



AMERICAN ACADEMY of ACTUARIES

October 4, 2010

Director Christina Urias
Chair of the International Solvency (EX) Working Group
National Association of Insurance Commissioners (NAIC)
Via email: kdefrain@naic.org

Dear Director Urias:

The American Academy of Actuaries¹ ERM Subcommittee is pleased to provide comments on the NAIC's International Solvency (EX) Working Group's *Consultation Paper on the Own Risk and Solvency Assessment (ORSA) for the Solvency Modernization Initiative*.

The introduction of an Own Risk and Solvency Assessment (ORSA) requirement into the US solvency framework could provide regulators with significant insight into a company's risk management and risk governance practices. If used effectively, such information has the potential to:

- Assist regulators with identifying those companies with weaker risk management systems, thus encouraging more frequent and effective interaction between the regulator and those regulated entities.
- Allow more effective and efficient use of regulatory and corporate resources.
- Be an effective tool for reviewing and assessing systemic risk issues.

In order to achieve support for these desirable outcomes, we strongly encourage the NAIC to clearly describe how the information contained within the ORSA might in fact be used by regulators. For example:

- Would regulators have the authority to compel an insurer to take specific actions based upon the information contained within the ORSA?
- Could a regulator require the use of hedging of financial market guarantees by an insurer that has elected not to hedge part of its risk exposure even if its rationale for this position is made clear?

In addition, it would be useful for the NAIC to articulate the benefits to regulated entities that the introduction of an ORSA might offer. For example:

- Might the ORSA provide the insight needed to allow the regulators to vary their level of interaction with insurers based on the strength of their risk management practices (i.e.,

¹ The American Academy of Actuaries ("Academy") is a 17,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

interacting less with those insurers who are deemed to have strong risk management practices)?

- Would the information contained within the ORSA allow the regulators to enhance the efficiency of risk-focused examinations when they do occur?
- Will this information allow for the elimination of other duplicative reporting requirements?

While many questions related to this process remain, we offer the following responses to the specific questions contained within the Consultation Paper:

1. A: Content: What content should be included in the ORSA/ERM tool about RISK MANAGEMENT?

In addition to the items listed, the ORSA should contain a description of ERM governance, including the roles and responsibilities of management and the Board in the risk management function; how decisions are made; the role of the audit; legal and actuarial functions in the risk management system; and the role of business units in the management of risk.

The ORSA should contain a qualitative assessment of management's views of how well a company has performed with the management of risk, how the ERM function helped the company manage risks and where the ERM function failed. Companies should provide insight into their use of feedback loops.

An ORSA should also highlight changes to the insurer's risk profile over time.

We recognize that some ERM concepts such as “risk appetite” are still evolving and have only been expressed by many insurers in general terms. However, an assessment of how the overall level of an insurer's risk exposures compares to its risk appetite should also be included within an ORSA, as well as the reasons for significant changes to its risk appetite over time. Inclusion of a discussion on risk appetite will be valuable for the regulator in understanding the degree of sophistication of the insurer's risk management practices as well as advancing the regulator's understanding of risk management practices. These practices could include a review of the company's use of soft limits within its risk appetite limits that identify escalating actions, higher level authorities, mitigation actions and reassessment deadlines.

1. B: Content: What content should be included in the ORSA/ERM tool about SOLVENCY ASSESSMENT?

Prospective solvency assessments should be provided only in the context of specific stress scenarios: if a particular event happens, will the company have sufficient capital to support it. Asking company management to opine on FUTURE solvency without stating specific conditions would not be meaningful or practical.

2. *Frequency: How often should the insurers perform this process (e.g. quarterly, annually, prior to financial examinations, when there is a significant change in the risk profile of a company)? How often should the insurer report on this process to regulators?*

Companies perform risk management activities with different frequencies; some activities are performed daily while others are performed annually or on an as-needed basis. Our understanding is that the ORSA would be provided to regulators to explain an insurer's risk profile and risk management practices. Ideally, the information contained in the ORSA would be a subset of the information already being prepared by an insurer for its risk management efforts. The ORSA requirement will be more effective if the information requested is not a "one off" regulatory requirement, but instead, leverages the information already prepared by the company.

The frequency and extent of ORSA reporting should be dependent upon how the regulators intend to use the information provided. Where real risk management needs exist and if the regulators plan to act upon the information contained within the ORSA, some risk measures may need to be reported more frequently than the financial examination cycle, while other risk measures may need to be reported less frequently. After an initial review and discussion of the ORSA, additional follow up reporting for different risk exposures could conceivably range from daily to once every five years.

One option discussed by the ERM Subcommittee is a phased-in approach to this new requirement. While all insurers would be required to perform this assessment internally as part of their ERM activities, the frequency and extent of the regulatory reporting of ORSAs could be increased (e.g., annual reporting) for a selected group of insurers based upon certain criteria or triggers established by the regulators. Once the regulators are able to refine their intended use of this new information and develop the internal resources required to review ORSAs, the appropriate reporting frequency could then be determined. This will allow both insurers and regulators sufficient time to prepare for this new requirement.

3. *Confidentiality: How should confidentiality be maintained (e.g. through examination process or via a new law/regulation)? Which component(s) of the content identified in #1 is not proprietary and could be made public?*

All information contemplated for inclusion in the ORSA should be confidential, and would need to be maintained as such. The need for confidentiality within the ORSA process is critical and the steps taken to protect confidentiality should be greater than for other confidential regulatory documents. The information contained in an ORSA would likely include very sensitive and proprietary information that, if disclosed for any reason, could potentially damage the insurance company. Further, the information contained in the ORSA would likely include assessments of current risk exposures, as well as emerging risks. Information related to risks that may or may not materialize must be handled with care. Information related to *potential* risks could be damaging to an insurer in the event this information became available to a plaintiff's attorneys or other legal representatives.

4. *Group / Legal Entity / Pool: At what level should regulators require this tool (e.g. group, legal entity, intercompany pool)? Should the tool be required based upon “how the enterprise is managed”? a. How should non-insurance entities be considered? b. Should international entities be included?*

An ORSA should be conducted on the basis of how risk is managed within a group. All insurance and non-insurance entities within a group should be included in the ORSA, both domestic and international, as all entities will affect the risk profile of the group in some manner. Any other requirement could create a level of compliance with less value to the insurer and the regulator.

An ORSA should cover all risk exposures of the group, regardless of reporting entity. As such, all risk exposures, whether or not reported on the balance sheet, should be covered in the ORSA.

5. *Proportionality: How should U.S. regulators implement proportionality (e.g. size, nature/scale/complexity, extent of international activity, certain lines of business, etc.)? What exclusions from the requirements or simplified reporting would you recommend, and for whom?*

Every insurer should be subject to an ORSA requirement. While the nature of an insurer's risks will likely differ by company size, all insurers need to understand their risks and have processes for managing those risks. The scope and complexity of an insurer's risk management practices will be reflected in the response to an ORSA requirement.

6. *Should the U.S. implement a questionnaire or a minimum level of standardized reporting? If so, should the reporting be an abbreviated reporting, with the full report available for review at the company upon request? Should a “sample report” or template be provided for educational purposes?*

ERM as a discipline is still in its infancy and will continue to evolve. Therefore, any standardized reporting created by the NAIC will likely be outdated before the information could be used. The ORSA should be principle-based in its entirety, not rule-based. Any form of standardized reporting will encourage conformity which would de-value the use of this assessment. Insurers would benefit, however, by the creation of a principle-based outline for the ORSA that identifies the most significant items that the regulators would find of interest.

7. *Should the tool be entirely driven by the company or should the regulators specify items such as specific stress tests or safety levels? a) If regulators specify stress or scenario tests, what should be the focus of the tests (e.g. major interest rate shift, major changes in lapse rates, misestimation of parameters, large adverse development in loss reserves (including adverse court decisions, etc.)? b) If regulators specify a safety level (e.g. 99.0% TVar) and time horizon for solvency assessment, what should those be?*

We support the use of and the reporting of stress testing in the ORSA requirement. We discourage standardized, fixed requirements for understanding risks. Stress testing does

provide useful information for company management and regulators. However, the specific stresses often change with the environment. Therefore, specifying stress tests that always need to be performed regardless of the current environment will create additional work with limited benefit.

We believe the initial requirements will be more effective if insurers provide stress testing results to regulators based on the stress testing already performed by the insurer. Insurers should perform this assessment on the same basis that risk is managed, and that is how it should be reported to the regulators

As a later step, there may be situations where regulators would ask for the results of specific stress tests, though it should occur within the context of the centralized CRO type expertise mentioned in question 9.

8. *Should the Board be responsible for the ORSA/ERM? If so, to what extent? Should there be a sign off or certification requirement (by an actuary, chief risk officer, risk professional)? Should there be a required report to the Board (e.g. on stress tests)?*

Yes, the Board should be responsible for the ORSA and ERM, and should describe and attest to their oversight role. In addition, the ORSA should be signed off on by a member of the senior management team with the appropriate level of experience. Specific reports to the Board should not be required as part of the ORSA; however, as part of the ORSA, companies should be required to disclose the nature and frequency of reporting to the Board.

9. *How great will the need be for additional resources? Do states need to hire more risk experts? Do they need these experts on staff, or should they hire consultants or share resources?*

State insurance departments will likely need to obtain additional resources to be able to evaluate the information contained in an ORSA, and may want to consider a centralized review function, such as the NAIC's Financial Analysis Working Group (FAWG.) The regulators would benefit from this centralization, not only from the perspective of shared resources but by enabling an industry-wide view of risk. To minimize the impact on resource needs, the NAIC should re-evaluate all of its risk reporting requirements and eliminate those that are redundant.

While the regulators may need to rely upon external consultants as part of the ORSA review process, the NAIC will first need to ensure that confidentiality restrictions could be extended to these external experts.

10. *What should we name this tool?*

"ORSA" does imply that an entity is observant of issues affecting its overall health and well being. If the US were to adopt a different name for this assessment requirement, it would ultimately be regarded as the "US ORSA." Therefore, we recommend that the ORSA name be utilized.

Thank you for this opportunity to comment. If you have any questions, please contact Tina Getachew, senior policy analyst, Risk Management and Financial Reporting Council, via email (getachew@actuary.org) or phone (202/223-8196).

Sincerely,



Maryellen Coggins
Chairperson, ERM Subcommittee
Risk Management & Financial Reporting Council
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The members of the Subcommittee who are responsible for this comment letter are:

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October 4, 2010

Director Christina Urias
Chair of the NAIC International Solvency (EX) Working Group
kdefrain@naic.org

Dear Director Urias:

The American Council of Life Insurers (ACLI) represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90% of the assets and premiums of the U.S life insurance and annuity industry. We appreciate the opportunity to offer our comments on the Working Group's Consultation Paper (CP) on Own Risk and Solvency Assessment (ORSA) on their behalf.

ACLI commends the NAIC on undertaking the Solvency Modernization Initiative. Our members welcome the deliberative process that you and the Working Group have adopted for considering the value to U.S. insurance regulators of aspects of other solvency regimes. That is particularly true with respect to an ORSA, as we have some reservations about its necessity within the context of U.S. insurance regulation. While we have not opposed the IAIS's high-level endorsement of an ORSA, we urge further discussion of its definition, value added, and related costs within the context of the current and evolving framework of U.S. insurance regulation. We note that the IMF's May 2010 Detailed Assessment of Observance of IAIS Insurance Core Principles did not include any recommendation for an ORSA.

Prior to implementing a procedure designed under a different regulatory regime, we suggest that the Working Group (WG) begin with a gap analysis, that is, by clearly identifying the gaps in current U.S. insurance regulation that the WG believes should be filled. Once the gaps are clearly identified, the next step would be to propose a definition of an ORSA tailored to any identified gaps. That process would help our collective understanding of any such tool and therefore improve its usefulness to us all. We are concerned that, absent such a process, an ORSA (however defined) may add to the cost and complexity of U.S. regulation without providing commensurate benefits to policyholders.

ACLI has previously shared with you our Solvency Principles and Application Guidance. It contains views that may be related to issues raised in the CP—

- A solvency assessment system should require an insurer to have a sound process for assessing its capital adequacy in relation to its risk profile. That process should be qualitative, forward-looking, judgment-based, iterative, and appropriate to the nature, scale, and complexity of each insurer.
- The solvency assessment system should also reward insurers by providing incentives for insurers that embed such a process in their cultures
- We believe that detailed prescriptive standards are inappropriate for an ORSA.

If the gap analysis shows need for an ORSA, we hope to refine these views and those in the attached responses in discussion with you and the Working Group. We wish to be as constructive as we can,

given the breadth of our membership and the importance of these issues to them and to the perception of the quality of U.S. insurance regulation.

We look forward to discussing these important issues with you and with the Working Group.

- NAIC Questions:**
- 1) A. Content: What content should be included in the ORSA/ERM tool about RISK MANAGEMENT?
Risk and Risk Management "Description"
 - a. Description of risk management and the process used to assess, monitor, and communicate risk. Explanation of how (or if) the report and its results ties to a company's management of the business. Note: Whether the report is required to tie to the company's management is identified as a topic for future decision.
 - b. Risk appetite, tolerances, and/or limits
 - c. Identification of significant risks faced by the insurer (underwriting, marketing, credit, investment, catastrophe, operational – including disaster recovery/business continuity risks, contagion, reputation, liquidity – including asset-liability management and cash flow and market value volatility, legal, reinsurance, reserving, concentration, and operational risk.)
 - d. Identification of emerging risks
 - e. New actions taken by the company that will impact the risk profile.
 - f.1. Recent changes that have occurred to the risk profile.
 - f.2. Risk Mitigation description – reinsurance, securitization, pooling, etc.
 - g. Contingency plans (actions the company expects to take under different circumstances).

ACLI: The factors listed above (a through g) might be part of an individual insurer's overall, judgment-based evaluation of its risks. We might discuss, for example, whether a certification from an insurer's chief risk officer—written at a very high-level—might be an appropriate means of assuring a domiciliary regulator that the insurer has incorporated such a process. Confidentiality of any such information would be key, and our members believe that the submission process must be flexible enough to accept insurers' reports as they exist currently.

ACLI: We believe that risk sensitive regulatory financial requirements should provide the incentive for optimal alignment of risk and capital management by the insurer and by the regulator. We view this feature as critical. We might discuss, for example, rewarding insurers that have successfully incorporated the risk management process into their cultures.

- Risk "Quantitative"**
- h. Quantification/Assessment of each significant risk, assumptions used, sensitivity of assumptions, changes made to assumptions and the impact of such, etc.
 - i. Forward-looking Stress Testing, Description and Results
 - j. Forward-looking Scenario Testing, Description and Results
 - k. Trends
 - l. Documentation of any internal models used (e.g. overview of model, impact of significant assumptions)
 - m. Identification of any insurers in the group that have triggered an RBC action or control level and how that is considered in the insurer's risk management.

ACLI emphasizes that an ORSA, as we have described it, would be essentially and fundamentally a qualitative assessment—not a quantitative process. The primary tool of prudential regulation in the U.S. should be on the setting of the total financial resources requirement that is necessary to substantially ensure the solvency of the insurer so that it can continue to meet its insurance obligations at all times. It would be useful for regulators in their overall risk assessment of insurers to understand and consider the full range of capital management techniques and methodologies available to and used by insurers.

As above, we suggest that we should discuss relying upon CRO risk assessment, with detail available upon request, rather than inundating insurance departments with large volumes of detailed assumptions and other technical analysis, would be the most effective and efficient way to incorporate this perspective.

Risk and Risk Management "Other?"

m. Are there any other risk/risk management items that should be included?

B. Content: What should be included in the ORSA/ERM tool about SOLVENCY ASSESSMENT?

aa. A company's view of the short- and long-term significant risks and the amount of funds necessary to cover them. ("Short- and long-term" would require definition).

bb. Upon reflection of the significant risks the company identifies, does the company believe the RBC is too low?

cc. Prospective (forward-looking) solvency assessment to attest to the ability to maintain a going concern.

- Qualitative assessment
- Quantitative calculations

dd. The company's own target capital

ee. Explanation and documentation of the internal models used by the company, including the extent of reliance on outside models.

ff. Description of the reflection of significant interrelationships between risks and diversification effects considered.

gg. Basis for the calculations (e.g. economic valuation)

hh. Other solvency assessment?

ACLI strongly urges that detailed prescriptive standards are inappropriate. In our view, insurers should be given the flexibility to shape their risk management frameworks in the way most suited to their business objectives, consistent with a range of guidance published by risk management organizations in recent years.

Consider, for example, the question (bb) above. In our view, the purpose of required capital is to identify weakly capitalized companies. We suggest that the WG should take a position on the purpose of required capital before our industry can answer this question. This is another example of why we think a full discussion is needed.

Frequency: How often should the insurer perform this process (e.g. quarterly, annually, prior to financial examinations, when there is a significant change in the risk profile of a company)? How often should the insurer report on this process?

ACLI believes that an insurer should apply the insight gained from its internal risk management process to its ongoing and long-term management and decision making. An ORSA should not be designed solely to enable the insurer to complete as-requested information for the supervisor. Rather, the culture of the business should embrace an active internal risk assessment and risk management process. We believe that an insurer should not be required to report metrics.

If we were to agree on a CRO risk assessment, for example, we might recommend that it occur once every 3-5 years. More frequent updates could be triggered upon the domiciliary commissioner's request based on objective economic factors.

Confidentiality: How should confidentiality be maintained (e.g. through examination process or via a new law/regulation)? Which component(s) of the content identified in #1 is not proprietary and could be made public?

ACLI believes that it is vitally important that all components of an ORSA review process should be viewed as confidential and protected from requests under state Freedom of Information Acts.

Group / Legal Entity / Pool: At what level should regulators require this tool (e.g. group, legal entity, intercompany pool)? Should the tool be required based upon "how the enterprise is managed?"

a. How should non-insurance entities be considered?

b. Should international entities be included?

ACLI believes that any ORSA must be based on how an insurer chooses to operate, *i.e.*, on a legal entity or on a consolidated group basis. Under any approach (*i.e.*, legal entity, consolidated or hybrid), group-

wide solvency assessment should be applied in a way that properly aligns with the risk and operational characteristics of the group and its members.

Proportionality: How should U.S. regulators implement proportionality (e.g. size, nature/scale/complexity, extent of international activity, certain lines of business, etc.)? What exclusions from the requirements or simplified reporting would you recommend, and for whom?

ACLI considers that the proportionality principle is essential and should be expressly endorsed in any ORSA. All insurers should not be required to perform either an ORSA or exactly the same ORSA. It and any similar requirement would have to be proportionate to the nature, size, and complexity of an insurer's risks.

Should the U.S. implement a questionnaire or a minimum level of standardized reporting? If so, should the reporting be an abbreviated reporting, with the full report available for review at the company upon request? Should a "sample report" or template be provided for educational purposes?

ACLI: The NAIC should not seek to develop prescriptive standards for risk management by insurers; rather, insurers should be given the flexibility to shape their risk management frameworks in the way most suited to their business objectives, consistent with a range of guidance published by risk management organizations in recent years. Companies should have the option of providing existing reports or analysis, to the extent that they are responsive to high level regulatory inquiries.

Should the tool be entirely driven by the company or should the regulators specify items such as specific stress tests or safety levels?

- a) If regulators specify stress or scenario tests, what should be the focus of the tests (e.g. major interest rate shift, major changes in lapse rates, misestimation of parameters, large adverse development in loss reserves (including adverse court decisions, etc.)?
- b) If regulators specify a safety level (e.g. 99.0% TVar) and time horizon for solvency assessment, what should those be?

ACLI believes that the NAIC should not seek to develop prescriptive standards for risk management by insurers; rather, insurers should be given the flexibility to shape their risk management frameworks in the way most suited to their business objectives, consistent with a range of guidance published by risk management organizations in recent years. On the other hand, we can understand that regulators may desire to make sure all companies are meeting a minimum ORSA standard. We suggest discussing the concept that an ORSA could be an assessment tool if its framework provided some incentives to insurers. For example, if a company was performing its risk management adequately and provided a comprehensive ORSA to its regulator as part of the financial examination process, there would be a greatly shortened financial examination at the company. If its risk management is inadequate and the ORSA is incomplete, then the company would have to do more to support the financial examiners in their assessment of the financial condition and the risk management of the company.

Should the Board be responsible for the ORSA/ERM? If so, to what extent? Should there be a sign off or certification requirement (by an actuary, chief risk officer, risk professional)? Should there be a required report to the Board (e.g. on stress tests)?

ACLI emphasizes that an ORSA is a process, not an "answer." Further, while the board of an insurer has ultimate oversight of that process, implementation should remain the responsibility of management.

How great will the need be for additional resources? Do states need to hire more risk experts? Do they need these experts on staff, or should they hire consults or share resources?

ACLI: We share the concern about staffing, training, and resources. That concern is among the reasons that we recommend discussing a CRO certification process once every 3-5 years. We acknowledge that non-routine, particularly complex situations could trigger the use of independent consultants.

What should we name this tool?

Should the gap analysis show need for an ORSA, ACLI suggests Insurer Solvency and Risk Assessment Profile (ISRAP).

Sincerely,



Carolyn Cobb

NAIC ORSA Questions

Response from the Group of North American Insurance Enterprises (GNAIE)

1. What content should be included in the ORSA/ERM tool about RISK MANAGEMENT? What be included in the ORSA/ERM tool about SOLVENCY ASSESSMENT?

GNAIE believes that any evaluation of enterprise risk and capital adequacy should be part of the regular risk focused financial examination process. We believe it is appropriate to review enterprise risk processes, capital adequacy, and the capital management techniques and methodologies used by companies, but it does not need to be a separate assessment process. One goal should be to avoid duplication of effort by the regulators and companies. Such duplication would only add expense.

We do not believe a separate ORSA template should be dictated for use by companies. The assessment should tie directly to the company's own ERM process. The regulatory role should be to evaluate how the company or group, identifies, assesses and manages risk and capital. The NAIC should focus on identifying the information it wishes to assess, identify any information which is not currently evaluated in the risk-focused exam process, and then consider whether additional items should be added to the risk focused examination.

If the examiner finds a company's ERM systems to be in need of improvement, there could be procedures for more targeted interim exams of the ERM process to determine that corrective actions have been taken.

We believe the items noted in question 1 are appropriate areas for evaluation with the exception of the following item:

It is unclear what question 1, B, bb is asking about as it relates to RBC. As RBC is generally thought of as a minimum level of capital that triggers regulatory actions, it is unclear what the expectation is for its consideration in an enterprise risk management program.

2. Frequency: How often should the insurer perform this process (e.g. quarterly, annually, prior to financial examinations, when there is a significant change in the risk profile of a company)? How often should the insurer report on this process?

The frequency of an insurer's ERM assessment will most likely be based on individual company/group factors or considerations. Where risk exposures change significantly or where capital levels fluctuate a more frequent assessment would be expected. Using this approach, a regulatory review, would be linked to other triggering events or follow-up from previous examinations. The timing may depend on the overall approach. If in the process of an exam, an issue is identified, than the review might be initiated earlier than the next exam process. We are still discussing the role of stress testing in the review process and its relationship to the exam review.

3. Confidentiality: How should confidentiality be maintained (e.g. through examination process or via a new law/regulation)? Which component(s) of the content identified in #1 is not proprietary and could be made public?

- a. How should non-insurance entities be considered?
- b. How should international entities be included?

Information included in a company's enterprise risk management program and assessment is highly sensitive and would have significant competitive value if it were to be made public. Therefore confidentiality is a major concern with any proposed additional reporting. Company risk management assessments must remain confidential. We are very concerned that providing these in writing as part of a reporting system would expose these tools to competitors. Use of the risk focused examination process, which in most states provides appropriate confidentiality protections, seems to be the best approach to provide regulators with the necessary information.

4. Group/ Legal Entity/ Pool: At what level should regulators require this tool (e.g. group, legal entity, intercompany pool)? Should the tool be required based upon "how the enterprise is managed?"

- a. How should non-insurance entities be considered?
- b. Should international entities be included?

This self assessment tool should be based on how the company or group is managed and/or how risks are assessed and managed. Non-insurance entities, (including international entities) that bring risk to the group or individual company should be included.

5. Proportionality: How should U.S. regulators implement proportionality (e.g. size, nature/scale/complexity, extent of international activity, certain lines of business, etc.)? What exclusions from the requirements or simplified reporting would you recommend, and for whom?

We agree that the nature, scale and complexity of an entity should be a factor.

6. Should the US implement a questionnaire or a minimum level of standardized reporting? If so, should the reporting be an abbreviated reporting, with the full report available for review at the company upon request? Should a “sample report” or template be provided for educational purposes?

As indicated above, a template form is not appropriate as there could be significant differences across companies as to how their ERM programs are structured and operate. Additional guidance could be added to the examiner’s handbook to identify common items the examiner should consider. Such guidance would not be considered hard requirements but rather common expectations or best practices that would provide for consistent evaluations

7. Should the tool be entirely driven by the company or should the regulators specify items such as specific stress tests or safety levels?

- a. **If regulators specify stress or scenario tests, what should be the focus of the tests (e.g. major interest rate shift, major changes in lapse rates, mis-estimation of parameters, large adverse development in loss reserves?**
- b. **If regulators specify a safety level and time horizon, what should those be?**

The role of the regulator is to evaluate the ERM processes of insurers and not dictate what they should be. Given that, it is important for both regulators and companies to have some common expectations. Additional guidance in the examiner’s handbook could provide for that without identifying too low a level of detail. For example, it might suggest that companies should consider catastrophe exposure under multiple safety levels (e.g. 1:100, 1:250, 1:1,000) but not dictate exactly which levels should be used.

8. Should the Board be responsible for the ORSA/ERM? If so, to what extent? Should there be a sign off or certification requirement (by an actuary, chief risk officer, risk professional)? Should there be a required report to the Board (e.g. on stress tests)?

We believe it is appropriate to expect the Board of Directors to have oversight responsibilities for the enterprise risk management program. Depending on the entity or group it may be at a parent or holding company level or integrated in a broader program, so specific required reporting should not be defined.

9. How great will the need be for additional resources? Do states need to hire more risk experts? Do they need these experts on staff, or should they hire consults or share resources?

To the extent possible department staff should perform the evaluation as it is a central component of an insurer profile. Effective monitoring of insurer is enhanced with first-hand knowledge of the ERM practices of regulated entities.

10. What should we name this tool?

We have several suggestions:

Enterprise Risk Management Assessment (ERMA)

Insurer Self Assessment of Risk and Solvency (ISARS)

Company assessment of Risk and Solvency (CARS)

Even though the tool may have its own name, we still believe it is important to have it be integrated in the risk focused examination for the reasons cited above.

From: Kasinow, Robert B.
Sent: Monday, October 04, 2010 3:47 PM
To: DeFrain, Kris
Subject: RE: ISWG: ORSA Consultation

Kris,

Page 6 B2 - Suggest prior to examinations and when there is a change in risk profile. Commissioner discretion may be included also.

Page 6 B3 - Confidential through the examination process or also through states that can keep analysis work confidential.

Page 6 B3 - Based on how the entity is managed. Start at the group level and if there are risks that are not identified at the group level, they need to be specifically considered by the insurance entity. There should be consistency with how risks at a group level are addressed with the Annual Financial Reporting Model.

Page 6 B5 - Proportionality is important. Size, type of business, complexity all should be considered for the depth an ORSA. A single state auto writer should not have anything near the detail and complexity of a multinational insurer.

Page 7 Question #8 - Based on the revised Holding Company Act, two conditions related to the Board exist, “responsible for” or “overseas”. We may want to consider both here to be consistent. In some states the Board may oversee ORSA and the CEO/CFO may be responsible. Sign off by the Chief Risk Officer seems appropriate and there should be a summary report to the Board.

Page 8 Questions #9 - States currently do not have the required expertise to review internal models. States are just beginning to get a grasp on risk focused surveillance which included the C level interview process. Hiring may be difficult. The immediate solution may be using outside resources or some collective use of outside help coordinated by the NAIC, e.g. a central internal model review function.

Page 8 Question #10 - Especially so we do not appear to be strictly following along the non US, a new name is best. Perhaps something as simple as Risk and Mitigation Assessment.

Robert B. Kasinow
Assistant Commissioner
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(609) 292-5350 ext. 50081

-----Original Message-----

From: Meyers, Glenn G. [mailto:GMeyers@iso.com]

Sent: Friday, October 01, 2010 10:31 AM

To: DeFrain, Kris

Subject: RE: ISWG: ORSA Consultation

Kris:

Here are my responses to the questions in the ORSA Consultation Paper.

1A - With exception of (b) I think that the content is appropriate for ORSA. Of course the devil is in the details and going through EU type (QIS) surveys should root out potential problems. With respect to (b), it seems that risk appetite (while relevant to investors) is not appropriate for policyholders. From policyholder's perspective the solvency standards should be independent of risk tolerance.

1B - Appropriate, but in (ff) the state of the art in quantifying the effect of diversification is problematic.

2-3 I have no particular insight on those matters.

4 - Start simple with individual companies, and to the extent that the relationship between companies and groups are legally binding work, upward to groups. "Binding" is a legal question. My (non-lawyer) sense is that the legal relationships are well established at the group level and we should be able to regulate effectively at the group level.

5 and 6 - The EU has a "standard formula" for insurers that are unable perform an ORSA. It is intended to be deliberately conservative. I think the US should have something similar.

7a - Scenario/Stress testing should definitely be part of ORSA. There can be regulatory specified scenarios as is done in the Canadian DCAT, or insurer generated scenarios as well. Internal modeling conditioned scenarios should be used to capture the "process risk" on top of the scenarios which can reflect (some of the ??) "parameter risk." I suspect that most of the insurer's risk can be capture by stress testing.

7b - While the 99% level TVaR sounds good in theory, it is not clear to me that our collective expertise in modeling is good enough to rely on such a calculation. These thoughts drive my advocacy of scenario and stress testing. Most of the arguments backing the stochastic models rely on "reasonable assumptions" rather than rigorous retrospective testing. I will be speaking more about this at various forums in the coming months.

8 - It is hard to answer no to the idea that the Board should be responsible for ERM. I am not that familiar with the intricacies of corporate governance, but something like the CEO signing off on the report of the CRO sounds appropriate.

I hope this does not strike you as being negative on the ORSA concept.

I think this is a significant positive development. As implied above (if not explicitly stated) I think it is crucial for us to go through a series of EU style QIS studies. We will learn more about what works.

Glenn Meyers
ISO Innovative Analytics
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November 4, 2010

Director Christina Urias, Chair
International Solvency (EX) Working Group
NAIC
2301 McGee Street
Kansas City, Missouri 64108
Attn.: Kris DeFrain
By E-Mail: kdefrain@naic.org

Dear Director Urias:

Introduction

We respond here to the Working Group's Consultation Paper on the Own Risk and Solvency Assessment that is part of the NAIC's Solvency Modernization Initiative. NAMIC is a trade association with more than 1,300 mutual insurer members domiciled throughout the United States that write more than 37 percent of the property-casualty premium in this country. NAMIC regularly participate on behalf of that membership in deliberations of NAIC committees and is once gratified to have its voice heard by your Working Group.

With respect to format of this response, we address those questions we believe relevant to our interests that are posed in the eight-page document dated August 6, 2010, and titled "Consultation Paper" However, we begin with the following introduction to our concerns:

A preface

We question the need for an ORSA or ORSA-like filing with regulators, suggesting that existing filings and regulatory tools function well and have not been shown to be inadequate or wanting in any material way. We understand the NAIC's efforts in exploring use of an ORSA or ORSA-like filing to be directed toward homogenization or harmonization with the European regulatory regime being developed under Solvency II. Were regulation under Solvency II proven or perfected, development of an NAIC/state ORSA might be justified; current data and empirical evidence do not, in our judgment, provide reason to now add a very significant component to the regulatory arsenal.

Were we now amid the ruins of significant numbers of failed insurers, or surveying many insurers now in some stage of regulatory intervention, addition of an ORSA-like tool might be incumbent on regulators. Yet severe turmoil in the capital markets has not resulted in significant attrition and widespread weakness in the insurance sector in this country. It is not at all unreasonable—and is perhaps complimentary of the regulatory regime—that the current system is effective. Should the mold being created by Solvency II be pressed onto the U. S. insurance industry?

Indeed, does it fit the rules-based nature of regulation—financial and otherwise—in the United States? To what extent might the NAIC intend to have both rules-based regulation and principles-based regulation? The NAIC has carefully and deliberately developed rules-based model laws and regulations that serve well. Given that labor and care, this accumulation of rules for insurers can not be said to be obtuse, inadequate, or archaic. The regime may be simple, but it is not simple minded.

Will a principles-based tool, such as the ORSA, if imposed, yield an increment of supervisory intelligence or deftness that justifies reporting entities' incremental toil and expense? Can an ORSA, eliciting qualitative data on management's processes for treating risk and quantitative data on capital and results of operations, better prevent insolvencies? We admit we do not know this. Further, we do not believe regulators have evidence of such results. Will modelling—stress tests, scenario tests, other hypothetical applications—preclude insolvencies? Or might insolvencies result from new circumstances not understood by an ORSA or like tools? Or from old causes such as management's ineptitude or dishonesty?

By no means do we suggest that insurer solvency regulation can not be further perfected. Our concerns lie in the states not fully using existing tools and superimposing what appears to be a principles-based tool—with its initial and ongoing costs—on a very extensive rule-based regime of solvency regulation.

If, despite our reservations, an ORSA must be imposed, then we ask that insurers be spared filing what is elsewhere present, or outmoded, in existing regulatory reporting requirements. In other words, a reasonable approach would preclude duplicative and unneeded elements. What we ask, quite simply, is that the regulatory load not include excess.

In addition to those fundamental concerns associated with any imposition of an ORSA-like tool, we believe a pilot program, which might begin with larger insurers, especially those insurers with material international exposure, would be the only rational approach. A shake-down period for assessment of the value of such an added regulatory requirement would seem crucial.

Responses to numbered questions

1) Our general reservations, stated above, are the foundation of our response here. With respect to this question, less objectionable elements would be as follows:

A. Content—risk management

- a. Description of risk management and the process used to assess
- c. Identification of significant risks
- d. Identification of emerging risks.
- f.1. Recent changes
- f.2. Risk mitigation
- h. Quantification/assessment of each significant risk
- l. Brief model documentation with commentary on assumptions.
- m. Identification of any group member with an RBC breach.

B. Content—solvency assessment

- aa. Company's view of short- and
- cc. Statement as to going-concern status.
- ee. Brief model documentation with commentary on assumptions.
- ff. Optional commentary on significant risk-diversification measures.

2) Filings should in no instance be more than annually, but a more rational scheduling of filings might be based on agreement with the regulator, e. g., based on regulator findings in an examination.

3) The examination process might be possible for preservation of confidentiality. In any event, full confidentiality, rather than partial disclosure would be preferable to avoid any misinterpretation by the public of results. The proprietary nature, even of our suggested limited selection of data (see 1) above) again suggests full confidentiality.

4) Group capital may be relevant for certain matters of contagion or other potential weaknesses at the group level. However capital requirements, we believe, must be conducted at the legal entity level. We understand there are efforts to analyze and factor group capital into solvency regulation, but those may prove difficult to perfect. To the extent there is great commonality among companies in a group, then perhaps some consolidation of an ORSA might be possible.

5) Proportionality is important for our membership, which ranges from the very largest property-casualty insurers to the very smallest. "Complexity" of the insurer's risks underwritten, investment operations, and geographical spread might be said to be a guide for proportionality, yet "complexity" has subtlety that may be beyond convenient measure and application to any scale for recognition of proportionality. More practical and familiar is a general division between life and non-life insurers and, within the latter, size tiers based on premium magnitude. A beginning guide for proportionality division for non-life insurers might be those levels found in the Model Audit Rule's Section 14.

As may further be relevant for proportionality, if there must be an ORSA, and as recommended in our *Preface* above, a pilot program should exempt smaller insurers for some period of time during a period of shake-down.

6) If there must be an ORSA, then we suggest that, for purposes of reasonably uniform regulation, it would appear that some minimal level of reporting, manifest in a questionnaire, would be appropriate. Without such a template, regulators can expect greatly variant compliance.

7) If there must be an ORSA, maximize companies latitude to operate within whatever template may be appropriate for their size. Question 7) a) and b) require careful, open evaluation by an actuarially sophisticated subgroup.

8) If there must be an ORSA, then top management can be responsible for content.

9) Either source of expertise would suffice, but guidance for companies would likely best come from a source within a department. Successful recruiting and retention of such persons responsible on behalf of regulators for ORSA interpretation and compliance—Master's and Ph.D. level—would very likely require high level salaries.

10) Whatever the name, a first step is to prove its utility to the solvency regulation process and not be duplicative to the existing regime.

Finally, need for addition of a major new component to the NAIC/state regulatory regime seems not proven at this time.

Respectfully,

/s/ William Boyd

William Boyd
Financial Regulation Manager



Stephen W. Broadie
Vice President, Financial Policy

October 4, 2010

Kris DeFrain, FCAS, MAAA, CPCU
Director, Actuarial and Statistical Department
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Re: International Solvency (EX) Working Group Consultation Paper on the Own Risk and Solvency Assessment (ORSA) for the Solvency Modernization Initiative

Dear Ms. DeFrain:

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to comment on the NAIC's consultation paper on the concept of an Own Risk and Solvency Assessment (ORSA). PCI is composed of more than 1,000 member property/casualty insurance companies, representing the broadest cross-section of insurers of any national trade association. PCI members write over \$174 billion in annual premium, 37.1 percent of the nation's property/casualty insurance.

PCI agrees that it is entirely appropriate for regulators to review insurer risk management. Currently the NAIC and the states have taken significant steps in that regard through the new risk-focused financial examination and analysis process. We understand that international standards now call for an ORSA-like approach. We also understand, however, that the ORSA approach was developed in the context of regulatory systems that (in general) call for significantly less review of insurer risk management processes than does current U.S. insurance regulation. Therefore, we would like to begin with two overriding concerns:

- Whatever is done in this project must be coordinated with the new risk-focused examination process and other regulatory tools dealing with risk management. It makes no sense to develop a tool that duplicates or interferes with procedures companies and regulators are already conducting.
- We are very early in the development process for this new process. We look forward to additional opportunities to comment as the NAIC develops its thinking.

Following are our responses to the specific questions asked in the consultation paper:

2. *Frequency: How often should the insurer perform this process (e.g. quarterly, annually, prior to financial examinations, when there is a significant change in the risk profile of a company)? How often should the insurer report on this process?*

Our preliminary thought is that the insurer should perform its assessment annually, but reporting should generally be consistent with the timing of the financial examination. Perhaps material differences could be reported on an annual basis (similar to Form C holding company reporting).

3. *Confidentiality: How should confidentiality be maintained (e.g. through examination process or via a new law/regulation)? Which component(s) of the content identified in #1 is not proprietary and could be made public?*

The process, including any reporting, should at least be subject to the confidentiality protections of the Model Law on Examinations.

4. *Group / Legal Entity / Pool: At what level should regulators require this tool (e.g. group, legal entity, intercompany pool)? Should the tool be required based upon "how the enterprise is managed?"*

- a. *How should non-insurance entities be considered?*
- b. *Should international entities be included?*

The level at which this tool is applied to a group should be the level at which the group performs its own enterprise risk management, whether group, subgroup or legal entity.

5. *Proportionality: How should U.S. regulators implement proportionality (e.g. size, nature/scale/complexity, extent of international activity, certain lines of business, etc.)? What exclusions from the requirements or simplified reporting would you recommend, and for whom?*

One size does not fit all – proportionality is critical. The approach should be principles-based – a company should report on how it manages the risks it is subject to. Smaller companies might be able to use a rating agency's capital adequacy assessment system, if the company determines that is appropriate.

6. *Should the U.S. implement a questionnaire or a minimum level of standardized reporting? If so, should the reporting be an abbreviated reporting, with the full report available for review at the company upon request? Should a "sample report" or template be provided for educational purposes?*

7. *Should the tool be entirely driven by the company or should the regulators specify items such as specific stress tests or safety levels?*

- a) *If regulators specify stress or scenario tests, what should be the focus of the tests (e.g. major interest rate shift, major changes in lapse rates, misestimation of parameters, large adverse development in loss reserves (including adverse court decisions, etc.)?*
- b) *If regulators specify a safety level (e.g. 99.0% TVar) and time horizon for solvency assessment, what should those be?*

The content of the tool should be driven by the company. Companies will have different risks and risk tolerances, and will be affected differently by their abilities to raise capital, ownership structures and other factors. Companies should not be forced into a straitjacket.

With regard to stress testing, again proportionality is the key consideration. We do not believe this process should specify a safety level. Companies set their economic capital targets based on their own considerations, and we believe regulators should only specify minimum capital levels through RBC.

8. *Should the Board be responsible for the ORSA/ERM? If so, to what extent? Should there be a sign off or certification requirement (by an actuary, chief risk officer, risk professional)? Should there be a required report to the Board (e.g. on stress tests)?*

Boards of directors will have to be involved in the ERM process. We would strongly oppose a certification requirement, however.

9. *How great will the need be for additional resources? Do states need to hire more risk experts? Do they need these experts on staff, or should they hire consultants or share resources?*

We believe the costs for states will be significant.

10. *What should we name this tool?*

We don't have a name to suggest, but we agree that ORSA is inappropriate.

If you have any questions or comments, please contact me at your convenience. PCI looks forward to working with you as the NAIC continues to examine this concept.

Sincerely,

A handwritten signature in black ink, appearing to read "Step W Brodie". The signature is fluid and cursive, with the first name "Step" and last name "Brodie" clearly legible.

Stephen W. Brodie

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