Session 089 PD - The Evolution of ORSA - Through 2017 and Beyond

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Session 89: The Evolution of ORSA – Through 2017 and Beyond

2017 SOA ANNUAL MEETING & EXHIBIT

Presenters:
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17 October 2017
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Agenda

• Opening remarks and introductions
• US ORSA update
• NAIC regulatory update
US ORSA update

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US ORSA overview

Background

• Many jurisdictions (e.g., US, Canada, Bermuda, EU) require companies to maintain an Own Risk and Solvency Assessment (ORSA) process and develop a periodic summary report as part of their solvency regimes

• The US NAIC defines the ORSA as “an internal assessment...conducted by [the] insurer of the material and relevant risk associated with an insurer’s current business plan and the sufficiency of capital resources to support those risks.”

• The two primary goals of the ORSA, per the US NAIC, are:
  • To foster an effective level of enterprise risk management at all insurers through which each insurer identifies, assesses, monitors and reports on 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
  • To provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view
US ORSA overview

High-level requirements

• Design, implement and conduct an ORSA process
• Annually create a summary report including information regarding:
  • (1) Description of risk management framework;
  • (2) Assessment of risk exposures; and
  • (3) Group risk capital and prospective solvency assessment
• Produce and retain documentation and materials to evidence the efficacy of the ORSA process for internal and external stakeholder review
US ORSA overview

Experience to date

- Many companies submitted their first ORSA Summary Report in 2015 (making 2017 submissions the third annual report submitted to regulators)
- ORSA Summary Report submissions generally have, and are expected to continue, to evolve and mature over time
- Initial observations on ORSA Summary Reports
  - Length/level of detail across sections
  - Risk framework information
  - Risk coverage
  - Stress/scenario testing approaches
  - Level of regulatory engagement
Connecting ERM and ORSA

Components of an ERM framework and ORSA

The quality of an ORSA Summary Report is bounded by the quality of and insurer’s ERM framework.

US ORSA Report
Section 1: Description of the Insurer’s Risk Management Framework

US ORSA Report
Section 2: Insurer’s Assessment of Risk Exposures

US ORSA Report
Section 3: Group Risk Capital and Prospective Solvency Assessment
Industry perspectives on ORSA
US ORSA Summary Report – Section 1

- Much of the industry has a well-documented ERM framework, but evidence of use and effectiveness remains inconsistent

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<tr>
<th>Industry perspectives</th>
<th>Common capability gaps</th>
<th>Implementation challenges</th>
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<tr>
<td>- Many companies feel that current capabilities meet most of the requirements of Section 1 of the US NAIC ORSA Guidance Manual</td>
<td>- Risk appetite and limits frameworks</td>
<td>- Companies have struggled to directly link risk appetite and limits across key risk types</td>
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<td>- Certain companies with immature ERM programs need to formalize aspects of their frameworks to address gaps</td>
<td>- Strong risk culture</td>
<td>- Including quantitative measures in the risk appetite requires the adoption of a consistent quantitative measure of risk</td>
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<td>- Governance structures in the insurance industry vary considerably from other financial services companies</td>
<td>- Evidence of risk management’s role in the business and strategic decision-making process</td>
<td>- Consistent implementation of an ERM framework across an insurance group can be a challenge across countries (e.g., multinationals) and lines of business (e.g., P/C vs. Life)</td>
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Industry perspectives on ORSA

US ORSA Summary Report – Section 2

• Companies must quantitatively and qualitatively assess key risk exposures in normal and stressed conditions

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<td>• Current risk assessments are highly dependent on risk taxonomy</td>
<td>• Quantitative and qualitative assessments supporting all risks in a comprehensive risk inventory</td>
<td>• Determining how to perform the assessment under &quot;stressed&quot; conditions when the metric may already be under a stress (e.g., stressing interest rates in a low interest rate environment)</td>
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<td>• In general, Life companies are less focused on operational risk</td>
<td>• Consistent metric/basis to measure risk exposure across risk types</td>
<td>• Building a more robust approach for both qualitative and quantitative assessment of a broader range of operational risks</td>
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<td>• In general, P/C and Health companies are less focused on investment/market risk</td>
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<td>• Difficult due to a lack of exposure data</td>
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<td>• Companies that have moved towards and economic capital framework often have a more mature quantitative approach in place</td>
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<td>• Quantitative approaches often require significant approximations</td>
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• Implementing a consistent metric/basis across risk types can be challenging due to differences in exposure data and methodologies.
Industry perspectives on ORSA
US ORSA Summary Report – Section 3

- The group risk capital and prospective solvency assessment components are both complex aspects of ORSA

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<td>- Group risk capital and prospective solvency assessments are complex and were not always a part of insurer ERM frameworks prior to ORSA</td>
<td>- Limited focus on “group risks” (e.g., fungibility of capital between legal entities in stressed conditions)</td>
<td>- Accounting differences across geographies and product lines increase difficulty in relying on existing frameworks</td>
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<td>- The flexibility provided by the US NAIC ORSA Guidance Manual has left many companies with questions on how to complete this section</td>
<td>- Projection of future income statements and balance sheets (including new business) under stressed conditions for key risks documented in the ORSA Summary Report</td>
<td>- Comprehensive views of future balance sheets under various accounting regimes (e.g., Statutory, GAAP, Economic)</td>
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<td>- Forecasting of future capital requirements, in particular, under internally developed measurement frameworks</td>
<td>- Approaches for calculating future required capital components for calculation intensive balances (e.g., projections of stressed market value of liabilities)</td>
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<td>- Incorporation of multiple capital frameworks to model future distributions of excess capital</td>
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<td>- Reliable aggregation of financial statements across legal entities</td>
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Industry perspectives on ORSA

Areas of focus for 2017

• Areas of focus for 2017 ORSA Summary Report submissions include:
  • Risk appetite and limits framework
  • Capital projections, quantitative analysis, risk reporting and explanations of analysis/results
  • Reflection of business and strategic planning in the ERM framework and ORSA process
  • Continued evidencing of use of the ERM framework and ORSA process in managing the company
NAIC regulatory update

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Implementation – State adoptions

Nation-wide adoption expected by end of 2017 as ORSA becomes a NAIC accreditation standard for the Departments Of Insurance (DOI) on January 1st, 2018

Implementation – Insurer’s experience

- For several states, 2017 is the 3rd round of ORSAs and ORSAs are improving
- 300+ reports expected in total (approx. 200 at group level, 100 legal entity only) - excluding international premium data
  - More than 100 from health insurers
  - Life insurers and P&C insurers are more ORSA-ready than health insurers
  - NAIC has reviewed half of them

- The Good:
  - US ORSA is principle-based and not prescriptive, so insurer chooses how to measure risks, how to quantify capital, the stresses, the projections
  - Forcing more discipline around risk management

- The Not-So-Good:
  - Interpretation issues – need for more guidance on NAIC ORSA Manual requirements and feedback on regulatory expectations
  - Compliance fatigue – more risk-related regulations than ORSA in short-future (see last slide)
  - Quantitative challenges – quantification of risk limits, risk exposures, risk capital
  - Robust rationale – evidence that methodologies, assumptions and stresses are “fit for own risk profile”
Implementation – DOIs’ experience

- So far: Read & Learn + Focus on consistency of DOIs’ reviews and Lead State to review and share review with other states

- The Good:
  - ORSA is additive – new and valuable info for regulators
  - Internal review framework in place - ORSA review procedures for DOI’s financial examiners and financial analysts and documentation + nearly all DOIs ORSA trained by the NAIC (3-yr program)
  - No big surprises on what the keys risks are, but more insight in how big they are and how assessed
  - View of capital at group level (instead of legal entity) and on capital fungibility across the group

- The Not-So-Good:
  - “How big?” still to be fully answered (many risks not quantified). Expect more pressure on quantification (including requests for more stresses)
  - “Are the numbers right?” still to be figured out (no appetite for regulatory approval but appetite for a deeper dive). Expect to provide more evidence & documentation on calculations & models. Consider ORSA implications of new ASOP on Capital Adequacy Assessment (2nd exposure soon).
  - Timeliness of information – too old, not prospective enough. Expect to provide more up-to-date information on risk exposures and prospective assessments
  - Foreign Group ORSA to understand group-ERM and group-capital – Expect DOI to ask for a copy
    - DOI should receive group ORSA (ORSA Manual requirement)
    - Steep curve for DOI to understand foreign regulatory regimes (e.g. Solvency II, Swiss Solvency Test, Bermuda, Canada)
  - Regulatory use of ORSA – incorporation for surveillance purposes into Holding Company Analysis
Implementation – DOIs’ feedback

- **Section 1 (ERM framework)** – KEY QUESTIONS ANSWERED: What are the key risks (based on business strategy)? How much risk do you want or can tolerate?
  - Limited information on key strategic goals (resistance to disclose business strategy)
  - No information on compensation of risk owners
  - List of key risks is provided but limited information on the identification process
  - Not all key risks have limits
  - Risk appetite statement is disjoint from individual risk limits and very generic
  - Tendency to disclose mostly financial controls, less operational controls
  - Need for more up-to-date information (e.g. quarterly KRIs reported to management & BoD)

- **Section 2 (assessment of risk exposures)** – KEY QUESTIONS ANSWERED: How big are the key risks (compared to the limits / tolerances)? How big could they be in case of a stress?
  - Not all key risks are assessed and the exposure are not compared to the limits
  - No explanation of why some key risks are not assessed: lack of data or methodology? Resistance to quantify operational risks
  - Very little support to the stresses selected and underlying assumptions; rarely reverse stress test

- **Section 3 (group risk capital and prospective assessment)** – KEY QUESTIONS ANSWERED: How much group capital is put at risk in case of an expected loss (now and tomorrow)? How are the key risks likely to change tomorrow?
  - Variety of metrics: regulatory RBC multiples (for Health insurers), rating agency (for P&C), economic capital (for Life) - no explanation of choice of risk metric and calibration (of economic capital)
  - No quantification of risk capital for each key risk (e.g. operational risk)
  - No explanation of diversification benefit (often “significant” reduction in capital)
  - Usually no prospective assessment of risks and capital
  - Limited to no information on validation (framework, scope, status, results)
More risk regulations than just ORSA

- Form F ("enterprise risk" at the holding level)
  - Already nation-wide adoption
  - More NAIC guidance under development
- Corporate Governance Annual Disclosure Model Act &Regs (#305 and 306):
  - 17 states have already adopted model act
  - Nation-wide adoption by 2020?
- New Insurance Data Security Model Law
  - Develop, implement and maintain a comprehensive written Information Security Program (ISP)
  - To be voted possibly at the NAIC National Meeting in December 2017
- CAT charge for RBC
  - Use of own CAT internal capital model, in addition to third-party approved CAT models
  - From 2018?
- Operational risk charge for RBC
  - 3% add-on factor (possibly 1% or 1.5% for 1st year)
  - From 2018?
- Group-RBC calculation
  - Still underdevelopment
  - With stresses?
- Other: EU-US covered agreement, Comframe & ICS
Questions?