risks from all sources for the purpose of increasing the organization’s short- and long-term value to its stakeholder.”
Background on ORSA: What Is It?

• Own Risk Solvency Assessment
• A realistic view of the risks a company faces due to its
  • Operations
  • Strategic decisions
  • External views of company (reputation)
  • Any other risks
• Holistic view of risk and is not limited by formula
• Application of Enterprise Risk Management principles
• NAIC has Model Regulation
• Implemented in 2015 for health insurance companies ($500m annual / $1B group)
Background on ORSA: Goals

1. To foster an effective level of ERM at all insurers
   a. Each insurer identifies, assesses, monitors, prioritizes and reports on its material and relevant risks
   b. Uses techniques that are appropriate to the nature, scale and complexity of the risks
   c. Conducts in a manner that is adequate to support risk and capital decisions

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

Key Goal Elements:

• Each insurer identifies its relative risks
  Based on an honor system, no template and based on own review
  Introspective review incorporating internal and external factors

• Supports risk and capital decisions
  Helps drive strategic decisions; considers all risks when going into new ventures

• Supplements legal entity view
  Confidential by state law
Background on ORSA

• Executive Summary

• Section 1 – Description of ERM Framework

• Section 2 – Assessment of Risk Exposures
  • Normal and Stressed Conditions

• Section 3 – Group Assessment of Risk Capital
  • Including Prospective Assessment
Executive Summary

• Overview of Business Strategy
• Risk Appetite Consistent with Strategy
  • Sought, Accepted/Tolerated, Avoided
• ERM Maturity
  • Identification and Assessment of Risks
  • Strength of Controls/Effects of Diversification
  • History and Future of ERM at the Company
    • Especially changes from last ORSA and planned changes for next ORSA
• Summarize Capital Assessment
  • Amount of Capital Needed
  • Compared to Amount of Capital Available
Section 1: Description of ERM

• Process Used to Identify Risks
• Stated Limits and Tolerances for Each Risk
  • Should tie into general appetite: seek, accept, avoid
• Specific Risk Appetite Statement
  • Consistent with Strategy, Risks Identified
  • Ideally this is more than just an X% RBC minimum
• Key Risk Indicators
  • How are Identified Risks Tracked
  • Risk Owners, Reports to Management, Action Plans, etc.
• Identification of Emerging Risks
  • How are New or Emerging Risks Identified
Section 2: Risk Exposure Assessment

• Include All Risks From Section 1
• Regulatory Review Includes All Branded Risk Categories
  • Branded Risks: Credit, Market (Equity and Interest Rate), Liquidity, Insurance, Reserving, Operational, Strategic, Legal/Regulatory, Other/Emerging
• Assessment
  • Deterministic or Stochastic Stresses
  • Qualitative – with reasoning as to why
  • Consistency of Normal and Stressed Environment across Risks
• Pre and Post Mitigation
Section 3: Group Capital Assessment

• Metrics Used
• Include All Key Risks
• Defend Mitigation/Diversification Benefits
• Justify Selection of Stressed Environments
• Include Prospective Assessment
ORSAs that Stand Out

• “OWN” It
  • Consistent With Strategy, Mission, Purpose
  • Part of ERM, not a regulatory exercise
  • ERM is a Culture Thing – Clear Owners of Each Risk

• Risk Appetite Tells a Story
  • Risks Sought, Tolerated and Avoided are Consistent with Strategy
  • Risk and Capital Assessment used to Establish Risk Limits and Tolerances

• Management Understands Controls and Diversification Benefits
  • Regular Reports
  • Dashboards and Heat Maps

• Management Knows How Much Capital Is Available
  • Amount of Capital Available
  • Amount of Free Capital
  • Cost of Capital – Amount Needed to Grow
Section 3: Group Capital Assessment

• Metrics Used
• Include All Key Risks
• Defend Mitigation/Diversification Benefits
• Justify Selection of Stressed Environments
• Include Prospective Assessment
Enterprise Risk Report/Form F

• Required under the Insurance Holding Company System Regulatory Act (Model #440) and Regulation (Model #450)
• Adopted by all states
• Watered down ORSA to give regulators ERM information for those companies that are exempt from ORSA based on their size
Panelist Questions
Panelist Question

Have you observed risk cultures and governance be affected by the ORSA requirements?
Panelist Question

What risks would you anticipate a typical health insurer to identify as key?
Panelist Question

Have you seen expansions in the risks that a typical health insurer identifies?

Has any identified risks surprised you?
Panelist Question

How has the regulator’s view on monitoring risks changed due to ORSA?
Panelist Question

How well have the application of quantitative and qualitative assessments been applied?
Panelist Question

What role should Risk Based Capital (RBC) play in ERM and ORSA?
Panelist Question

How has the use of external capital models (RBC, rating agency) and internal capital models evolved to improve management’s understanding of free capital?
Panelist Question

How well have ORSA reports demonstrated the reasonability of risk mitigation and diversification in terms of assumptions and expected outcomes?
Panelist Question

What insights can you give regarding the use of stress tests versus stochastic analyses?
Panelist Question

What are elements of a poor ORSA?
Which elements tend to be underdeveloped?
What regulatory reactions follow?
Panelist Question

Given what you have observed to date, what recommendations might you suggest to improve ORSA reports for next year?