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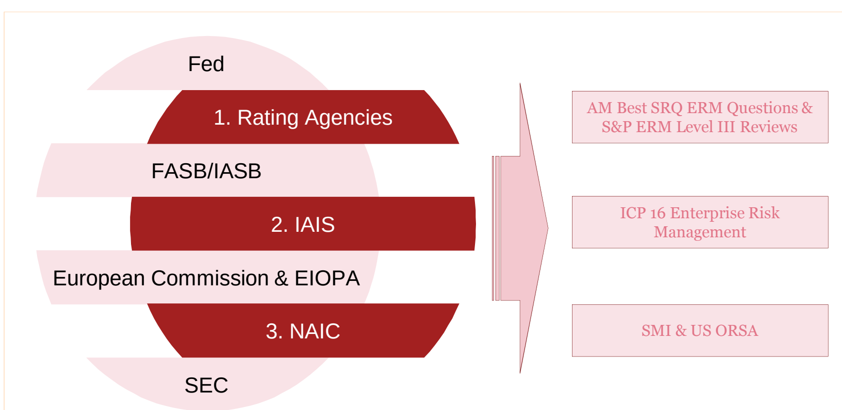
Drivers of Enterprise Risk Management ("ERM")



Developing an ORSA Guidance Manual for the US

"An insurer…will be expected to regularly conduct an ORSA to assess the adequacy of its risk management and current, and likely future, solvency position, internally document the process and results, and provide a high-level summary report annually to the domiciliary regulator, if requested"

NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual

- As part of the Solvency Modernization Initiative (SMI), the NAIC has adopted a US ORSA requirement.
- The ORSA Guidance Manual was adopted in November 2011 after a period of intense industry comment and engagement.
- The NAIC approved the RM ORSA model law in September 2012, that will implement the ORSA requirement with the first Summary Reports filed in 2015.
- A pilot exercise was run in 2012, and a further exercise in 2013 is likely.

The US ORSA is part of a global trend in insurance supervision

- In 2011, the NAIC added an Enterprise Risk Report requirement to the Insurance Holding Company System model regulation.
- The NAIC has adopted the US ORSA requirement in response to the IAIS's ICP 16 – Enterprise Risk Management, which requires ORSA.
- In common with other territories, the US is assessed against the ICPs under the IMF's Financial Sector Assessment Program (FSAP). The next review is expected in 2014.
- ORSA requirements are also being introduced in many other territories, include Europe, Bermuda and Canada. Overall, these are consistent with ICP 16 and therefore with the US ORSA.
- For international groups, the NAIC's intention is to recognize group ORSA's produced to meet other territory requirements, where these are consistent with ICP 16 and the US guidance. The NAIC expects reciprocal recognition by overseas regulators of ORSA's prepared following US guidance

NAIC – US ORSA scope and objective

"The ORSA Summary Report may help determine the scope, depth and minimum timing of risk-focused analysis and examination procedures…Insurers with ERM frameworks deemed to be robust for their relative risk may not require the same scope or depth of review, or minimum timing for a risk-focused surveillance as those with less robust ERM functions."

NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual

- **Risk management** – The ORSA will be a tool to help supervisors understand the risks insurers are exposed to, and how adept insurers are at managing those risks. Regulators plan to assess ERM capability, and to use it to guide their supervisory strategy
- **Group capital assessment** – Examiners and NAIC analysts will use the ORSA to assess groups' own assessment and management of their capital at group level. While the ORSA will not set a group capital requirement, it will provide information to regulators that will help guide supervisory action
- **Encouraging ERM** – The NAIC expects the ORSA to help foster effective ERM practices at all insurers

Insurers will file the ORSA annually with their lead state regulator, and with other states on request

- Insurers will be expected to provide a summary ORSA report to their lead state commissioner annually. Other domiciliary state commissioners may also request the summary report.
- Insurers are expected to conduct the ORSA process regularly internally, and to maintain more detailed documentation of the risk management framework, ORSA process and results, which the supervisor may review as part of analysis or examination procedures.
- The filing of the summary report will be coordinated with the insurer's strategic planning process, in addition to any ORSA requirements to which an insurer is subject in other jurisdictions, so that the information is timely, and the process is not completed more than once annually.
- The ORSA may also be requested if an insurer's situation is troubled.

The guidance exempts smaller insurers, although states or regulators may still require the ORSA

- The NAIC's guidance includes the following exemption thresholds:
  - If the **individual insurer's** annual direct written and unaffiliated assumed premium*, including international direct and assumed premium, does not exceed **$500 million**; *and*
  - If the **group's** annual direct written and assumed premium*, including international direct and assumed premium, and excluding affiliated reinsurance premium, does not exceed **$1 billion**
- Where one or both of the threshold(s) is/are exceeded, the ORSA must be provided for the group and/or relevant legal entities
- A regulator may require any insurer to provide the ORSA, and any insurer may request a waiver, based on unique circumstances

  * Excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program

The ORSA guidance manual requires a 3-section structure for the ORSA summary report

Section 1 – Description of the insurer's risk management framework

- Section 1 provides a summary of the risk management framework and policies, aligned to the following principles:
  - Risk Culture and Governance
  - Risk Identification and Prioritization
  - Risk Appetite, Tolerances and Limits
  - Risk Management and Controls
  - Risk Reporting and Communication
- The level of detail should be appropriate to the nature and complexity of the company, and is not intended to be lengthy. Section 1 can reference more detailed internal documentation (e.g. risk policies), providing these are available to the supervisor on request

The ORSA guidance manual requires a 3-section structure for the ORSA summary report

Section 2 – Insurer's assessment of risk exposures

- Section 2 documents management's quantitative, or where quantitative assessment is not feasible, qualitative assessment of risk exposures in normal and stressed environments. The section should include:
  - Details of risks identified, measurement approaches used and assumptions
  - Quantification of risk for each major risk category
  - Outcomes of plausible adverse scenarios
  - The impact of stressed environments on available capital, considering multiple capital viewpoints if relevant (e.g. regulatory, rating agency)
- The structure of the assessment should reflect the way the business is managed in practice. Where appropriate or requested by the regulator, a group assessment may be mapped to legal entities

The ORSA guidance manual requires a 3-section structure for the ORSA summary report

Section 3 – Group risk capital and prospective solvency assessment

- Section 3 explains how the assessment of risk is used to determine the financial resources the company requires to achieve its business objectives over its business planning period, considering normal and stressed conditions, and may include:
  - Definition of solvency
  - Accounting or valuation regime
  - Time horizon of risk exposure
  - Risks modeled
- The assessment should consider the group as a whole, including the impact of inter-group transactions and financing arrangements, the transferability and fungibility of capital, and contagion risk

The ORSA guidance manual requires a 3-section structure for the ORSA summary report

Section 3 – Group risk capital and prospective solvency assessment

- The section should demonstrate that the organization has sufficient capital to executive its 2-5 year business plan, taking into account the potential impact of adverse scenarios, and should consider the company's own economic solvency needs in addition to regulatory capital requirements
- Where necessary, the section should detail the actions that management has taken or will take where capital may not be adequate, for example, modifications to the business plan, or the raising of new capital

Life insurers will face a number of key challenges in meeting the US ORSA requirements

Risk culture and governance	• Achieving high engagement by the Board and buy in from Senior Management • Shifting from informal to formal risk culture and demonstrating "use" • Establishing clear roles and responsibilities – on-going accountability
Risk appetite	• Defining Risk Appetite and linking to business strategy • Cascading approved Risk Appetite down to tolerances and limits
Reporting and communication	• Lack of comprehensive risk information which is readily produced and accurate • Inconsistency of risk reports across enterprise making aggregation and escalation difficult • Achieving high comfort with the quality and timeliness of management information to support confident, timely decision making– addressing model risk and process
Assessment of risk exposures under normal and stressed environments	• Choice of risk measurement framework • Measurement required across each major risk category • Approach to stress testing • People, process and technology constraints
Group capital and prospective solvency	• Choice of enterprise-wide risk measurement framework • Projection of risk measures over business planning period • Reflecting management's actions

ORSA – From required to essential
Excellence in ERM will separate the winners from the losers

- Which risks?
- How much risk?
- Surplus, what a drag!

Thank you…

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