Mr. James Hattaway,  
Co-Chair, Risk-Focused Surveillance Working Group  
National Association of Insurance Commissioners  
Attn: Ms. Becky Meyer, Financial Examination Manager  
Via e-mail: bmeyer@naic.org

Re: Draft ORSA Financial Analysis and Examiners Handbook Guidance

Dear Mr. Hattaway:

The undersigned Interested Parties thank you for the opportunity to comment on the Risk-Focused Surveillance (E) Working Group’s (RFSWG) draft ORSA Financial Analysis and Examiners Handbook Guidance, both of which were exposed during the Working Group’s March 18th conference call. We outline our general concerns below with both the Analysis and Examiners Handbooks, followed by some of our more detailed section-by-section concerns individually for each Handbook. We have also attached track changes versions of the Financial Analysis and Examiners Handbooks with suggested revisions. The page references included below refer to the track changes versions of the Handbooks that we have included. While we appreciate the opportunity to provide these initial comments, we look forward to a continued collaboration as the Working Group finalizes the ORSA Handbook additions.

We appreciate the need to include a review of ORSA Summary Reports in the Financial Analysis and Examiners Handbooks. We also appreciate attempts to retain references in the Handbooks’ introduction and background to the “Own” quality of U.S. ORSAs. However, we believe that the draft ORSA sections of the Handbooks that were recently exposed need some substantial modifications in order to ensure that the provisions are consistent with, rather than conflict with, the overall structure of the ORSA as defined by the ORSA model law and ORSA Guidance Manual.

GENERAL CONCERNS

- Premature – High level ORSA Summary Reports are still in the testing and pilot phase, with only a limited number of preliminary reports reviewed to-date. Therefore, there is a very limited set of experiences upon which regulators and industry can draw for any generalizations regarding expectations for the ORSA Summary Reports, as they get filed for the first time in 2015. Therefore, the depth and breadth of the ORSA Guidance Manual at this time is premature. We suggest that developing detailed specifications about how each aspect of the ORSA Guidance Manual should be reviewed should be undertaken only after we have learned from the pilot projects and the initial submission of the ORSA Summary Reports in 2015. Rather than rushing to develop draft Guidance before industry and regulators have learned from the new submissions, we urge the Working Group to undertake the same process that was used when Risk-Focused examinations were first introduced, which was to post general guidance on the NAIC’s website while simultaneously developing and rolling-out specific training programs.
• **Use of Checklists** – The draft Guidance inappropriately provides examples of stress tests and risks, with little regard to how these may vary by type of insurer. For example, there are multiple references to liquidity risk and detailed lists of asset risks with no reflection of the fact that these risks have only minor relevance to the vast majority of insurers in certain lines, while giving only cursory mention of high-priority risks in other lines. This serves to illustrate the pitfalls of attempting to incorporate a checklist review format, rather than train the reader to analyze the reports without a checklist and from an outcomes-based perspective. We urge the Working Group to remove all checklists from the manuals, and instead, develop a training program to ensure that all analysts and examiners have the appropriate levels of training and expertise to evaluate an enterprise risk framework.

• **Lead State** – It is critical for the ultimate success of the ORSA Summary Report project that all states adopt and adhere to the lead state concept. The Handbook is the appropriate vehicle to clarify the various roles of the lead and non-lead state in the review of the ORSA Summary Reports. Multiple, potentially conflicting and uncoordinated reviews of a company ORSA by various non-lead state regulators, without coordination through the lead state supervisor, will lead to confusing and conflicting directions to companies. Analysts and examiners should have clear direction to defer ultimate analysis to the lead state supervisor. While there is mention of the lead state concept on page 1, “ORSA Summary Report,” nevertheless the remainder of the document is silent, and in fact can be read as requiring all analysts and examiners to undertake all reviews, even when they are non-lead states. We have therefore recommended that the manuals make clear that analysis is being conducted in the first instance by the lead state, and point out as well that clarifying this concept is consistent with the intent to demonstrate a national coordinated supervision of the insurance industry for the Financial Sector Assessment Program (FSAP). We have attempted to make this change in the attached track changes versions of the Financial Analysis and Examiners Handbooks submitted with this letter, where applicable.

• **Conflict with ORSA Guidance Manual** – Both Handbooks reference “required” documentation and filings that are not referenced by the guidance provided in the ORSA Guidance Manual. While we recognize that the ORSA Guidance Manual has an intended audience of industry representatives and filers, and that the Handbooks have the regulatory analysts and examiners as their intended audience, nevertheless, the NAIC should not be providing conflicting guidance to the different audiences. Regulators must be trained to review the ORSA Summary Report in accordance with the Manual with which it was prepared or the entire purpose of creating an ORSA Summary Report – or the purpose of creating an ORSA Summary Report that is consistent with the guidance in the Manual – is undermined.

• **Too much expected from a “high level” summary** – The draft Guidance is extraordinarily detailed, and instructs analysts to perform a detailed evaluation and analysis of what the ORSA Guidance Manual itself describes as a “high level” Summary Report. The Handbook requires the analyst to make fine, granular assessments that normally would be impossible without significantly more detail than will be included in an ORSA Summary Report.
The ORSA Summary Report is not designed or intended to provide this level of detail. Therefore, the Handbook is setting the analyst up for an impossible task, given the material provided, and underscores the need to develop detailed training, and high-level guidance, rather than the list of specifics currently included in the Handbooks.

- **Risk review – generally** – The language throughout the draft Guidance should include the phrase “reasonably foreseeable and relevant material” before “risk” in all instances. Risks that are not reasonably foreseeable, or are not either relevant or material should not be considered. It is important that analysts and examiners exercise their educated, professional judgement in determining that which is important to solvency oversight, and that which is immaterial.

- **Overly prescriptive requirements that undermine the usefulness of ORSA** – The NAIC Working Group tasked to develop the requirements for the ORSA Summary Report was very clear and careful to ensure that its requirements did not interfere with a company’s own process of internal review of its risk and solvency. The ORSA Summary Report is precisely that – a report of a company’s own review of its own risks and its own solvency assessment. The draft Guidance, despite preamble language to the contrary, effectively contradicts the “own” nature of the internal assessment, as well as the “own” nature of the ORSA Summary Report by including detailed checklists and specifications and expectations that in many, if not most cases, will not be reflected in an ORSA Summary Report. The Handbooks, as noted above, should follow the ORSA Guidance Manual format. They should not undermine what has already been adopted by the NAIC by effectively creating a template that the original ORSA Guidance Manual drafters agreed was not in keeping with the spirit or purpose of the ORSA and ORSA Summary Report.

- **Capital modeling and capital assessments** – The draft Guidance regarding group capital assessment implies far more precision than the science of risk assessment and risk modeling can produce. The draft Guidance should focus more on ranges of results and acknowledge shades of gray in the science, rather than looking for precise values.

- **Incorrect focus on the nine branded risk categories** – The ORSA process and reports are intended to provide for insight into an insurer’s own unique risks and view on those risks. The risk-focused exam is then meant to focus on the most material and relevant risks, ideally utilizing the ORSA to provide insight on where to focus the examination. This may be undermined by focusing the examiner’s draft Guidance on the nine branded risk categories, especially where the Handbook directs the examiner to use those categories for their documentation of the exam. Rather than focusing on the risks identified by the ORSA, this draft Guidance seems to direct the examiner to focus on the nine branded risks in structuring their examination and documenting the result. The risk to this approach is that the analyst, by focusing on the “nine branded risks” will omit or ignore real risks, because companies are being required to assess their risks in the same manner. A non-standardized assessment will better highlight areas for further discussion.
• **Over-focus on stress tests without sufficient context** – The draft Guidance directs the examiner to evaluate the range of stress tests performed, without first focusing on the risks to be evaluated. Stress testing is a tool to aid in evaluating a risk, and that tool is applied differently for different risks. For example, catastrophe model runs implicitly utilize hundreds if not thousands of scenarios. Hence the use of an established cat model is by itself evidence of stress testing without the need for listing of individual scenarios. Similarly, models of reserving risk generally look at the range of possible outcomes that implicitly reflect many different scenarios. Therefore one would not expect to see a list of detailed scenarios when evaluating the assessment of reserving risk. The draft Guidance should provide more context on the role of stress testing for different risks, rather than creating an expectation for examiners that it plays the same role in assessing all risk types. We suggest including the language from the ORSA Guidance Manual, page 7: “U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer should test.”

• **Use of the ORSA Summary Report** – The Handbooks throughout reference the “use” of the ORSA Summary Report by company boards of directors. We suggest this reflects a possible misunderstanding of the intent behind the creation of the ORSA Summary Report. Companies, in the absence of regulatory requirements, do not create an “ORSA Summary Report” for their own use. Companies perform their “own risk and solvency assessment” in order to ensure that they have an understanding of their own risks, and that the company is well positioned to maintain its solvency in the face of those risks. This is an ongoing series of processes and analyses that have no real “beginning” and no real “end” but are instead, a continuous cycle of self-evaluation. In order to require companies to report on this self-evaluation, the NAIC developed a “Summary Report” which is created only and solely for use by regulators. Boards of Directors are involved in the company enterprise risk process in real time, on an on-going basis. They do not need a “Summary Report” of the company process because they are involved in it, and companies do not anticipate that board of directors will “use” the Report. The Report, rather, is intended as a communication vehicle to regulators. Reporting to the Board will be informed by the ORSA framework; however, the Board of Directors oversees management’s actions. It does not manage the day-to-day operations of the company.

• **Mandatory Use of RIMS RMM** – Both Handbooks reference the RIMS RMM in such a way as to preclude the use of any other model by the analysts or insurers. The Analysis Handbook for example, at page 3, paragraph 3, states that “The maturity level is assessed (emphasis added) through the incorporation of concepts developed within Risk and Insurance Management Society’s RIMS Risk Maturity Model (RMM).” We question why the NAIC has mandated the use of this particular model when others are available and in wide use. The Handbook should not be drafted in such a way as to suggest to the reader that there is a “correct” way for analysts and insurers to perform their analyses, when in fact there are many. As the Handbook notes, its draft Guidance “integrates the maturity level scale of the RMM,” thereby failing to make provisions for analysts and insurers that do not choose to use the RMM. The ORSA Summary Report is not intended to be a prescriptive document to drive an insurer’s
internal assessment of its own risks, but rather is intended to inform regulators about how that insurer performs its own analysis. The prescriptive language should be revised to inform the reader that RMM is only one of a number of available models and that the analysts/examiners should become familiar with whichever methodology the insurer has chosen to use.

- **Inappropriate Generalizations** – Throughout the draft Guidance, the words and phrases “most common”, “generally”, “commonly”, “much,” “most,” and “typically” are used when discussing internal models. These words create implicit standards for ORSA Summary Report preparers. They will often be inaccurate, or lead to inaccurate analysis. For example, while the risk tolerance/limits arising out of internal model usage may be used in day-to-day underwriting of homeowners policies, the model itself is not used for “day to day” decisions. (See page 26, Financial Analysis Handbook). Modeling is used to steer a wide course in risk analysis and possibly in some cases, pricing. They are often not used to make specific decisions about specific risks, and are generally, due to their complexity, only run on a quarterly or less frequent basis. Another example of an inappropriate generalization includes the use of the phrase “all areas” on page 8, in the “Managed Practices” subsection of the Financial Analysis Handbook. The term “all” should be used sparingly in the document, as any trait is rarely universal and can be countered with a single counter-example if materiality is not a consideration. It is also difficult to see how one can determine whether “all areas” meet or don’t meet certain criteria from a high level Summary Report.

The analysts should not be encouraged to consider that there are models that are used “most” frequently or that are “common” or that are in some way more appropriate than others. Rather, the analyst should be encouraged to understand the process that each company has devised for itself and to exercise appropriate and educated professional judgement when reviewing that process.

- **Use of the ORSA by Regulators** – The draft Guidance indicates that “the primary purpose of the ORSA is to serve as an input into the risk-focused surveillance process where among other things, the insurers risk is assessed and such assessment has a direct impact on the ongoing supervisory plan...up to and including a hazardous financial condition determination.” This suggests that regulators expect to use quantitative risk and capital benchmarks established by companies as the basis for regulatory action. This is inappropriate and unwise, as it encourages companies to adopt weaker “own” frameworks so as to mitigate regulatory risk. This also undermines the true regulatory value of the ORSA requirement, which centers on a deeper understanding of the company’s business, strategy, risks, and management. (See for example, page 2, paragraph 3, Financial Analysis Handbook)

**SPECIFIC COMMENTS**

In addition to the “General Concerns” noted above that are applicable to both Handbooks, we offer the specific comments below with respect to the Financial Analysis and Examiners Handbook as illustrations of changes that would need to be made in order for the Handbooks to conform to the actual guidance that has been provided to the industry via the ORSA
Guidance Manual, and to prevent the Handbooks from undermining the usefulness of the ORSA as a means to determine what a company’s own internal risk and solvency assessment program includes.

SPECIFIC COMMENTS – FINANCIAL ANALYSIS HANDBOOK

We incorporate the “General Concerns” noted above for inclusion in the Financial Analysis Handbook. In addition, we make the following specific comments with respect to this exposure:

Background
We appreciate and support language in the draft Guidance that cautions against dictating specifics for what should be included in the ORSA Summary Report.

I. Page 3 – “General Summary of Guidance for Each Section”

a. On page 5, paragraph 2, the phrase: “how these risks are mitigated” is used in the last sentence. This should be changed to “how these risks are managed”, as mitigation is only one risk management option.

b. On page 5, paragraph 3, the phrase “9 branded risk classifications” is used. As noted above, it is critical that the Handbooks do not create a static template of risks. The concept of a static template runs counter to the concept of “own” and fails to take into consideration the variations between companies and industries. We suggest instead that the analyst’s report should document the prioritized or key risks identified in the insurer’s ORSA report. If the Financial Analysts Handbook contains a series of detailed checklists for the analyst’s review of ORSA Summary Reports, it will entirely undermine the regulator’s ability to analyze a company’s own analysis of its own risks – which is the ultimate purpose of the ORSA Summary Report. Analysts should be encouraged to move away from a “check the box” analysis and instead, consider each company ORSA on its own merits.

II. Page 7 – “Review of Section I – Description of the Insurer’s Risk Management Framework”

a. On page 7, paragraph 1, the phrase “assessment of the insurer’s maturity level for each key principle” is used in the last sentence. While acknowledging the intent for only an “initial” assessment, it is probably expecting too much for the analyst to perform the granular assessment for each of the 5 listed key principles from just a high level Summary Report. The expectation is excessive both with regard to what the analyst can achieve and what a high level Summary Report can communicate. As such, this expectation should be more in line with a high level Summary Report – i.e., a high level summary assessment. As noted above, the depth and breadth of the information being requested at this stage of the program is overly extensive, and we suggest that the NAIC devote its resources at this point in time to developing an in-
depth training program to give examiners and analysts the appropriate training to allow them
to exercise appropriate professional judgement when reviewing an enterprise risk framework.

b. Beginning on page 7, leading onto page 8, the Handbook informs the reader that a
company’s risk culture is necessarily “top driven.” This is not necessarily correct. Company
culture is as different as any other facet of company operations, and so the Handbook should
not instruct the analyst otherwise. While we believe everyone agrees that “tone from the top”
is critical, nevertheless companies can and do have different levels of risk culture being driven
at different levels within the company and it is inappropriate for the NAIC to mandate that only
one approach be required or preferred.

c. Page 10, in the first paragraph of “C. Risk Appetite, Tolerances and Limits,” the
Handbook states: “For example ... a 1 year horizon with 99.97% confidence”
An analyst should better understand and document the basis of calibration, if appropriate. We
suggest deleting the sentence that includes this numeric example.

d. Page 14, fourth bullet point, directs the analyst to require companies to “Describe your
board of directors’ review of the ORSA Summary Report and their reaction.” This language
should be revised to refer instead to the “ORSA process.” The question presumes that the
board of directors for every company will be reading the precise document that will be
submitted to meet the ORSA Summary Report filing requirement. This is not correct. As noted
above, boards are involved in the enterprise risk and internal solvency oversight of their
companies on an ongoing basis. The Group Solvency Issues Work Group [has recognized] that
the board will not “read” the ORSA Summary Report, but rather that they will receive reports
throughout the year that may include the information contained in a portion, or section, of the
ORSA Summary Report. During the course of financial examination, the minutes of board
meetings are routinely reviewed so examiners are already reviewing company discussion of
financial and solvency oversight at the board level.

e. Page 16, “Required Documentation for Section I”
As noted above in our general comments, we urge the Working Group to remove all
“mandatory” checklists from the Handbooks. Analysts instead should be trained to exercise
appropriate professional judgement and to review the ORSA Summary Report pursuant to the

III. Page 18 – “Review of Section II – Insurer’s Assessment of Risk Exposure”

a. Pages 18-20, Use of Checklists
The Handbook sets out a check the box list of risk documentation that, despite any language in
the introduction to the contrary, will be used by analysts as a static, routine filing requirement
for all companies. This is directly contrary to the spirit and directives of the ORSA Summary
Report and the ORSA pilot project. The whole concept behind the ORSA Summary Report was
to move away from a checklist approach to solvency oversight. The proposed language would
result in analysts not being encouraged or trained to analyze and understand their companies;
rather than being encouraged to “check the boxes.” The simplistic descriptors, such as “Pricing and underwriting practices are inadequate to provide for risks assumed” does nothing to instruct the reader how to learn about the company and its solvency and risks, it does not train the analyst how to review the ORSA Summary Report to find the information that according to the ORSA Guidance Manual will not be set out in checklist form, and does nothing to tie the analysis to the ORSA Guidance Manual at all. Rather, it only creates a template that does not recognize the risks that the company sees for itself in its own business. Furthermore, the definitions of specific risks should include the appropriate description based on the line of business or line of insurance involved (e.g. P&C, Life, or Health).

b. On Page 20, paragraph 2, “Most Relevant Information Documented by the Analyst from Section II,” the Handbook states that the “analyst’s documentation should be focused on grouping the information into the above format” As noted above, this is not an appropriate method of analyzing an ORSA Summary Report. The language suggests that the ORSA should follow a template. Just as the ORSA should be customized to reflect an insurer’s unique risks and situation, the analysts’ reviews of the ORSA should be customized to reflect the unique situation they are reviewing. Too much standardization is counter-productive to understanding the risks of the insurer.

c. On page 20, in the second paragraph under “Most Relevant Information Documented by the Analyst from Section II,” the Handbook indicates that the risks listed “generally represent the most material and most quantifiable risks.” Appropriate review of an ORSA Summary Report is not susceptible to a checklist approach; analysts should be taught, and encouraged, to use appropriate professional judgement when performing and ORSA Summary Report analysis. Forcing a review by a check-the-box analysis fails in all respects to honor the underlying concept of the ORSA Summary Report – that it is a report to inform a regulator about that company’s internal process, not to develop or steer the process.

To the extent that the proposed checklists are not specifically included in the ORSA Guidance Manual, then they conflict with it. The ORSA Guidance Manual is what insurers will look to for guidance in developing their ORSA Summary Reports – that guidance must be the same as the guidance given to those who will analyze those reports. The NAIC does a significant disservice to both companies and regulators by developing a tool for regulators that differs in any way – much less in such significant ways – from the guidance being given to insurers.

d. Pages 21 and 22 contain a list of sample stress tests. We repeat and reincorporate our comments above regarding the use of lists, and again respectfully refer the work group to the language in the ORSA Guidance Manual on page 7, which states that “U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer should test.”

IV. Page 24 – “Review of Section III – Group Assessment of Risk Capital”

a. On page 24, paragraph 1, there is a reference to “the appropriate amount of capital for the group.” There are many places in Section III where the phrase “appropriate” is used to
describe capital standards. This language implies more precision in capital assessment than is warranted. We suggest amending the language to focus on the reasonableness of group capital rather than the appropriateness, with more recognition of risk measurement uncertainty.

b. On page 24, paragraph 3, the Handbook states: “it may be appropriate to request the most recent quarter’s calculated amounts (required capital and available capital)”. This language does not recognize the timing issue embedded in the ORSA Summary Report filing requirement, which provides for annual reporting with no strict timetable. The instructions to the analyst imply that the analysis should consider recalculating all risks on a quarterly basis. This direction is not appropriate for an ORSA analysis.

c. Page 25, paragraph 1 contains language that appears to incorporate Solvency II metrics and phrasing such as “market consistent” and “99.5% probability”. This implies that all economic capital models use “market consistent” balance sheets. (Note that “market consistent” valuations do not necessarily inform the analysis of the future cash flows expected from an item, and future cash flows should be the focus of many internal models rather than liquidation values as represented by “market consistent” values.) The discussion also references the Solvency II standard of 99.5% probability, which some believe is beyond the level of reliable precision for risk analysis. These references should be removed. If any example approaches are used they should include approaches consistent with U.S. statutory accounting and risk-based capital.

d. Page 25, the last sentence of paragraph 2 states “When this is combined with the inherent risks that exists with any model (e.g. inaccurate data inputs, risk factors, incorrect model specification), it is difficult for an analyst to place too much reliance on an economic capital figure, even though it can be extremely informative” and the first sentence of the second full paragraph on page 26 states “For purposes of evaluating capital, the more appropriate capital measure considered by the analyst may be the rating agency capital.” These comments bring into question the value of internal capital models while encouraging the use of rating agency capital models and seem to contradict the emphasis on “Own” given that it encourages use of “one-size-fits-all” capital models employed by rating agencies in place of internal models reflecting the uniqueness of each organization. The draft Guidance should not state a preference for one capital model over another.

e. On page 25, at the bottom, continuing to the top of page 26, there is a discussion regarding testing and validating internal models. We reincorporate the comment we made in section II.a., above. The expectation that the analyst will be able to perform this task given the high-level nature of an ORSA Summary Report is excessive both with regard to what the analyst can achieve and what a high level Summary Report can communicate. Therefore, this expectation should be more in line with a high level Summary Report – that is, a high level summary assessment. As noted above, the depth and breadth of the information being requested at this stage of the program is overly extensive, and we suggest that the NAIC devote its resources at this point in time to developing an in-depth training program to give examiners
and analysts the appropriate training to allow them to exercise appropriate professional judgement when reviewing an enterprise risk framework.

f. Page 26, in the first full paragraph the Handbook suggests that the “U.S. regulator has the authority to require the entire group ORSA even though it’s in a different form.” While we agree that the Holding Company Act provides for access to group-level information, the ORSA itself is not the required medium for providing it. We would propose that the draft Guidance focus on the evaluation of the ORSA and the range of ways that an insurer may meet the requirement to provide a group capital assessment, and not include or introduce specific requirements to provide a report which may not be available or may not meet the requirements of the U.S. ORSA.

V. Page 27 – “Required Documentation for Section III” – Grid of capital requirements

a. This mandatory grid implies more precision to the undertaking of assessing capital than actually exists. Capital management and evaluation generally does not produce hard and fast numbers but instead produces ranges. There is a general range where the capital is roughly in an “AA” range, and a range where it is roughly in an “A” range, for example, but those ranges may overlap. Similarly, if using economic capital model runs, they may vary based on certain assumptions and parameters, with no clear signal as to which set of assumptions/parameters are the “right” ones, or which are more right than the others. Hence requiring a table of numbers for this documentation places the analyst in the position of demanding information and results that do not exist. We suggest removing the table, and inserting, instead, the following. The language below is taken from the ORSA Guidance Manual and should be inserted into both Handbooks.

Because the risk profile of each insurer is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer should run, however, the regulator may have input regarding the level of stress that the insurer should consider for each risk category. The ORSA Summary Report should demonstrate the insurer’s process for model validation, including factors considered and model calibration. Unless a particular assumption is stochastically modeled, the group’s management will be setting their assumptions regarding the expected values based on their current anticipated experience studies and what they expect to unfold over the next year. The regulator may provide input to an insurer’s management on a stress factor that should be applied for a particular assumption that is not stochastically modeled. For assumptions that are stochastically modeled, the regulator may provide input on the level of the measurement metric to use in the stressed condition or may specify particular parameters under in the economic scenario generator. The aforementioned input provided by regulators will likely occur during either the financial analysis process and/or the financial examination process.

b. On page 28 in the section titled “Cushion Based Upon Use of Economic Capital Scenarios and/or Stress Testing,” we recommend the following revisions (additions indicated with an underline and deletions with a strikethrough):
Perhaps the most subjective determination when considering group capital is determining the sufficiency of such amount above a predefined minimum. That minimum, be it regulatory, rating agency, or economic, uses certain assumptions, including assumptions that already provide a cushion. In determining adequate additional cushions, one approach would suggest a cushion that is either unlikely to be necessary, or is developed in a manner that attempts to capture some precision in a cushion that may be deemed most desirable by the company. The above discusses the use of economic capital and how such approach captures some level of precision since it sets aside an estimate of capital for a given security standard; for example, a 1 in 100 year event numerous scenarios unlikely to commonly occur. The above also discusses the value of stress testing for providing similar value and more easily transparent scenarios. It’s difficult to suggest one method and approach is better than another, just as it’s difficult to suggest certain stresses are more important and relevant than others. The Lead State analyst shall bear in mind the “Own” in ORSA, noting that each insurer’s methodology and stress testing will vary. However, the Lead State analyst should be able to develop and document the general level of precision that can be obtained methodology applied and—how outputs from the prospective solvency calculations that compares with recent trends for the group, and in general, be able to determine if the cushion is either sufficient, or well in excess of internal or rating agency capital.

VI. Pages 30-31 – “More Specific Considerations for Reviewing Section III – Group Capital”

Many of the sample questions outlined in the draft Guidance are too leading, and therefore will not provide accurate information for the analyst. For example, the question in the third bullet on page 30, “do the data series or model inputs look back far enough to cover all possible events … [o]r does the data go back less than 5 years” implies that 5 years is sufficient, even in situations where the past 5 year history does not reflect certain foreseeable stress events. A better question in such a situation would be to ask, what assurance does the insurer have that such an experience period is long enough?

In addition, some of the questions set impossible expectations. For example, the question in the fifth bullet on page 30 includes: “how often do you stress your risk diversification/correlation patterns and do you have any recent back testing available for review.” In this example, it is impossible to collect data on correlations for 1 in 100 year events given how dynamic the underlying environment can be. The world changes too fast to collect enough such data to back test correlations at the tail. This question should be deleted.

In general, we also suggest that discussions regarding back testing should be in the financial examiners Handbook, rather than the analysis Handbook, as review of back testing is more appropriately an examination function.

SPECIFIC SECTIONS – FINANCIAL EXAMINERS HANDBOOK

We incorporate the “General Concerns” noted above for inclusion in the Financial Examiners Handbook. In addition, we make the following specific comments with respect to this exposure:
I. **Preamble and Background Sections**

We include proposed revisions to the Preamble and Background sections in the attached track changes version of the Examiners Handbook, in order to bring both into compliance and agreement with the ORSA Guidance Manual. While we recognize that the ORSA Guidance Manual’s intended readership is the industry and the Handbook’s intended audience are state examiners, nevertheless it is critical that both regulators and industry have the same understanding and background regarding the history and purpose of the ORSA project.

II. **Page 4 – “General Summary of Guidance for Each Section”**

a. We suggest including language in the General Summary of draft Guidance, at the beginning of the section that reminds the examiner that there are no specific stress conditions that each company should test, and to refrain from using a “checklist” approach to examinations. We suggest the following be inserted at the end of the paragraph on page 4, prior to “Section I”:

   Further, regulators do not believe there is a standard set of stress conditions each insurer should test. The Lead State examiner should never specify the stresses to be performed, nor what should be included in the insurer’s ORSA Summary Report, as this would eliminate the “Own” aspect of the ORSA and defeat its purpose, which is to permit the Lead State regulator to better understand the risk from the perspective of the insurer. This is not to suggest that the Lead State examiner should not consider asking questions about the extent to which the insurer considers particular risks, as these questions may provide the insurer an opportunity to discuss the robustness of its processes and considerations, either in specifically identified stresses, or the inclusion of similar risks within a stochastic economic capital model for a particular risk.

b. On page 4, paragraph 1 under “Section I”, we suggest removing the language beginning with “In addition” down through the end of the paragraph. The purpose of the examination is to review what the company has done with regard to its own risk and solvency analysis. The examiner should not be performing an independent set of tests to determine other risks with regard to the ORSA review; rather they should be reviewing the ORSA Summary Report to gain a deeper understanding of how the company does its own analysis.

c. On page 5, in the second full paragraph after the bulleted list, which begins with “Ultimately,” we suggest removing the sentence beginning with “For example” through the end of the paragraph. The example is not precisely accurate and does not add significant value to the discussion.

d. On page 6, paragraph 2 of “Section II,” the draft Guidance states that “… the examiner should use the [nine branded risk] categories as a way to organize and evaluate the information presented …” Despite the caution about an insurer not being expected to address each of these
risks, instructing the examiner to use this list in the first instance for organizing, evaluating and, as discussed later, documenting the examination of the insurer’s risks creates a \textit{de facto} ORSA template. We suggest instead that the risk categorization be based on the company’s own risk identification and prioritization, not on a pre-established, potentially irrelevant, incomplete or incorrect, universal list of risks. We also reincorporate our general comments, above, regarding the use of the nine branded risks.

e. On page 6, in the last paragraph before Section III, insert: “However, regulators do not believe there is a standard set of stress conditions each company should test. Consistent with the language on page 7 of the ORSA Guidance Manual, the Lead State examiner should not specify the stresses to be performed nor what should be included in the company’s ORSA Summary Report, as this would eliminate the “Own” aspect of the ORSA.”

f. On page 6, paragraph 1 of “Section III”, the Handbook uses the phrase “capital the insurer determines is necessary.” We suggest changing the word “necessary” to “reasonable”. Capital requirements to sustain a rating are typically not hard and fast bright lines, especially when dealing with the capital required to survive an uncertain stress event or when dealing with hard-to-quantify tail risks. The science underlying this analysis is not exact or precise.

\textbf{III. Page 7 – Review of Section I - Description of the Insurer’s Risk Management Framework}

a. On page 7, paragraph 1 under “C,” the handbook states that “[a]n initial evaluation of each of the [key risk management] principles should be performed by the financial analyst …” As indicated in our comments to the Financial Analysis Handbook, we question whether the high level ORSA Summary Report will contain sufficient information for an analyst to opine on each of the five principles. Furthermore, the analyst should not necessarily focus on the five principles but rather on the specific risks identified by the insurer in the ORSA Summary Report. We believe that the analyst should only be expected to produce a high level evaluation regarding application of the key principles (given that they would only be working with the “high level” ORSA Summary Report), although that would be a natural starting point for the examiner’s evaluation.

b. Beginning on page 7, throughout the section titled “Considerations When Reviewing Key Principles,” the instructions to the examiner appear to confuse the functions of management and boards of directors. \textit{Management}, not boards will establish frameworks for solvency review. The \textit{Board of directors} generally approves risk appetite statements. It is critically important that this section not provide examiners with expectations of corporate culture that is inappropriate, inaccurate or misleading. We have included substitute language in the attached track changes version of the Examiners Handbook.

c. On page 10, the section titled “Risk Appetite, Tolerances and Limits” states: “For example ... a 1 year horizon with 99.97% confidence.”
An analyst should better understand and document the basis of calibration, if appropriate. We suggest deleting the sentence that includes this numeric example.

d. In the chart beginning on page 14 under “Examination Procedures for Section I,” the word “management” or “management committee” should be inserted before “board” or “directors” throughout to recognize that companies may vary in their practices. The manual should not dictate how companies govern themselves, and examiners should be cautioned against recommending one process or procedure over another.

IV. Page 16 – “Required Documentation for Section I”

We repeat our comments above regarding the use of mandatory documentation language and checklists. The Examiners should not be encouraged to tick and tie to a checklist, but instead, should be encouraged and trained to use appropriate and accurate professional judgement in their review of an ORSA Summary Report and evaluation of an ORSA framework. The use of a checklist undermines the entire nature and purpose of an ORSA Summary Report and creates confusion and conflict with the ORSA Guidance Manual that regulators have provided to the industry.

V. Page 17 – “Review of Section II - Insurer’s Assessment of Risk Exposure”

a. Page 18, in the first full paragraph immediately before “Stress Testing,” there are multiple references to the “nine branded risk classifications.” As noted above, instructing the examiner to use this list of nine risks for organizing, evaluating and documenting the examination of the insurer’s risks inappropriately creates an ORSA template. Instead, the risk categorization should be based on the company’s internal risk identification and prioritization, not on a pre-established list of risks.

b. On page 18, in the first paragraph under “Stress Testing,” the Handbook states: “… Section II also requires the risk exposures to be documented under both normal and stressed environments.” This appears to be an overstatement of the requirement in the ORSA Guidance Manual. The Manual requires that “the insurer should analyze (emphasis added) the results under both normal and stressed environments,” but does not require that the result be documented in a particular manner. Hence it would be reasonable for an examiner to investigate proof of the analysis but not to require pre-existing formal documentation of the result.

c. The “Stress Testing” section in general, page 18. As noted in the general comments, above, this draft Guidance creates an expectation that a company have a list of stress tests for each risk identified, which is inappropriate. The Handbook should instead instruct the reader about the role of stress testing, which then may lead the examiner to investigate the stress testing for those situations where it is appropriate, and to the extent that it is appropriate.
Otherwise this Handbook would make a list of stress tests for each risk identified into an implicit standard or checklist requirement for all ERM work.

We acknowledge the caution at the end of the stress test examples about not expecting stress tests for all risk areas, but believe this is too late in the discussion and not sufficiently clear. The draft Guidance regarding “evaluating the effectiveness of the insurer’s stress testing for each of the nine branded risk classifications” found at the top of page 20, and the inclusion of checklists in the draft Guidance effectively contradict and undermine this caution. We again respectfully refer the work group to the language on page 7 of the ORSA Guidance Manual, which states: “U.S. regulators do not believe there is a standard set of stress conditions that each insurer should test.”

Note also that we have a similar concern with the expectation raised in Section E at the end of the External Capital Models discussion on pages 23-24.

d. Beginning on page 20, there is language regarding the use of the nine branded risk classifications in the “Required Documentation for Section II.” As noted above, we urge the Working Group to remove this list of risk categories for the required documentation, which also conflicts with the ORSA Guidance Manual on which the ORSA Summary Report is based. It creates an implicit checklist requirement, rather than focusing on the unique risks of the insurer. We suggest that the reference to required documentation oversteps the spirit of the “own” in ORSA. Furthermore, the definitions of specific risks should include the appropriate description based on the line of business or line of insurance involved (e.g. P&C, Life, or Health).

VI. Page 21 – “Review of Section III - Group Assessment of Risk Capital”

a. Page 22, paragraph 1: “Sufficiency of capital”
The reference to capital “sufficiency” implies the determination of a single number. This is not an appropriate message to the examiner, given that capital assessments, particularly on a group level will aim for a reasonable range, rather than to hit a specific target. Examiners should be directed to focus on the reasonableness of the company’s assessment, rather than to independently determine capital under a rigid, inappropriate, and unworkable standard.

b. On page 22, in the last paragraph before “Internal Capital Models,” the Handbook states: “Some insurers will develop a group capital assessment based upon an internal model, whereas other insurers may rely on an external model …” In a later section of this draft Guidance, it is acknowledged that many insurers using an internal model also look at external models. This use multiple metrics/models should be acknowledged up front.

c. On page 22, in the second paragraph under “Internal Capital Models,” the Handbook states: “The most common method attempts to develop an estimated amount of economic capital necessary to satisfy policyholder claims and other group obligations at a particular confidence level (e.g. 99.5% probability the insurer will be able to meet its obligations over the next 12 months).” We have several concerns with this wording.
• First, the use of the word “most common” may lead to an implicit standard for companies based on the expectations of examiners following this draft Guidance and should be deleted. At least some U.S. insurers determine their economic capital using a longer time horizon and correspondingly appropriate confidence level, akin to U.S. RBC.

• Second, it mentions only one risk metric rather than discussing the variety of risk metrics used. The metric mentioned is also labeled Value at Risk (VaR), but Tail Value at Risk (TVaR) is also common, and the ability to withstand a stated scenario may also be used. The draft Guidance should mention more than one metric, and should not dictate the application of any one metric, as the methodology used should be applicable to the company’s own risk tolerance.

• Third, by mentioning only one specific confidence level (the one used in Solvency II), the draft Guidance may result in making that level an examiner expectation. If a confidence level is to be mentioned, it should be generic, such as “X.XX% probability”.

• Fourth, if any example approaches are used they should include approaches consistent with U.S statutory accounting and risk-based capital.

d. In the diversification and correlation discussion on page 22, third paragraph under “Internal Capital Models, it presumes that this concept relates only to product or business diversification strategies. This is incorrect. An insurer that takes an insurance risk and invests the premium has both insurance risk and investment risk, hence diversification issues arise even for monoline insurers. Diversification and correlation issues arise whenever there is exposure to more than one risk. The concept is that the worst cases scenarios for each of the risk exposures are unlikely to all occur at the same time. The discussion of diversification should be revised to more correctly communicate this concept.

This discussion also references the Solvency II confidence level of 99.5%, raising this as an expectation for examiners when performing their work. This reference to a specific confidence level should be deleted so as to avoid creating an unwarranted expectation.

e. On page 25, under “Required Documentation for Section III” paragraph 1.a. the Handbook states: “Discuss the method used ...” We suggest changing this to “Discuss the method(s) used ...”, as many insurers will use more than one of the listed methods.

f. On page 25, under “Required Documentation for Section III” paragraph 1.b., the Handbook states: “discuss ... [m]aterial assumptions and methodologies utilized in calculating a diversification credit based on the correlation between risk components.” We observe that this is frequently a highly technical area. Will the examiner community be adequately trained and prepared to provide this discussion, or is the expectation instead that consultants engaged by insurance departments will provide this discussion?

We thank you for your consideration and response to our concerns. The Interested Parties, as noted below, agree with the comments contained in this letter.
<table>
<thead>
<tr>
<th>Organization</th>
<th>Name</th>
<th>Phone Number</th>
<th>E-mail Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Council of Life Insurers</td>
<td>Kelly Ireland</td>
<td>202-624-2387</td>
<td><a href="mailto:kellyireland@acli.com">kellyireland@acli.com</a></td>
</tr>
<tr>
<td>American Insurance Association</td>
<td>Adam E. Kerns</td>
<td>202-828-7163</td>
<td><a href="mailto:akerns@aiadc.org">akerns@aiadc.org</a></td>
</tr>
<tr>
<td>America's Health Insurance Plans</td>
<td>Bob Ridgeway</td>
<td>501-333-2621</td>
<td><a href="mailto:bridgeway@ahip.org">bridgeway@ahip.org</a></td>
</tr>
<tr>
<td>BlueCross BlueShield Association</td>
<td>Joseph E. Zolecki</td>
<td>312-297-5766</td>
<td><a href="mailto:joseph.zolecki@bcbsa.com">joseph.zolecki@bcbsa.com</a></td>
</tr>
<tr>
<td>National Association of Mutual Insurance Companies</td>
<td>Michelle Rogers</td>
<td>307-875-5250 x1070</td>
<td><a href="mailto:mrogers@namic.org">mrogers@namic.org</a></td>
</tr>
<tr>
<td>Property Casualty Insurers Association of America (PCI)</td>
<td>Stephen W. Broadie</td>
<td>847-553-3603</td>
<td><a href="mailto:steve.broadie@pciaa.net">steve.broadie@pciaa.net</a></td>
</tr>
<tr>
<td>Reinsurance Association of America</td>
<td>Joseph B. Sieverling</td>
<td>202-783-8312</td>
<td><a href="mailto:sieverling@reinsurance.org">sieverling@reinsurance.org</a></td>
</tr>
</tbody>
</table>
This section on the Handbook provides general guidance for use in reviewing, assessing and utilizing the results of an insurer’s Own Risk and Solvency Assessment (ORSA) in conducting risk-focused examinations. While only certain insurers will be required to file an ORSA Summary Report (ORSA Summary Report or Summary Report), concepts included in this section of the Handbook may also be beneficial to Lead State examiners in reviewing, assessing and utilizing the results of Enterprise Risk Management (ERM) activities performed by the insurers. Therefore, this guidance may be used in support of the risk management assessments outlined in other sections of the Handbook (e.g., Phase 1, Part Two: Understanding the Corporate Governance Structure, Exhibit M – Understanding the Corporate Governance Structure) at the discretion of the Lead State examiner.

A. ORSA Summary Report

The NAIC Risk Management and Own Risk and Solvency Assessment Model Act (Model #505) requires all insurers with direct written premium and unaffiliated assumed premium of $500 million and greater to submit an annual ORSA Summary Report and/or all insurers who are a member of an insurance group that have direct written premium and unaffiliated assumed premium of $1 billion and greater to submit a group annual ORSA Summary Report. The model gives the insurer and insurance group discretion as to whether the report is submitted by each individual insurer within the group or by the insurer group as a whole (See NAIC ORSA Guidance Manual for further discussion).

In the case where the insurance group chooses to submit one ORSA Summary Report for the group, it must be reviewed by the Lead State. The Lead State is to perform a detailed and thorough review of the information, and initiate any communications about the ORSA with the group. The suggestions below set forth some possible considerations for such a review. At the completion of this review, the Lead State should prepare a thorough summary of its review, which would include an initial assessment of each of the three sections. The Lead State should also consider and include key information to share with other domestic states that have adopted the confidentiality provisions of Model #505 and that are expected to place significant reliance on the Lead State’s review. Non-Lead States are not expected to perform an in-depth review of the ORSA, but instead place significant reliance on the review completed by the Lead State. The non-Lead State review of an ORSA should be performed only for the purpose of having a general understanding of the work performed by the Lead State, and to understand the risks identified and monitored at the group-level so the non-Lead State may better monitor and communicate to the Lead State when its legal entity could impact the group. Any concerns or questions related to information in the ORSA or group risks should be directed to the Lead State. By taking this approach, it avoids unnecessary duplication of efforts for the states and the insurers, and allows resources to be better deployed throughout the state-based system to increase the effectiveness of supervision and regulation of all U.S. groups.

In the case where there is only one insurer within the insurance group, or the group decides to submit separate ORSA Summary Reports for each legal entity, the domestic state is to perform a detailed and thorough review of the information, and initiate any communications about the ORSA directly with the legal entity. The suggestions below set forth some possible considerations for a review. At the completion of this review, the domestic state should prepare a thorough summary of its review, which would include an initial assessment of each of the three sections. Such a review should also be shared with the Lead State (if applicable) so it can develop an understanding of the risks within the entire insurance group. Non-domestic states are not expected to review the ORSA, but instead place significant
reliance on the review completed by the domicile state, which need not be shared with non-Lead States. Instead, other states may choose to rely on the Insurer Profile. [define Insurer Profile]

Regulators expect most ORSA Summary Reports to be submitted at the insurance group level as opposed to the legal entity. Throughout a significant portion of the remainder of this document, the term insurer is used to refer to both a single insurer for those situations where the report is prepared by the legal entity, but is also used to refer to an insurance group. However, in some cases, the term group is used to reinforce the importance of the group wide view.

This section on the Handbook provides general guidance for use in reviewing, assessing and utilizing the results of an insurer’s Own Risk and Solvency Assessment (ORSA) in conducting risk-focused examinations. While only certain insurers will be required to file an ORSA Summary Report, concepts included in this section of the Handbook may also be beneficial to examiners in reviewing, assessing and utilizing the results of Enterprise Risk Management (ERM) activities performed by all insurers. Therefore, this guidance may should be used in support of conjunction with the risk management assessments outlined in other sections of the Handbook (e.g., Phase 1, Part Two: Understanding the Corporate Governance Structure, Exhibit M – Understanding the Corporate Governance Structure) at the discretion of the examiner.

Background Information
To understand the appropriate steps for reviewing the ORSA Summary Report, regulators must first understand the purpose of the ORSA. As noted in the ORSA Guidance Manual, the ORSA has two primary goals:

1. To foster an effective level of ERM at all insurers, through which each insurer identifies, assesses, monitors, prioritizes and reports on its material and relevant risks identified by the insurer, 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; and

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

In addition, separately, the ORSA Guidance Manual discusses the regulator obtaining a high level understanding of the insurer’s ORSA, and discusses how the ORSA Summary Report may assist the commissioner in determining the scope, depth and minimum timing of risk-focused analysis and examination procedures. However, it also notes each insurer’s ORSA and ORSA Summary Report will be unique, reflecting the insurer’s business, strategic planning and approach to ERM. Therefore, regulators should use caution before using the results of an ORSA review to modify ongoing supervisory plans, as a variety of practices may be appropriate depending upon the nature, scale and complexity of each insurer.

Collectively, the goals above are the basis upon which this regulatory guidance is established. More specifically, although it’s recognized that the ORSA is intended to foster an effective level of ERM at insurers, the primary use of the ORSA by the Lead State examiner is to serve as an input into the risk-focused surveillance process where among other things, the insurers’ risk is assessed and such assessment has a direct impact on the ongoing supervisory plan. It should be recognized however that the ORSA Subgroup of the Financial Condition (E) Committee believes the ORSA Summary Report will not have this type of direct impact until the Lead State becomes fairly familiar with and comfortable with each insurer’s report, and moreover, its processes. This could take more than a couple of years to occur in practice since the Lead State would likely need to review at least one or two ORSA Summary
Reports and likely perform some type of targeted on-site examination wherein certain aspects of the processes used to develop the report are validated. However, its envisioned that the ORSA Summary Report can be used to assist the Lead State in better evaluating the risks of the insurer including whether risk management practices are being used by the insurer. Consequently, the information provided in this financial analysis guidance was not developed to provide specifics on the expectation of the analysis report. In fact, outside of requiring very specific sections of the report, even the ORSA Guidance Manual only provides a high level summary of items that are recommended. This is because regulators view the ORSA Summary Report as a means for the insurer to demonstrate how their processes help to manage risks. Therefore, the Lead State examiner should NOT use the following guidance in a way that dictates specifics in the report. However, although the ORSA Guidance Manual allows discretion to the insurer in communicating its ERM processes, a lack of report detail may lead to the Lead State regulator under-assessing the maturity of the insurer’s risk management practices. Ultimately, the goal of this guidance is to assist the Lead State examiner in evaluating the robustness of the insurer’s processes and how they, as well as the other information in the ORSA Summary Report, impact the Lead State examiner’s evaluation of risk within the insurer. To assist in the evaluation process, the ORSA Summary Report is divided into distinct sections as follows:

- **Section I** - Description of the Insurer’s Risk Management Framework
- **Section II** - Insurer’s Assessment of Risk Exposure
- **Section III** – Group Assessment of Risk Capital and Prospective Solvency Assessment

### A. Background Information

Pursuant to the NAIC’s *Risk Management and Own Risk and Solvency Assessment Model Act* (#505), each U.S. insurer is required to “maintain a risk management framework to assist the insurer with identifying, assessing, monitoring, managing and reporting on its material and relevant risks.” In addition, larger insurers and/or insurance groups are required to complete an ORSA “at least annually to assess the adequacy of its risk management and current, and likely future, solvency position.” This ORSA requirement applies to any individual U.S. insurer that writes more than $500 million of annual direct written and assumed premium, and/or insurance groups that collectively write more than $1 billion of annual direct written and assumed premium.

As stated in the NAIC’s ORSA Guidance Manual (Guidance Manual), the ORSA has two primary goals:

1. To foster an effective level of ERM at all insurers, through which each insurer identifies, assesses, monitors, prioritizes and reports on its material and relevant risks identified by the insurer, using techniques appropriate to the nature, scale and complexity of the insurer’s risks, in a manner adequate to support risk and capital decisions; and

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

The Guidance Manual states that regulators should obtain a high level understanding of the insurer’s ORSA to assist in determining the scope, depth and minimum timing of risk-focused analysis and examination procedures. These determinations can be documented as part of each insurer’s ongoing supervisory plan. However, the Guidance Manual also states each insurer’s ORSA will be unique, reflecting the insurer’s business model, strategic planning and overall approach to ERM. Therefore, regulators should use caution before using the results of an ORSA review to modify ongoing supervisory plans, as a variety of practices may be appropriate depending upon the nature, scale and complexity of each insurer.
To assist insurers in demonstrating the effectiveness and results of their ORSA process to regulators, an ORSA Summary Report is required to be filed on an annual basis. The ORSA Summary Report is divided into three distinct sections as follows:

- **Section I** – Description of the Insurer’s Risk Management Framework
- **Section II** – Insurer’s Assessment of Risk Exposure
- **Section III** – Group Assessment of Risk Capital and Prospective Solvency Assessment

### B. General Summary of Guidance for Each Section

Each of the sections of the ORSA Summary Report requires distinct consideration to be adequately understood and assessed. However, each of the sections can supplement the understanding and assessment of the other sections. For example, Section II provides a company the opportunity to demonstrate the robustness of its process by including a detailed description of the significant reasonably foreseeable and relevant material risks it faces and their potential impact to the company. This can allow the regulator to gain a better understanding and increased appreciation for the company’s processes to identify and prioritize reasonably foreseeable and relevant material risks described in Section I. Alternately, Lead State regulators may assess stresses applied to individual risks in Section II as appropriate, but may not feel stresses are appropriately aggregated to determine an adequate group capital assessment in Section III. Therefore the review and assessment of each section requires a full understanding of each of the other sections and Lead State regulators should exercise caution in the allocation of review responsibilities in this area.

Further regulators do not believe there is a standard set of stress conditions each insurer should test. The Lead State examiner should never specify the stresses to be performed, nor what should be included in the insurer’s ORSA Summary Report, as this would eliminate the “Own” aspect of the ORSA and defeat its purpose, which is to permit the Lead State regulator to better understand the risk from the perspective of the insurer. This is not to suggest that the Lead State examiner should not consider asking questions about the extent to which the insurer considers particular risks, as these questions may provide the insurer an opportunity to discuss the robustness of its processes and considerations, either in specifically identified stresses, or the inclusion of similar risks within a stochastic economic capital model for a particular risk.

### Section I

The guidance in Section I is designed to assist the Lead State examiner in reaching an assessment of the risk management framework of the insurer. The examiner’s assessment should utilize existing assessments of the insurer’s risk management framework performed by the Lead State financial analyst through a review of the ORSA Summary Report, but should supplement the Lead State analyst’s assessment with additional onsite verification and testing to reach a final conclusion. In addition, the examination team may need to review and test other risk management processes and practices that may not have been outlined in the ORSA Summary Report to reach an accurate assessment in this area. In doing so, the examination team should seek to review and test the most current risk management practices in place, as opposed to practices described in a previous ORSA Summary Report that may be out of date.

The section I procedures are focused on determining the insurer’s maturity level in regards to its overall risk management framework. The maturity level is assessed through the incorporation of concepts developed within Risk and Insurance Management Society’s (RIMS) Risk Maturity Model (RMM). The
RMM provides a scale of six maturity levels upon which an insurer can be assessed, ranging from Leadership to Non-existent. The six maturity levels can generally be defined as follows:

- **Level 5 – Leadership**: The insurer is at the leading edge of companies in relation to risk management. Risk management is embedded in strategic planning, capital allocation, and other business processes and is used in daily decision-making. Risk limits and early warning systems are in place to identify breaches and require corrective action from board and management.

- **Level 4 – Managed**: The insurer is advanced in its risk management capabilities. Risk management activities are coordinated across business areas and tools and processes are actively utilized. Enterprise-wide risk identification, monitoring, measurement and reporting are in place.

- **Level 3 – Repeatable**: The insurer has risk management processes in place designed and operated in a timely, consistent and sustained way. The insurer takes action to address issues related to high priority risks.

- **Level 2 – Initial**: The insurer has implemented risk management processes, but the processes may not be operating consistently and effectively. Certain risks are defined and managed in silos, rather than consistently throughout the organization.

- **Level 1 – Ad hoc**: The insurer has not developed or documented standardized risk management processes and is relying on the individual efforts of staff to identify, monitor and manage risks.

- **Level 0 – Non-existent**: The insurer has not recognized a need for risk management and risks aren’t directly identified, monitored or managed.

The guidance developed for use in this Handbook integrates the maturity level scale of the RMM with the general principles and elements outlined in Section I of the ORSA Guidance Manual to assist Lead State regulators in reaching an overall assessment of the maturity of an insurer’s risk management framework. The guidance for Section I provides examples of various attributes that would indicate where an insurer’s company falls on the maturity scale for each individual principle. Most companies are expected to fall somewhere in between Non-existent and Leadership for many of the assessed principles. Therefore, the Lead State examiner will need to closely consider and verify the operating effectiveness of attributes and activities outlined within the ORSA Summary Report to reach an accurate assessment of the insurer’s company’s maturity level for each assessed principle. In reviewing this guidance, the Lead State examiner should understand the goal of making maturity assessments is not to require corrections to the ORSA Summary Report, but to identify potential deficiencies, concerns or areas for improvement that can be discussed with management onsite or through written communication in a management letter.

Ultimately, it will be up to the company to determine what, if any, action it takes in response to such discussions and communications. However, an assessment of Non-existent, Ad hoc or Initial maturity levels related to one or more of the recommended risk management principles may require adjustments to the supervisory plan of the insurer (e.g. may result in increased intensity and scope of ongoing supervisory work). Any determination of the impact such an assessment should have on the ongoing supervisory plan should carefully consider the nature, size and complexity of the insurer in determining whether the assessed maturity level is of concern. For example, it may be appropriate for a smaller insurer writing only one line of insurance to have an Initial maturity level for its practices relating to Risk Appetite, Tolerances and Limits. However, it should also be noted that a significant lack of maturity in risk management principles at a larger or more complex insurer could result in more serious adjustments to the ongoing supervisory plan up to and including a hazardous financial condition determination, which affords the Commissioner a wide range of regulatory actions that can be taken under state law.
For those insurers that demonstrate mature frameworks and principles, such facts are intended to allow Lead State regulators flexibility to adjust the scope and intensity of the monitoring that otherwise may be performed on the insurer. This is based upon the belief that a mature risk management framework is able to help an insurer manage, reduce risk more effectively, in ways that make them more manageable or the impact is more likely to be less pronounced. In recognition of this concept, guidance has been developed at the end of this section to demonstrate how mature and effective risk management frameworks may allow for reductions in the scope or extent of other risk-focused examination procedures. In addition, a mature risk management framework may provide the basis for reducing other planned regulatory activities for the insurer by adjusting the ongoing supervisory plan.

Section II

The guidance for use in reviewing Section II is primarily focused on assisting the Lead State examiner in gaining an understanding of management’s assessment of its reasonably foreseeable and relevant material risks. In addition, the guidance assists the Lead State examiner in understanding the potential impact of significant risks by considering the stress scenarios and stress testing presented by the insurer. Finally, information in Section II can inform or support the assessment of key principles reached during a review of Section I.

In order for the Lead State examiner to understand and utilize the information on significant reasonably foreseeable and relevant material risks provided in Section II, the Lead State examiner must obtain a minimum level of confidence regarding the accuracy and completeness of the information presented. Many of the most significant solvency risks an insurer’s face will likely be encompassed within the nine branded risk classifications outlined in the Handbook (see Exhibit L – Branded Risk Classifications) may be their area of focus. Therefore, the guidance on reviewing and utilizing Section II of the Summary Report requires Lead State examiners to consider whether significant reasonably foreseeable and relevant material risks impacting the insurer have been appropriately discussed. However, this is NOT meant to suggest the ORSA Summary Report is required or expected to address risks in each of the nine branded risk classifications. Instead, the Lead State examiner should use the categories as a way to organize and evaluate the information presented, with the expectation that certain categories may not be relevant or significant for each insurer.

As part of evaluating the information presented on reasonably foreseeable and relevant material significant risks, the Lead State examiner may be required to consider the appropriateness of the stress scenarios identified and stress testing performed by the insurer. Therefore, guidance has been provided to assist the Lead State examiner in considering the reasonableness of the assumptions and methodologies used in conducting stress scenarios/testing. However, regulators do not believe there is a standard set of stress conditions each company should test. Consistent with the language on page 7 of the Guidance Manual, the Lead State examiner should not specify the stresses to be performed not what should be included in the company’s ORSA Summary Report, as this would eliminate the “Own” aspect of the ORSA.

Section III

The guidance for reviewing Section III of the ORSA Summary Report is intended to assist the Lead State examiner in understanding and assessing the estimated amount of capital the insurer determines is necessary reasonable to sustain its current business model. This determination typically utilizes and/or aggregates the outputs of Section II (i.e., stress testing) to calculate the amount of capital required to support ongoing business operations for a wide range of potential outcomes. Therefore, much of the guidance in this section relates back to the reasonableness of the assumptions and methodologies utilized to calculate and allocate capital to the reasonably foreseeable and relevant material risks the company
faces. Often, this calculation may be wholly or partially based on internal models developed by the company for this purpose. Therefore, the guidance also directs the Lead State examiner to consider and evaluate the company’s processes to validate the suitability, accuracy, reasonability, and reliability of its internal models.

C. Review of Section I - Description of the Insurer’s Risk Management Framework

The Guidance Manual requires the insurer to discuss five key principles of an effective risk management framework in Section I of the ORSA Summary Report. Therefore, the Lead State examiner is required to review and assess the company’s risk management framework by considering and evaluating each of the key principles. An initial evaluation of each of the key principles should be performed by the Lead State financial analyst, upon receipt of the ORSA Summary Report. During an onsite examination, the Lead State examiner is expected to supplement this initial assessment with additional procedures to verify the reported information and test the operating effectiveness of the company’s risk management processes and practices. Upon concluding these procedures, the Lead State examiner should reach their own assessment regarding each of the five principles, which should be utilized to adjust the scope of risk-focused examination and communicated back to the Lead State financial analyst for ongoing monitoring and adjustment of the supervisory plan.

Guidance is provided to assist the Lead State examiner in developing review procedures and to give examples of attributes that may indicate the insurer is more or less mature in its handling of the individual key risk management principles. These attributes are meant to assist the Lead State examiner in reaching an assessment of the insurer’s maturity level for each key principle at Leadership, Managed, Repeatable, Initial, Ad hoc or Non-existent.

Key Principles
1. Risk Culture and Governance
2. Risk Identification and Prioritization
3. Risk Appetite, Tolerances and Limits
4. Risk Management and Controls
5. Risk Reporting and Communication

Considerations When Reviewing Key Principles
When reviewing processes described in the ORSA Summary Report, the Lead State examiner should consider the extent to which the above principles are integrated into the organization. To do so, the Lead State examiner may need to review processes and practices beyond those documented within the ORSA Summary Report. In addition, the Lead State examiner may need to review and consider changes made to risk management processes since the filing of the last ORSA Summary Report. In so doing, the Lead State examiner may need to consider information beyond what is included in the ORSA Summary Report to reach an assessment of the insurer’s maturity level for each key principle.

In reviewing these key principles, examples of various attributes/traits associated with various maturity levels for each key principle are provided. However, these attributes only demonstrate common currently known practices associated with each of the various maturity levels and practices of individual insurers may vary significantly from the examples provided. For that reason, it may be helpful to engage the insurer in discussing how their processes meet the principles set forth in the Guidance Manual. It is possible that the insurer has mature practices in place, even if those practices differ from the example attributes provided. Therefore, the Lead State examiner should exercise professional judgment in
determining the appropriate maturity level to select when assessing each of the key risk management principles.

1. Risk Culture and Governance
Risk culture and governance can be the cornerstone to managing risk. The Guidance Manual defines this principle to include a structure that clearly defines and articulates roles, responsibilities and accountabilities; and a risk culture that supports accountability in risk-based decision making. Therefore, the objective is one approach may be to have a structure in place that provides a tone at the top to stress the importance of risk management and to encourage rigor within the organization to manage reasonably foreseeable and relevant material risks in a way that is continuously improved.

Leadership Practices
Risk culture is analyzed and reported as a systematic view of evaluating risk. Executive sponsorship is strong and the tone from the top has sewn an ERM Process into the corporate culture. The Board of Directors Management establishes the framework and the risk culture and the Board of Directors approves the risk appetite statement in collaboration with the chief executive officer (CEO), chief risk officer (CRO) where applicable, and chief financial officer (CFO). Those officers translate the expectations into targets through various practices embedded throughout the organization. Risk management is embedded in each material business function. Internal audit, IT, compliance, controls and risk management processes are highly integrated and coordinate and report risk issues. All areas Material business functions use risk-based best practices. The risk management lifecycle for each business process area is routinely improved evaluated.

Managed Practices
Risk culture is associated with career development. The organization company’s ERM processes are self-governed with shared ethics and trust; promise-makers are held accountable. Risk management issues are understood at all levels and risk plans are conducted in all material business process areas. The Board of Directors, CEO and Chief Risk Officer (if applicable), and CFO expect a risk management plan to include a qualitative risk assessment for significant projects, new products, business practice changes, acquisitions, etc. what management believes to be the reasonably foreseeable and relevant material risks with reporting to management or the Board on priorities as appropriate. All areas The insurer uses the ERM Process framework to enhance their functions via the ERM framework, with frequent and effective communication on risk issues. Process owners incorporate managing their risks and opportunities within regular planning cycles. The company All areas create and evaluate far-sighted scenarios consistent with its business planning horizon and follow-up activities occur accordingly.

Repeatable Practices
ERM risk plans are understood by management and the organization. Senior management expects that a risk management plan includes a qualitative risk assessment for significant projects, new products, business practice changes, acquisitions, etc. captures reasonably foreseeable and relevant materials risks in a qualitative manner. Most areas use the ERM Process framework and report on risk issues. Process owners take responsibility for managing their risks and opportunities. Risk management creates and evaluates far-sighted scenarios consistent with the business planning horizon.

Initial Practices
Risk culture is enforced by policies interpreted primarily as compliance in nature. An executive champions ERM management to develop an ERM Process framework. One area has used the
ERM Process framework, as shown by the department head and documented team activities. Business processes are identified and ownership is defined. Risk management is used to consider risks in line with the insurer’s business planning horizon a far-sighted manner.

Ad Hoc Practices
Corporate culture has little risk management accountability. Risk management is not interpreted consistently. Policies and activities are improvised. Programs for compliance, internal audit, process improvement and IT operate independently and have no common framework, causing overlapping risk assessment activities and inconsistencies. Controls are based on departments and finances. Business processes and process owners aren’t well defined or communicated. Risk management focuses on past events. Qualitative risk assessments are unused or informal. Risk management is considered a quantitative analysis exercise.

Non-existent Practices
No recognized need for an ERM Process and no formal responsibility for ERM. Internal audit, risk management, compliance and financial activities might exist but aren’t integrated. Business processes and risk ownership aren’t well defined.

2. Risk Identification and Prioritization
The Guidance Manual defines this as key to the organization; and responsibility for this activity should be clear; and the risk management function is responsible for ensuring the processes are appropriate and functioning properly at all organizational levels. Therefore, the objective is an approach for risk identification and prioritization may be to have a process in place that identifies risk and prioritizes such risks in a way that all potential reasonably foreseeable and relevant material risks are addressed in the framework.

Leadership Practices
Internal and external best practices, support functions, business lines and regions reasonably foreseeable and relevant material risks are systematically gathered and maintained for material business units or functions. A routine, timely reporting structure directs risks and opportunities to senior management. The ERM Process framework promotes frontline employees’ participation and documents risk issues’ or opportunities’ significance. Process owners regularly review and recommend risk indicators that best measure their areas’ risks. The results of internal adverse event planning are considered a strategic opportunity.

Managed Practices
Process owners aggressively manage a growing list of material business area-unit or functional reasonably foreseeable and relevant material specific risks locally to create context for risk assessment activities as a foundation of the ERM Process framework. Risk indicators deemed critical to their areas are regularly reviewed in collaboration with the ERM team. Measures ensure downside and upside outcomes of risks and opportunities are aggressively managed. Standardized evaluation criteria of impact, likelihood and controls’ effectiveness are used to prioritize risk for follow-up activity. Risk mitigation is integrated with assessments to monitor effective use.

Repeatable Practices
An ERM team manages a growing list of material business area-unit or functionally reasonably foreseeable and relevant specific risks, creating context for risk assessment as a foundation of the ERM Process framework. Risk indicator lists are collected by most process owners. Upside and downside outcomes of risk are understood and managed. Standardized evaluation criteria of impact, likelihood and controls’ effectiveness are used, prioritizing risk for
follow-ups. Enterprise level information on risks and opportunities are shared. Risk mitigation is integrated with assessments to monitor effective use.

**Initial Practices**
Formal lists of reasonably foreseeable and relevant material risks exist for each department, material business units or functions, and discussions of risk are part of the ERM Process framework. Corporate risk indicators are collected centrally, based on past events. Departments, Material business units or functions might maintain their own informal risk checklists that affect their areas, leading to potential inconsistency, inapplicability, lack of sharing or under-reporting.

**Ad Hoc Practices**
Risk is owned by specialists, centrally or within a department, business unit or function. Risk information provided to risk managers is probably incomplete, dated or circumstantial, so there’s a high risk of misinformed decisions, with potentially severe consequences. Further mitigation, supposedly completed, is probably inadequate or invalid.

**Non-existent Practices**
There might be a belief that the reasonably foreseeable and relevant material most important risks are known, although there is probably little documentation.

3. **Risk Appetite, Tolerances and Limits**
The Guidance Manual states that a formal risk appetite statement, and associated risk tolerances and limits are foundational elements of risk management framework for a company, insurer; understanding of the risk appetite statement ensures alignment with risk strategy by management or the board of directors. Not included in the manual, but widely considered, is that risk appetite statements should be easy to communicate and for should be understood by stakeholders to understand, and should be closely tied to the organization’s strategy and address its material risks. They should be used to help set boundaries and expectations by using quantitative limits and qualitative statements for risks that are difficult to measure. These boundaries may be expressed in terms of earnings, capital, or other metrics (growth, volatility). The objective is An approach may be to put mechanisms in place to measure the risk the organization is willing to accept. For example, the risk appetite statement may require the organization to maintain sufficient capital to cover a 1 year horizon with 99.97% confidence, or maintain an “AA” solvency standard.

After the overall risk appetite for the organization is set, the underlying risk tolerances and limits can be selected and applied to individual business units and risk areas as deemed appropriate by the company. The risk tolerances/limits provide direction outlining the Company’s tolerance for taking on certain risks, which sometimes can be established and communicated in the form of the maximum amount of such risk the entity is willing to take (e.g. no more than 10% of the new business written/invested assets). However, in many cases these will be coupled with more specific and detailed limits or guidelines the company uses (e.g. equity securities not to exceed 5% of assets, counterparty exposure to a specific reinsurer not to exceed a specific dollar amount, catastrophe risk (1 in 500 year event) not to exceed more than 20% of required capital). The limits should be measurable and should be monitored as often as needed in order to prevent a company from unknowingly breaching its limits. The effectiveness of these items may be best measured by the impact they have on the organization, which can be difficult to demonstrate in a written report. Due to the varying level of detail and specificity different organizations incorporate into their risk appetites, tolerances and limits, regulators should consider these elements collectively to reach an overall assessment in this area and should seek to understand the company’s approach through follow-up discussions and dialogue.

**Leadership Practices**
A risk appetite statement has been developed to set clear boundaries and expectations for the organization to follow by establishing quantitative limits and qualitative risk statements. A process for delegating authority to accept risk levels in accordance with the risk appetite statements is communicated throughout the organization. Risk management uncovers risk, reduces uncertainty and costs and increases return on equity in accordance with this statement. The management team and risk management committee, if applicable, define tolerance levels and limits for all-material business units and reasonably foreseeable and relevant material significant risk areas in accordance with the risk appetite statements. A mechanism compares and reports actual assessed risk versus risk tolerance. The organization manages business areas and has a diverse portfolio collection to balance risk positions. Management prioritizes resource allocation based on the gap between risk appetite and assessed risk and opportunity. The established risk appetite is examined periodically. Example: Take more risk and gain more market share versus a conservative hold position and protect the brand.

Managed Practices
Risk appetite is considered in each the ERM Process framework step. Resource allocation decisions consider the evaluation criteria of business areas. The organization forecasts planned mitigation’s potential effects versus risk tolerance as part of the ERM Process framework. Portfolio views are dynamic and risk tolerance is evaluated based on different views. Risk is managed by process owners. Risk tolerance is evaluated as a decision to increase performance and measure results. Risk-reward tradeoffs within the business are understood and guide actions.

Repeatable Practices
Risk assumptions within management decisions are clearly communicated. There’s a structure for evaluating risk on an enterprise-wide basis and for gauging risk tolerance. Risks and opportunities are routinely identified, evaluated and executed in alignment with risk tolerances. The ERM framework quantifies gaps between actual and target tolerances as part of the ERM Process. Portfolio views to balance risk positions are created and risk tolerance is evaluated based on portfolio analysis.

Initial Practices
Risk assumptions are only implied within management decisions and aren’t understood outside senior leadership with direct responsibility. There's no ERM framework for resource allocation. Defining different views of business units or functions from a risk perspective can’t be easily created and compared.

Ad Hoc Practices
Risk management might lack a portfolio view of risk. Risk management might be viewed as risk avoidance and meeting compliance requirements or transferring risk through insurance. Risk management might be a quantitative approach focused on the analysis of high-volume and mission-critical areas.

Non-existent Practices
The need for formalizing risk tolerance and appetite isn’t understood.

4. Risk Management and Controls
The Guidance Manual stresses managing risk is an ongoing ERM activity, operating at many levels within the organization. This principle is discussed within the governance section above from the standpoint that a key aspect of managing and controlling the reasonably foreseeable and relevant material risks of the organization is the governance process put in place. For many companies, the day to day governance starts with the material business units, but those units put mechanisms in place to identify, quantify and monitor risks, which are reported up to the next level based upon the risk reporting and
risk limits put in place. In addition, controls are also put in place on the backend, by either the internal audit team, or some independent consultant, which are designed to ensure compliance and a continual enhancement approach. Therefore, the objective is an approach may be to put controls in place to ensure the organization is abiding by its limits.

**Leadership Practices**
ERM, as a management aspect, is embedded in all material business processes and strategies. Roles and responsibilities are process driven with teams collaborating across material central and field positions. Risk and performance assumptions within qualitative assessments are routinely revisited and updated. The organization uses an ERM process of sequential steps that strive to improve decision-making and performance. A collaborative, enterprise-wide approach is in place to establish a risk management committee staffed by all relevant supporters qualified management. Accountability for risk management is woven into all material processes, support functions, business lines and geographies as a way to achieve goals. To evaluate and review the effectiveness of ERM efforts and related controls, the organization has implemented a ‘Three Lines of Defense’ model or similar system of checks and balances that is highly effective and fully integrated into the insurer’s materials business processes. The first line of defense may consist of business unit owners and other front line employees applying internal controls and risk responses in their areas of responsibility. The second line of defense could consist of risk management, compliance and legal staff providing oversight to the first line of defense and establishing framework requirements to ensure reasonably foreseeable and relevant material risks are actively and appropriately managed. The third line of defense may consist of auditors performing independent reviews of the efforts of the first two lines of defense to report back independently to senior management or the board of directors, as appropriate.

**Managed Practices**
Risk management is clearly defined and enforced at every level. A risk policy framework articulates management’s responsibility for risk management, according to established risk management processes. A risk management committee exists and management develops and reviews risk plans. The ERM Process framework is coordinated with managers’ active participation. Opportunities associated with risk are part of risk plans’ expected outcome. Authentication, audit trail, integrity and accessibility promote roll-up information and information sharing. Periodic reports measure ERM progress on all reasonably foreseeable and relevant material risks for stakeholders, including the management or Board of Directors, as appropriate. The organization has implemented a “Three Lines of Defense” model to review and assess its control effectiveness, but those processes may not yet be fully integrated or optimized.

**Repeatable Practices**
The ERM Process accommodates all framework supports material business units or functions and support areas’ needs. ERM is a process of steps to identify, assess, evaluate, mitigate and monitor reasonably foreseeable and relevant material risks. ERM Process frameworks includes the management of opportunities. A risk management committee exists and senior management actively reviews risk plans. The ERM Process is collaborative and directs important issues to senior management. The “Three Lines of Defense” are generally in place, but are not yet performing at a highly effective level.

**Initial Practices**
Management recognizes a need for an Enterprise Risk Management Process framework. Agreement exists on a framework, which describes roles and responsibilities. Evaluation criteria are accepted. Risk mitigation activities are sometimes identified but not often executed. Qualitative assessment methods are used first in all material risk areas and inform determine what
needs deeper quantitative methods, analysis, tools and models. The “Three Lines of Defense” are not yet fully established, although some efforts have been made to put these processes in place.

Ad Hoc Practices
Management is reactive and ERM might not yet be seen as a process. Few processes and controls are standardized and are instead improvised. There are no standard risk assessment criteria. Risk management is involved in business initiatives only in later stages or centrally. Risk roles and responsibilities are informal. Risk assessment is improvised. Standard collection and assessment processes aren’t identified.

Non-existent Practices
There’s little recognition of the ERM Process’s framework’s importance or controls in place to ensure its effectiveness.

5. Risk Reporting and Communication
The Guidance Manual indicates risk reporting and communication provides key constituents with transparency into the risk-management processes and facilitates active, informal decisions on risk-taking and management. The transparency is generally available because of reporting that can be made available to management, board members or compliance departments. However, most important is how the reports are being utilized to identify and manage reasonably foreseeable and relevant material risk at either the group, business unit level or some other level within the organization where decisions are made. The reporting provides the current measure of risk used to monitor such risk. Therefore, the objective is an approach may be to have reporting in place that allows various decisions to be made throughout the organization and by the appropriately authorized people, with ultimate ownership by management or the Board of Directors, as appropriate.

Leadership Practices
The ERM Process framework is an important element in strategy and planning. Evaluation and measurement of performance improvement is part of the risk culture. Measures for risk management include process and efficiency improvement. The organization measures the effectiveness of managing uncertainties and seizing risky opportunities. Deviations from plans or expectations are also measured against goals. A clear, concise and effective approach to monitor progress toward strategic goals is communicated regularly with material business units or functional areas. Individual, management, departmental, divisional and corporate strategic goals are linked with standard measurements. The results of key measurements and indicators are reviewed and discussed by senior management and board (or committee) members, as appropriate, on a regular basis and as frequently as necessary to address breaches in risk tolerances or limits in a timely manner.

Managed Practices
The ERM Process framework is an integrated part of strategy and planning. Risks are aggressively considered as part of strategic planning. Risk management is a formal part of strategic goal setting and achievement. Investment decisions for resource allocation examine the criteria for evaluating opportunity impact, timing and assurance. The organization forecasts planned mitigation’s potential effect on performance impact, timing and assurance prior to use. Employees at all levels use a risk-based approach to achieve strategic goals. The results of key measurements and indicators are shared with senior management and board (or committee) members on a regular basis, as appropriate.

Repeatable Practices
The ERM Process framework contributes to strategy and planning. All Strategic goals have performance measures and all performance measures are linked with goals. While compliance might trigger reviews, other factors are integrated, including process improvement and efficiency. The organization indexes opportunities qualitatively and quantitatively, with consistent criteria. Employees understand how a risk-based approach helps them achieve goals. Accountability toward goals and risk’s implications are understood, and are articulated in ways frontline personnel understand. The results of key measurements and indicators are shared with senior management and board (or committee) members as appropriate.

Initial Practices
The ERM Process framework is separate from strategy and planning. A need for an effective process to collect information on opportunities and provide strategic direction is recognized. Motivation for management or support areas to adopt a risk-based approach is lacking.

Ad Hoc Practices
Not all strategic goals have measures and not all measures are linked with strategic goals. Strategic goals aren’t articulated in terms the frontline management understands. Compliance focuses on policy and is geared toward satisfying external oversight bodies. Process improvements are separate from compliance activities. Decisions to act on risks might not be systematically tracked and monitored. Monitoring is done and metrics are chosen individually. Monitoring is reactive.

Non-existent Practices
No formal framework of indicators and measures for reporting on achievement of strategic goals and management exists.

Examination Procedures for Section I

The following table provides example test procedures that could/may be performed by the Lead State examiner to verify the accuracy of information on risk management processes included in the ORSA Summary Report or to test the operating effectiveness of such practices. A number of these procedures may be performed in conjunction with other risk-focused examination processes and Lead State examiners should attempt to gain efficiencies by coordinating testing and review efforts wherever possible. Lead State Examiners should use professional judgment in selecting or tailoring procedures to assist in the assessment of each of the five risk management principles for the insurer. In addition, the Lead State examiner should incorporate any specific verification or testing recommendations made by the Lead State financial analyst into the planned examination procedures for Section I and consider the extent to which additional procedures should be utilized to test the changes that have been made to the insurer’s enterprise risk management framework since the last on-site examination.

<table>
<thead>
<tr>
<th>Principle</th>
<th>Possible Test Procedures</th>
</tr>
</thead>
</table>

14
| Risk Culture and Governance | • Obtain and review management, board or committee minutes/packets for the director group responsible for ERM oversight and evaluate the level of oversight provided  
• Interview a management or board member(s) with responsibilities for risk management oversight to determine level of knowledge and involvement of management or directors in risk management processes  
• Interview company executives to get a feel for the “tone at the top” of the organization and the level of consistency in applying risk management processes across departments  
• Obtain and review information on the company’s compensation plans to determine that risk management decision making isn’t undermined by compensation structure  
• Obtain and review job descriptions or performance review criteria for select management positions to determine whether risk management elements are incorporated |
| Risk Identification and Prioritization | • Obtain a current copy of the organizations risk listing/universe and review for adequacy/appropriateness  
• Verify that the organization’s risk listing/universe is updated/reviewed on a regular basis by requesting copies at various dates  
• Interview select process owners/business unit leaders to verify their role in risk identification and prioritization  
• Interview risk management staff to understand and evaluate how risks are identified and aggregated across the organization |
| Risk Appetite, Tolerances and Limits | • Review management committee or board minutes supporting materials to verify that the organization’s risk appetite is reviewed and approved on a regular basis  
• Review and evaluate steps taken to address breaches in risk limits on a sample basis (if applicable)  
• Interview select risk owners to get an understanding of how risk limits are set and updated  
• Verify that checks and balances (i.e., supervisory review) are in place to ensure that risk limits are set in accordance with the organization’s overall risk appetite |
| Risk Management and Controls | • Obtain minutes of internal risk management committee (or equivalent management group) meetings to review frequency and extent of oversight activities  
• Obtain a listing of internal audit reports to determine whether risk management processes are subject to frequent review  
• Identify and test the operating effectiveness of preventive controls in select areas to determine how risk limits are enforced |
Risk Reporting and Communication

- Obtain a current copy of the organization’s risk dashboard (or equivalent report) to verify that metrics are tracked for all reasonably foreseeable and relevant material significant risk areas.
- Verify the frequency with which risk information is accumulated and reported by selecting a sample of historical risk dashboards (or equivalent reports) to review.
- Test the accuracy and reasonableness of information included on the risk dashboard (or equivalent report) on a sample basis.
- Review and evaluate the timeliness with which breaches in risk limits are reported and communicated to the appropriate authority.

**Required Examples of Supporting Documentation for Section I**

The Lead State examiner should prepare documentation summarizing the results of the risk management framework assessment by addressing each of the five principles set forth in the Guidance Manual as follows. Each assessment should first provide a summary of the Lead State analyst’s initial assessment, followed by a summary of the results of Lead State exam procedures, leading to a Lead State final exam assessment for each principle. The summary of Lead State exam results should provide rationale for any deviation from the Lead State analyst’s initial assessment of the principle. See the maturity level definitions previously presented in this guidance on ORSA.

1. **Risk Culture and Governance**—Governance structure that clearly defines and articulates roles, responsibilities and accountabilities; and a risk culture that supports accountability in risk-based decision making.

   - Initial Lead State Analyst Assessment:
   - Summary of Lead State Exam Results:
   - Final Lead State Exam Assessment:
     - ☐ 5 – Leadership ☐ 4 – Managed ☐ 3 – Repeatable ☐ 2 – Initial ☐ 1 – Ad Hoc ☐ 0 – Non-existent

2. **Risk Identification and Prioritization**—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 the process is appropriate and functioning properly at all material business or functional organizational levels.

   - Initial Lead State Analyst Assessment:
   - Summary of Lead State Exam Results:
   - Final Lead State Exam Assessment:
     - ☐ 5 – Leadership ☐ 4 – Managed ☐ 3 – Repeatable ☐ 2 – Initial ☐ 1 – Ad Hoc ☐ 0 – Non-existent

3. **Risk Appetite, Tolerances and Limits**—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, e.g. relationship between risk tolerances and the amount and quality of risk capital.
4. **Risk Management and Controls**—Managing risk is an ongoing ERM activity, operating at many levels within the organization. *(e.g. monitoring processes and methods)*

5. **Risk Reporting and Communication**— Provides key constituents with transparency into the risk-management processes and facilitate active, informal decisions on risk-taking and management. *(e.g. risk assessment tools, feedback loops, used to monitor and respond to changes in risks, operations, economic environment, & strategies, and includes new risk information)*

Overall Assessment

After considering the assessment of each of the five previously identified principles and taking into account any additional factors identified by the Lead State examiner during the review of ERM framework, develop an overall assessment of the insurer’s Risk Management Framework using the same risk maturity model. The assessment, along with findings from Section II and Section III, will assist the Lead State examination team in determining the extent of reliance to be placed on the insurer’s ORSA/ERM processes throughout the remaining phases of a full-scope examination and through modifications to the ongoing supervisory plan.

D. Review of Section II - Insurer’s Assessment of Risk Exposure

Section II of the ORSA Summary Report is required to provide a high level summary of the insurer’s quantitative and/or qualitative assessments of its reasonably foreseeable and relevant material risk exposure. There may be a great deal of variation in how this information is displayed from one insurer company to the next, but in most cases, insurers companies tend to organize this information around the
The Guidance Manual does give possible examples of relevant material risk categories (credit, market, liquidity, underwriting, and operational risks).

**Lead State Examiners** may find the information regarding **reasonably foreseeable and relevant material risk exposures** the most beneficial aspect of the ORSA Summary Report, as this information may be useful in identifying risks and controls for use in the remaining phases of a risk-focused examination. This may be attributed to the fact that Section II provides risk information on the insurance group that may be grouped in categories similar to the NAIC’s nine branded risk classifications (see Exhibit L). However, the grouping of risk information in the report is entirely up to the insurer and the **Lead State** examiner should not expect each of the nine branded risk classifications to be directly addressed within Section II. As the nine branded risk classifications are familiar to examiners and companies alike, these categories will provide the format for the **Lead State** examiners’ review and assessment of the information provided by the **insurer-company** in Section II.

**Stress Testing**

In addition to providing background information on each **reasonably foreseeable and relevant material** risk the **insurer-company** is facing, Section II also requires the risk exposures to be **documented-analyzed** under both normal and stressed environments. Therefore, as part of evaluating the information presented on **reasonably foreseeable and relevant material** risks, the **Lead State** examiner is expected to consider the appropriateness of the stress scenarios identified and stress testing performed by the **insurer-company**. In so doing, the **Lead State** examiner should evaluate the reasonableness of the assumptions and methodologies used by the insurer in conducting stress scenarios/testing. Before such an evaluation is designed, the **Lead State** examiner should obtain information from the analyst to determine the extent to which the **Lead State** has already been provided information on the assumptions and methodologies. The presumption is that the **Lead State** analyst’s evaluation of such assumptions and methodologies may have been more cursory and the **Lead State** examiner’s evaluation would therefore be more in-depth, reviewing additional internal documentation and detail to validate the robustness of the processes used by the insurer to develop assumptions and methodologies. Some common scenarios that may be considered by the insurer for each of the nine branded risk classifications are presented as follows:

1. **Credit**
   - Counterparty exposure (loss of specified amount to reinsurer, derivatives party, supplier)
   - Equity securities (40%/50% drop, no growth in stocks in 3 years)
   - General widening of credit spreads (increase in defaults)
   - Other risk assets

2. **Market**
   - 300 basis point pop up change in interest rates
   - Prolonged low interest rates (10 year treasury of 1%)
   - Material drop in GDP & related impacts
   - Stock market crash or specific extreme condition (Great Depression)
   - Eurozone collapse
   - U.S. Treasury collapse
   - Foreign currency shocks (e.g. percentages)
   - Municipal bond market collapse
   - Prolonged multiple market downturn (e.g. 2008/2009 crisis/or 1987 stock market drop-or 50% drop in equities, 150bp of realized credit losses)
3. Pricing/Underwriting (NOTE: Certain suggested scenarios are only applicable to a particular type of insurer.)
   - Significant drop in sales/premiums due to varying reasons
   - Impact of 20% reduction in mortality rates on annuities
   - Material product demonstrates specific losses (e.g. 1 in 20 year events)
   - Severe pandemic (e.g. Avian bird flu based upon World Health Organization mortality assumption)
   - California and New Madrid earthquakes, biological, chemical or nuclear terrorist attacks in locations of heaviest coverage (consider a specified level of industry losses)
   - Atlantic hurricane (consider a specified level of industry losses previously unseen/may consider specified levels per different lines of coverage) in different areas (far northeast, northeast, southeast, etc.)
   - U.S. tornado over major metropolitan area with largest exposure
   - Japanese typhoon/earthquake (consider a specified level of industry losses previously unseen)
   - Major aviation/marine collision
   - Dirty bomb attack
   - Drop in rating to BB

4. Reserving
   - Specified level of adverse development (e.g. 30%)
   - Regulatory policy change requires additional reserves (e.g. 30%)

5. Liquidity
   - Catastrophe results in material immediate claims of 3X normalized amounts
   - Call on any existing debt
   - Material spike in lapses (e.g. 3X normal rates)
   - Drop in rating to BB

6. Operational
   - Loss of systems for 30 days
   - Terrorist act
   - Cybercrime
   - Loss of key personnel
   - Specified level of fraud within claims

7. Legal
   - Material adverse finding on pending claim
   - Worst historical 10 year loss is multiplied at varying levels

8. Strategic
   - Product distribution breakup

9. Reputational
   - PR crisis
   - Drop in rating to BB

The Lead State examiner should not expect the insurer to have performed stress testing in each of these areas, but should consider whether stress testing has been performed to evaluate the impact that the most significant solvency risks facing the insurer could have on its stress scenarios to the company’s ongoing
operations, compared to the insurer’s specified solvency standard. In reviewing the insurer’s efforts in this area, the Lead State examiner’s focus would be on considering if additional information and support for the stress testing of individual risks or groups of risks are available in order to test the effectiveness of such processes. In evaluating the effectiveness of the insurer’s stress testing for each of the nine branded risk classifications (if applicable), the Lead State examiner should consider each of the following elements:

- Was each of the most significant solvency risks facing the company identified and subjected to scenario analysis/stress testing?
- Were scenarios utilized to evaluate/stress the impact of such risks appropriately described and justified?
- Were techniques utilized to perform stress testing in accordance with company standards and industry best practices?
- Did the results of the stress testing indicate that the insurer had appropriately mitigated the impact that the risk might have on the insurer?

Examples of Supporting Required Documentation for Section II

Upon the conclusion of the Lead State examiner’s review and testing of the information provided in Section II and related processes, the following information should be documented by the Lead State examiner:

1. Based on your knowledge of the group, did the insurer include in its ORSA a discussion of risks within each of the branded risk classifications below you consider appropriate for the group, bearing in mind that use of the 9 branded risk classifications are not mandatory?

   Lead State Examiner Summary of Risks and Stress Testing

   - **Credit**—Amounts actually collected or collectible are less than those contractually due.

     [ ] Yes, discussion of risks appears appropriate  [ ] Yes, but limited  [ ] Not discussed, but appears applicable  [ ] Not discussed, but does not appear applicable

   Lead State Examiner Summary of Risks and Stress Testing

   - **Market**—Movement in market rates or prices (such as interest rates, foreign exchange rates or equity prices) adversely affects the reported and/or market value of investments.

     [ ] Yes, discussion of risks appears appropriate  [ ] Yes, but limited  [ ] Not discussed, but appears applicable  [ ] Not discussed, but does not appear applicable

   Lead State Examiner Summary of Risks and Stress Testing

   - **Pricing/Underwriting**—Pricing and underwriting practices are inadequate to provide for risks assumed.

     [ ] Yes, discussion of risks appears appropriate  [ ] Yes, but limited  [ ] Not discussed, but appears applicable  [ ] Not discussed, but does not appear applicable
• **Reserving**—Actual losses or other contractual payments reflected in reported reserves or other liabilities will be greater than estimated.

☐ Yes, discussion of risks appears appropriate ☐ Yes, but limited ☐ Not discussed, but appears applicable ☐ Not discussed, but does not appear applicable

<table>
<thead>
<tr>
<th><strong>Lead State Examiner Summary of Risks and Stress Testing</strong></th>
</tr>
</thead>
</table>

• **Liquidity**—Inability to meet contractual obligations as they become due because of an inability to liquidate assets or obtain adequate funding without incurring unacceptable losses.

☐ Yes, discussion of risks appears appropriate ☐ Yes, but limited ☐ Not discussed, but appears applicable ☐ Not discussed, but does not appear applicable

<table>
<thead>
<tr>
<th><strong>Lead State Examiner Summary of Risks and Stress Testing</strong></th>
</tr>
</thead>
</table>

• **Operational**—Operational problems such as inadequate information systems, breaches in internal controls, fraud or unforeseen catastrophes resulting in unexpected losses.

☐ Yes, discussion of risks appears appropriate ☐ Yes, but limited ☐ Not discussed, but appears applicable ☐ Not discussed, but does not appear applicable

<table>
<thead>
<tr>
<th><strong>Lead State Examiner Summary of Risks and Stress Testing</strong></th>
</tr>
</thead>
</table>

• **Legal**—Non-conformance with laws, rules, regulations, prescribed practices or ethical standards in any jurisdiction in which the entity operates will result in a disruption in business and financial loss.

☐ Yes, discussion of risks appears appropriate ☐ Yes, but limited ☐ Not discussed, but appears applicable ☐ Not discussed, but does not appear applicable

<table>
<thead>
<tr>
<th><strong>Lead State Examiner Summary of Risks and Stress Testing</strong></th>
</tr>
</thead>
</table>

• **Strategic**—Inability to implement appropriate business plans, to make decisions, to allocate resources or to adapt to changes in the business environment will adversely affect competitive position and financial condition.

☐ Yes, discussion of risks appears appropriate ☐ Yes, but limited ☐ Not discussed, but appears applicable ☐ Not discussed, but does not appear applicable

<table>
<thead>
<tr>
<th><strong>Lead State Examiner Summary of Risks and Stress Testing</strong></th>
</tr>
</thead>
</table>

• **Reputational**—Negative publicity, whether true or not, causes a decline in the customer base, costly litigation and/or revenue reductions.

☐ Yes, discussion of risks appears appropriate ☐ Yes, but limited ☐ Not discussed, but appears applicable ☐ Not discussed, but does not appear applicable

<table>
<thead>
<tr>
<th><strong>Lead State Examiner Summary of Risks and Stress Testing</strong></th>
</tr>
</thead>
</table>

E. **Review of Section III - Group Assessment of Risk Capital**
Section III of the ORSA is unique in that it is required to be completed at the insurance group level, as opposed to the other sections that may be completed at a legal entity level. However, in many cases, insurers will choose to also complete Sections I and II at the group level as well. The requirement to complete Section III at the group level is important because it provides the means for insurance regulators to assess the sufficiency of capital of the entire insurance group based upon its existing business plan. The focus of financial analysis in reviewing Section III will be to understand the insurer’s assessment of the sufficiency of capital held at the group level to withstand potential losses and detrimental events, as well as the prospective outlook of the company’s solvency position. The focus of the Lead State examiner in reviewing Section III should be on understanding and evaluating the process used by the insurer to accumulate and present the information provided. To perform this review, the Lead State examiner may need to request additional detail supporting the group capital calculations performed by the insurer.

In focusing on the insurer’s process to calculate and assess its group risk capital, the Lead State examiner will need to consider the source of the group’s internal capital assessment. Some insurers will develop a group capital assessment based upon an internal model, whereas other insurers may relying on an external model developed by regulators or rating agencies (e.g., RBC, Best’s Capital Adequacy Ratio – BCAR, etc.). While the insurer is free to select whichever approach it feels is most appropriate to meet its needs, the Lead State examiner should consider whether the approach selected is consistent with the nature, size and extent of risks faced by the group.

Internal Capital Models

The Guidance Manual states the analysis of an insurer’s group assessment of risk capital requirements and associated capital adequacy description should be accompanied by a description of the approach used in conducting the analysis. This should include key methodologies, assumptions, and considerations used in quantifying available capital and risk capital. Examples of information to be provided in Section III describing an insurer’s processes in this area are provided in the Guidance Manual and Lead State examiners should become familiar with these elements in order to assess an insurer’s processes in this area.

In developing internal capital models, the insurer may use a series of individual risk models designed to quantify the necessary capital for different risks using various assumptions. These individual risk models may be based upon stochastic or deterministic scenarios depending upon the type of risk and availability of relevant data. A deterministic model is one in which one potential outcome, or point estimate, is calculated. Conversely, in a stochastic model, the result of the model is the average of a number of different scenarios that are probability weighted outcomes are generated to reach an overall result. After individual risks are modeled using stochastic or deterministic scenarios, the results may be aggregated to determine the total amount of capital required by the group to maintain its solvency standing based on the individual company’s desired security standard. The most common economic capital models may also consider the likelihood that all of the modeled events will happen at the same time, some of which may offset each other. This factor is referred to as correlation, or diversification, since it refers to the belief that insurers can diversify their risks in a way that serve as a natural hedge against such risks happening simultaneously. The concept of correlation is generally not disputed and, in fact, it’s used within the NAIC’s risk-based capital formula. From this standpoint, it’s recognized that diversification of risk should theoretically reduce the amount of capital that an entity may need to hold at one time. However, what can vary significantly from company
to company is the extent to which diversification benefits can reduce capital needs/requirements. In many cases, the diversification benefit can range from 40%-60% of the 99.5% probability.

In reviewing an insurer’s use of internal models, the Lead State examiner should gain an understanding of the work performed by the insurer to validate its own models, whether completed by internal audit, a third party consultant, or some other party. The importance of reviewing the insurer’s self-validation process is not only to gain comfort on the information provided in Section III of the report, but also due to the fact that the company is likely making business decisions based on the results of its modeling. As it’s a widely considered fact that the output of every internal model is wrong, it’s much more important to consider the reasonableness of the inputs and outputs and the processes used by the insurer/group. However, the Lead State examiner should be aware that many international regulators expect the group wide supervisor to perform a fair amount of testing on such models so they can be relied upon that the models may be useful decision support tools. Many other countries with this view actually require a specified group capital calculation for insurance groups based in their countries, where specified assumptions are required to be used. It may be important for the U.S. regulator to discuss these facts with the insurer and determine if other involved supervisors (countries) of this international active U.S. based insurer have such expectations in planning the examination of the group. Expectations may warrant the Lead State conducting a limited-scope exam or expanding the exam procedures in Section III to perform additional testing or validation of the internal models used in group capital calculations.

Depending upon the strength of the insurer’s internal model validation processes, Lead State examiners may need to perform some level of independent testing to review and evaluate the internal model(s) utilized by the insurer for its group economic capital calculation. This is largely due to the challenges inherent in developing, implementing and maintaining an effective internal capital model. In instances where independent testing is deemed necessary, this testing may consist of procedures to evaluate the appropriateness of assumptions and methodologies used in stochastic/deterministic modeling scenarios for individual risks or in estimating the amount of diversification benefit realized. In so doing, the Lead State examiner may need to select a sample of individual risks for review and consideration and involve an actuary or other experienced professional in advanced mathematics/statistics to assist in the evaluation. Whether involving an actuary or other experienced professional, the primary focus of this review would be on evaluating the reasonableness of the inputs and outputs of the models. An actuary or other experienced professional may be able to provide input on the reasonableness of the inputs while the outputs may be most easily tested by performing a walkthrough in which the inputs are modified and the Lead State examiner, actuary or other experienced professional evaluates and discusses with the insurer the impact that the change has on the outputs. There is no one set of assumptions or methodologies that fit every company. Regulators must use professional judgement to assess the reasonability and plausibility of capital model inputs and outputs. This is not to suggest that the Lead State examiner should not consider asking questions about the modeling approach used by the company, as such questions may provide the company an opportunity to elaborate on information provided in the ORSA Summary Report and further the Lead State examiner’s understanding.

External Capital Models

For a number of companies, the group capital assessment may be based largely on rating agency capital. Rating agencies measure capital in ways similar to economic capital, in that they attempt to develop a higher level of required capital than what may be required under regulatory capital models (e.g. RBC). However, they typically use either deterministic assumptions or factor based approaches, which may not be as accurate appropriate in capturing particular specifics of each insurer’s business mix. Although these models also typically include a diversification benefit, the models are applied universally to all companies, and therefore provide a benchmark for relative comparisons. Virtually all insurers are rated by agencies, and the ratings can have a material impact on the perception of the insurer and the ability of the insurer to write business. Most notably, many commercial property/casualty products and many
Some insurers may also perform similar tracking of RBC, as well as other consolidated figures regarding regulatory capital. This type of analysis can also be helpful, and is extremely beneficial since it provides a hard line consolidated capital that must be maintained as of a point in time. This may be more valuable for some insurers than others (e.g. insurers that are less highly capitalized and do not sell rating sensitive business), however for most insurers, this cannot replace similar disclosure of rating agency capital since it is usually set at a higher level and since an inability to retain a particular rating may create an inability to carry out the current business model.

In assessing the current capital position, the company should also consider the impact of stresses on its capital position. For example, if a company elects to present its standing in relation to external capital models, then the companies may also elect to provide information showing their potential standing after considering the impact of stresses. This information may be beneficial as it can demonstrate what types of events an insurer could withstand before potentially losing their rating or violating regulatory capital requirements. While some of this information may be presented in Section II of the report, the impact of stresses on external capital models, while not a requirement, may be considered in an assessment of Section III. There are a number of ways this can be demonstrated including the rigor the insurer applies to its stress scenarios.

If an insurer bases its group capital assessment largely on rating agency capital calculations or regulatory capital requirements, the Lead State examiner should consider the appropriateness of such reliance based upon the nature, scale and complexity of the insurer’s reasonably foreseeable and relevant material risks. In addition, the Lead State examiner should consider whether the insurer has applied appropriate stress scenarios to its available capital to determine its prospective standing in relation to external capital models under a wide range of different scenarios.

Prospective Solvency Assessment

The Guidance Manual requires the insurer to consider the prospective solvency of the group. Many insurers will include information developed as part of their strategic planning including proforma financial information displaying possible expected results as well as projected capital adequacy in those future periods. However, the Lead State examiner should review the information provided to understand the impact such an exercise has on the ongoing business plans of the group. For example, to the extent such an exercise suggests that under expected outcomes, the group capital position will weaken, or recent trends may result in certain internal limits being breached, the Lead State examiner should understand what actions the insurer/group expects to take as a result of such an assessment (e.g. reduce certain risk exposure, raise additional capital, etc.). In addition, the Lead State examiner should consider how any planned changes in risk exposure or strategy may impact both the insurer’s short and long-term solvency positions. Finally, the examiner should consider whether the assumptions and methodologies used in preparing the prospective solvency assessment are consistent with the company’s business strategy and industry best practices. There is no one set of assumptions or methodologies that fit every insurer. Regulators must use professional judgement to assess the reasonability and plausibility of capital model inputs and outputs. This is not to suggest that the Lead State examiner shouldn’t consider asking questions about the modeling approach used by the company, as such questions may provide the company an opportunity to elaborate on information provided in the ORSA Summary Report and further the Lead State examiner’s understanding.

Required Examples of Supporting Documentation for Section III
1. Summarize exam conclusions regarding the insurer’s assessment of group risk capital by addressing each of the following elements:

   a. **Overall Method of Capital Measurement**: Discuss the method(s) used (e.g., internal, external, combination) by the insurer in assessing its overall group capital target and their basis for such a decision.

   b. **Internal Capital Models**: If internal capital models are utilized in the process to assess group risk capital, discuss each of the following items:
      i. Material assumptions and methodologies utilized in calculating capital to be allocated to individual risk components.
      ii. Material assumptions and methodologies utilized in calculating a diversification credit based on the correlation between risk components.
      iii. Controls over model validation and/or results of independent testing performed in this area.

   c. **External Capital Models**: If external capital models are utilized in the process to assess group risk capital, discuss each of the following items:
      i. External capital models utilized and their importance to the insurance group.
      ii. Stress scenarios and testing applied to the external capital model to account for a wide range of potential events.

2. Summarize exam conclusions regarding the prospective solvency assessment provided by the insurance group by discussing each of the following elements:

   a. **Prospective Solvency Projections**: Discuss the material assumptions and methodologies utilized by the insurer in performing a prospective solvency assessment. Are assumptions consistent with the insurer’s overall business plan and strategy?

   b. **Changes in Risk Exposure**: Discuss material changes in individual risk exposures outlined by the insurer. Document whether any of the information provided present concerns to be addressed in the remaining phases of the examination.

F. **Utilization of ORSA Results in the Remaining Phases of the Examination**

The review and assessment of the insurer’s ORSA/ERM processes during an onsite examination is meant to provide input and feedback to the Lead State financial analyst for updating the insurer’s ongoing supervisory plan and in reaching a final assessment regarding the maturity of the insurer’s ERM framework. However, the knowledge gained by the Lead State examiner in performing this review and assessment should also be utilized to gain efficiencies, if appropriate, in the seven-phase risk-focused examination process.

The extent to which the examination team utilizes information from the insurer’s ORSA/ERM processes to create efficiencies should depend upon the overall assessment of the insurer’s ERM framework as follows:

<table>
<thead>
<tr>
<th>Maturity Level</th>
<th>Resulting Examination Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 - Leadership</td>
<td>Examination team may place a high degree of reliance on the insurer’s general ERM processes and related controls and should utilize ORSA conclusions to substantially reduce and focus the scope of remaining examination activities.</td>
</tr>
<tr>
<td>4 - Managed</td>
<td>Examination team may place a moderate-high degree of reliance on the</td>
</tr>
</tbody>
</table>
Examination team may place a moderate degree of reliance on the insurer’s general ERM processes and related controls, but significant individual controls/strategies should be subject to testing. ORSA information should be considered in limiting and focusing the scope of remaining examination activities.

**3 - Repeatable**

Examination team may place a low degree of reliance on the insurer’s general ERM processes and related controls. Individual controls/strategies should be subject to examination testing. ORSA information should be considered in focusing the scope of remaining examination activities.

**2 - Initial**

Examination team should not place reliance on the insurer’s ERM processes and related controls without performing testing on individual controls/processes. ORSA information can be considered in scoping examination activities, but should be supplemented by additional tools and resources.

**1 - Ad-Hoc**

Examination team should not place any reliance on nor consider the results of the insurer’s ERM/ORSA processes in scoping examination activities.

**0 - Non-Existent**

While this guidance is developed with ORSA compliant insurers in mind, the concepts may also be applied to non-ORSA companies that have implemented risk management functions. Therefore, the **Lead State** examination team should customize the consideration of ERM processes during each examination to meet the needs of the insurer being reviewed.

While the results of the ERM maturity assessment can be broadly utilized in customizing risk-focused examination activities, additional guidance has been prepared to provide examples of specific information obtained through the ERM/ORSA review process that may be utilized to reduce or facilitate the remaining phases of the **Lead State** financial examination. The **Lead State** examination team may be able to utilize information obtained through a review of ERM/ORSA processes to gain exam efficiencies as outlined in the following table:

<table>
<thead>
<tr>
<th>ERM/ORSA Information</th>
<th>Related Examination Process(es)</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section I – Description of the Insurer’s Risk Management Framework</td>
<td>Phase 1, Part Two: Understanding the Corporate Governance Structure</td>
<td>The <strong>Lead State</strong> examiner’s work to review and assess the insurer’s ERM framework (as reported in the ORSA) may be used to satisfy the requirement to review the insurer’s risk management practices as part of the Phase 1 corporate governance review.</td>
</tr>
<tr>
<td>Section I – Risk Identification &amp; Prioritization; Section II – Insurer’s Assessment of Risk Exposure</td>
<td>Phase 1, Part Five: Prospective Risk Assessment; Exhibit V – Prospective Risk Assessment; Phase 2: Identifying and Assessing Inherent Risks</td>
<td>The risks described, prioritized and quantified through the insurer’s ERM/ORSA processes should assist the <strong>Lead State</strong> examiner in identifying and assessing risks to be reviewed during the exam.</td>
</tr>
<tr>
<td>Section I – Risk Appetites Tolerances and Limits; Section II –</td>
<td>Phase 3 – Identify and Evaluate Risk Mitigation Strategies/ Controls;</td>
<td>Risk tolerances and limits set by the company may represent strategies/ controls that can be relied upon to mitigate risks in Phase 3 of the</td>
</tr>
<tr>
<td>Insurer’s Assessment of Risk Exposure</td>
<td>Exhibit V – Prospective Risk Assessment</td>
<td>examination process or to address overarching prospective risks.</td>
</tr>
<tr>
<td>--------------------------------------</td>
<td>----------------------------------------</td>
<td>------------------------------------------------------------------</td>
</tr>
<tr>
<td>Section II – Insurer’s Assessment of Risk Exposure; Section III – Group Assessment of Risk Capital</td>
<td>Phase 5 – Establish/Conduct Detail Test Procedures</td>
<td>The results of stress testing performed by the insurer as well as the amount of capital allocated to individual risk components may assist the Lead State examiner in determining the ultimate impact of unmitigated residual risks on the insurer. To the extent that certain residual risks are accepted by the company and capital is allocated to the risk under a wide range of potential outcomes, the Lead State examiner may choose to document this fact in Phase 5 and avoid documenting a finding in this area.</td>
</tr>
<tr>
<td>Section III – Group Assessment of Risk Capital</td>
<td>Exhibit DD – Critical Risk Categories (Capital Management)</td>
<td>The overall results of the group risk capital assessment as well as the prospective solvency assessment performed by the insurer should provide evidence of whether the company’s capital management plans are adequate. This information may be used to address risks related to capital management required to be considered by Exhibit DD – Critical Risk Categories.</td>
</tr>
<tr>
<td>Section III – Prospective Solvency Assessment</td>
<td>Phase 6 – Update Prioritization &amp; Supervisory Plan; Phase 7 – Draft Exam Report &amp; Management Letter</td>
<td>Information provided in the insurer’s prospective solvency assessment should address the company’s ongoing strategy and business outlook. This information may be useful in reaching overall exam conclusions and determining steps for future monitoring efforts required to be documented in Phases 6 and 7 of the examination.</td>
</tr>
</tbody>
</table>
ORSA Summary Report

The NAIC Risk Management and Own Risk and Solvency Assessment Model Act (Model #505) requires all insurers with direct written premium and unaffiliated assumed premium of $500 million and greater to submit an annual ORSA Summary Report and/or all insurers who are a member of an insurance group that have direct written premium and unaffiliated assumed premium of $1 billion and greater to submit a group annual ORSA Summary Report. The model gives the insurer and insurance group discretion as to whether the report is submitted by each individual insurer within the group or by the insurer group as a whole (See NAIC ORSA Guidance Manual for further discussion).

In the case where the insurance group chooses to submit one ORSA Summary Report for the group, it must be reviewed by the Lead State. The Lead State is to perform a detailed and thorough review of the information, and initiate any communications about the ORSA with the group. The suggestions below set forth some possible considerations for such a review. At the completion of this review, the Lead State should prepare a thorough summary of its review, which would include an initial assessment of each of the three sections. The Lead State should also consider and include key information to share with other domestic states that are expected to place significant reliance on the Lead State’s review. Non-Lead States are not expected to perform an in-depth review of the ORSA, but instead place significant reliance on the review completed by the Lead State. The non-Lead States’ review of an ORSA should be performed only for the purpose of having a general understanding of the work performed by the Lead State, and to understand the risks identified and monitored at the group-level so the non-Lead State may better monitor and communicate to the Lead State when its legal entity could impact the group. Any concerns or questions related to information in the ORSA or group risks should be directed to the Lead State. By taking this approach, it avoids unnecessary duplication of efforts for the states and the insurers, and allows resources to be better deployed throughout the state-based system to increase the effectiveness of supervision and regulation of all U.S. groups.

In the case where there is only one insurer within the insurance group, or the group decides to submit separate ORSA Summary Reports for each legal entity, the domestic state is to perform a detailed and thorough review of the information, and initiate any communications about the ORSA directly with the legal entity. The suggestions below set forth some possible considerations for a review. At the completion of this review, the domestic state should prepare a thorough summary of its review, which would include an initial assessment of each of the three sections. Such a review should also be shared with the Lead State (if applicable) so it can develop an understanding of the risks within the entire insurance group. Non-domestic states are not expected to review the ORSA, but instead place significant reliance on the review completed by the domicile state, which need not be shared with non-Lead States. Instead, other states may choose to rely on the Insurer Profile.

Regulators expect most ORSA Summary Reports to be submitted at the insurance group level as opposed to the legal entity. Throughout a significant portion of the remainder of this document, the term insurer is used to refer to both a single insurer for those situations where the report is prepared by the legal entity, but is also used to refer to an insurance group. However, in some cases, the term group is used to reinforce the importance of the group wide view.
Background Information

To understand the appropriate steps for reviewing the ORSA Summary Report, regulators must first understand the purpose of the ORSA. As noted in the ORSA Guidance Manual, the ORSA has two primary goals:

1. To foster an effective level of ERM at all insurers, through which each insurer identifies, assesses, monitors, prioritizes and reports on its material and relevant risks identified by the insurer, 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; and

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

In addition, separately, the ORSA Guidance Manual discusses the regulator obtaining a high level understanding of the insurer’s ORSA, and discusses how the ORSA Summary Report may assist the commissioner in determining the scope, depth and minimum timing of risk-focused analysis and examination procedures. However, it also notes each insurer’s ORSA and ORSA Summary Report will be unique, reflecting the insurer’s business, strategic planning and approach to ERM.

Collectively, the above goals and effects are the principles upon which this regulatory guidance is established. More specifically, although it’s recognized that the ORSA is intended to foster an effective level of ERM at all insurers, the primary purpose of the ORSA is to serve as an input into the risk-focused surveillance process where among other things, the insurer’s risk is assessed and such assessment has a direct impact on the ongoing supervisory plan. It should be recognized however that the ORSA Subgroup of the Financial Condition (E) Committee believes the ORSA Summary Report will not have this type of direct impact until the Lead State becomes fairly familiar with and comfortable with each insurer’s report, and moreover, its processes. This could take more than a couple of years to occur in practice since the Lead State would likely need to review at least one or two ORSA Summary Reports and likely perform some type of targeted on-site examination wherein certain aspects of the processes used to develop the report are validated. However, its envisioned that the ORSA Summary Report can be used to assist the Lead State in better evaluating the risks of the insurer including whether risk management is being used by the insurer in a way that reduces the inherent risk that otherwise may exist. Consequently, the information provided in this guidance was not developed to provide specifics on the report. In fact, outside of requiring very specific sections of the report, even the ORSA Guidance Manual only provides a high level summary of items that are expected. This is because regulators view the ORSA Summary Report as a means for the insurer to demonstrate how their processes help to mitigate risks.

Therefore, the Lead State analyst should NOT use the following guidance in a way that dictates specifics on the report. However, although the ORSA Guidance Manual allows discretion to the insurer in communicating its ERM processes, a lack of report detail may lead to the Lead State regulator under-assessing the maturity of the insurer’s risk management practices. Ultimately, the goal of this guidance is to assist the Lead State analyst in evaluating the robustness of the insurer’s process and how that, as well as the other information in the ORSA Summary Report, impacts the Lead State analyst’s evaluation of risk within the insurer. To assist in the evaluation process, the ORSA Summary Report is divided into distinct sections as follows:

- **Section I** - Description of the Insurer’s Risk Management Framework
- **Section II** - Insurer’s Assessment of Risk Exposure
- **Section III** – Group Assessment of Risk Capital and Prospective Solvency Assessment
General Summary of Guidance for Each Section

The guidance that follows below shows how each of the above sections is reviewed. It should be noted that each of the sections can be informative to the other sections. As an example, Section II affords a company the opportunity to demonstrate the robustness of its process through its assessment of risk exposure. In some cases, it’s possible the analyst may conclude the insurer did not summarize and include information about its framework and risk management tools in Section I in a way that allowed the analyst to conclude it was Leadership (defined below), but in practice by review of Section II, it appears to meet the level. Likewise, the analyst may assess Section II as Leadership level but may be unable to see through Section III how the totality of the insurer’s system is Leadership level because of a lack of rigor, or demonstrated rigor documented in Section III. Therefore the assessment of each section requires the analyst to consider other aspects of the ORSA Summary Report. This is particularly true of Section I, because as discussed in the following, the other two sections have very distinct objectives whereas the assessment of Section I is broader.

At a very high level, the guidance in Section I is designed to assist the analyst in making an initial assessment of the overall risk management framework of the insurer. This assessment is an initial assessment since the examiner trusts the information provided is accurate, but at some point in the future, the examiner would verify some aspects of the report for accuracy or perform some other procedures through a full scope or limited scope examination. Although one of the purposes of the on-site examination is verification of information and processes, it’s important for the analyst of the Lead State to take the primary responsibility for the use of the ORSA Summary Report. This is important in part because the analyst is expected to develop summary documentation of their review of the ORSA Summary Report on an annual basis. However, this summary documentation should also include specific suggestions of items that should be reviewed by the examiner either in a targeted on-site or full scope examination. Although the analyst is expected to make this initial determination, most states believe there is value in including the examiner-in-charge and actuary in the initial discussions with the insurer since the same team will be a part of the ongoing monitoring of the insurer and the ORSA Summary Report is expected to be at the center of the regulatory processes. It’s also important for the analyst to understand the ORSA Summary Report is not intended to be a report that is reviewed once annually, with no further consideration in the regulatory process. Rather, its outputs are intended to be used in the continuous review process, with an input into the annual holding company analysis, as well as other communication the Lead State may have with the group throughout the year.

The section I procedures are focused on determining the insurer’s maturity level in regards to its overall risk management framework. The maturity level is assessed through the incorporation of concepts developed within Risk and Insurance Management Society’s (RIMS) Risk Maturity Model (RMM). The RMM provides a scale of six maturity levels upon which an insurer can be assessed, ranging from Leadership to Non-existent. The six maturity levels can generally be defined as follows:

- **Level 5 – Leadership:** The insurer is at the leading edge of companies in relation to risk management. Risk management is embedded in strategic planning, capital allocation, and other business processes and is used in daily decision-making. Risk limits and early warning systems are in place to identify breaches and require corrective action from board and management.
- **Level 4 – Managed:** The insurer is advanced in its risk management capabilities. Risk management activities are coordinated across business areas and tools and processes are actively utilized. Enterprise-wide risk identification, monitoring, measurement and reporting are in place.
V. Group-wide Supervision—E. ORSA Procedures

- Level 3 – Repeatable: The insurer has risk management processes in place designed and operated in a timely, consistent and sustained way. The insurer takes action to address issues related to high priority risks.
- Level 2 – Initial: The insurer has implemented risk management processes, but the processes may not be operating consistently and effectively. Certain risks are defined and managed in silos, rather than consistently throughout the organization.
- Level 1 – Ad hoc: The insurer has not developed or documented standardized risk management processes and is relying on the individual efforts of staff to identify, monitor and manage risks.
- Level 0 – Non-existent: The insurer has not recognized a need for risk management and risks aren’t directly identified, monitored or managed.

The guidance developed for use in this Handbook integrates the maturity level scale of the RMM with the general principles and elements outlined in Section I of the ORSA Guidance Manual to assist Lead State regulators in reaching an overall assessment of the maturity of an insurer’s risk management framework.

The guidance for Section 1 provides examples of various attributes that would indicate where an insurer falls on the maturity scale for each individual principle. Most companies are expected to fall somewhere in between Non-existent and Leadership for many of the assessed principles. Therefore, the analyst Lead State analyst will need to closely consider the attributes and activities outlined within the ORSA Summary Report to reach an accurate assessment of the insurer’s maturity level for each assessed principle. In reviewing this guidance, the analyst Lead State analyst should understand the goal of making maturity assessments is not to adjust the ORSA Summary Report itself (e.g. make recommendations on how the report should be modified). Instead, consistent with the risk-focused surveillance approach, to the extent the analyst Lead State analyst sees principles of an effective risk management framework that are lacking maturity, such items should be noted for discussion with management during the review of the ORSA or shortly thereafter.

Ultimately, it will be up to the company to determine what, if any, action it takes in response to such discussions, but an assessment of Non-existent, Ad hoc or Initial maturity levels may impact the supervisory plan of the insurer (e.g. may result in increased intensity and scope of ongoing supervisory work). Any determination of the impact such an assessment should have on the ongoing supervisory plan should carefully consider the nature, size and complexity of the insurer in determining whether the assessed maturity level is of concern. For example, it may be appropriate for a smaller insurer writing only one line of insurance to have an Initial maturity level for its practices relating to Risk Appetite, Tolerances and Limits. However, it should also be noted that a significant lack of maturity in risk management principles at a larger or more complex insurer could result in more serious adjustments to the ongoing supervisory plan up to and including a hazardous financial condition determination, which affords the Commissioners a wide range of regulatory actions that can be taken under state law in such a situation.

For those insurers that demonstrate mature frameworks and principles, such facts are intended to ultimately allow the regulator Lead State regulator flexibility to adjust the scope and intensity of the monitoring that otherwise may be performed on the insurer. This is based upon the belief that a mature risk management framework is able to help an insurer reduce risk in ways that make them more manageable or the impact is more likely to be less pronounced. This is of course the purpose of risk management, but in an effort to balance the costs and resources necessary to put such into place, U.S. insurance regulators approach is to encourage such, but not in a way that overemphasizes its benefits beyond what is deemed appropriate by the insurer who dedicates the resources to put such processes in
place. In fact, as the analyst reviews the ORSA Summary Report and discusses it with management, one of the primary discussion points should be the consistent use of the ORSA Summary Report by the board of directors.

The emphasis on the use of the ORSA Summary Report by the board of directors should not be minimized. One of the primary concerns of regulators is that the insurer develops the ORSA Summary Report to meet the regulatory requirement. The analyst, and the insurer should recognize the primary reason the NAICs ORSA Guidance Manual was developed in such a non-prescriptive way was to encourage insurers to “tell its story”, including the same story told to its Board, to the regulator. As discussed in the ORSA Guidance Manual, all insurers use risk management, and the ORSA Summary Report provides the insurer an opportunity to describe, and even “sell” the regulator on how such risk management is used to reduce inherent risks. A critical aspect of risk management is the extent to which it’s embedded within the organization (risk culture) and how it’s used by the board of directors. Many regulators expect the ORSA Summary Report to be reviewed and approved by the board of directors. In order to meet this objective, many regulators understand insurers will develop a report recognizing the reality that a lengthy report may be less valuable to the board of directors than a more concise report that utilizes a significant number of exhibits and appendices to demonstrate various practices, actions, reports used by the board of directors and senior management. All of this is to emphasize U.S. insurance regulators are strongly supportive of an ORSA process and ORSA Summary Report that emphasizes the “Own” and any discussion by the analyst with the insurer should recognize this important concept.

Section II takes a much different approach. It provides guidance to allow the analyst to better understand the range of practices they may see in ORSA Summary Reports. However, such practices are not intended to be requirements, as that would eliminate the “Own” aspect of the ORSA and defeat its purpose. Rather, the guidance can be used in a way to allow the analyst to better understand the power of the information in this section. Ultimately, Section II may be the most informative aspect of the ORSA Summary Report for the analyst from the standpoint that it provides management’s discussion on its reasonably foreseeable and relevant material risks. The information can be extremely powerful in allowing the analyst to better understand what the insurer is attempting to achieve and its obstacles. Those obstacles are the risks it faces and how those risks are mitigated.

Regulators believe informative ORSA Summary Reports can be critical in the ongoing financial analysis process, and have developed the guidance for Section II around the 9 branded risk classifications, which are used as a common language in the risk-focused surveillance process. The primary reason for utilizing this approach is that it’s not uncommon for insurer’s to identify within its ORSA Summary Report, many of the same types of risks, therefore the analyst can leverage this information in their analysis of the insurer. It should be emphasized putting the analysis into this format is NOT meant to suggest the ORSA Summary Report is required to address the same risks. In fact, the analyst should not approach this section in any way where it is suggested the report is lacking because a particular branded risk is not addressed in the summary report. Instead, the analyst should only use the classifications as a way to organize the format for the narrative summary expected to be completed by the Lead State. The following represents the classifications, and the related definition of each of the 9 branded risks.

- **Credit**—Amounts actually collected or collectible are less than those contractually due.
- **Market**—Movement in market rates or prices (such as interest rates, foreign exchange rates or equity prices) adversely affects the reported and/or market value of investments.
• **Pricing/Underwriting**—Pricing and underwriting practices are inadequate to provide for risks assumed.

• **Reserving**—Actual losses or other contractual payments reflected in reported reserves or other liabilities will be greater than estimated.

• **Liquidity**—Inability to meet contractual obligations as they become due because of an inability to liquidate assets or obtain adequate funding without incurring unacceptable losses.

• **Operational**—Operational problems such as inadequate information systems, breaches in internal controls, fraud or unforeseen catastrophes resulting in unexpected losses.

• **Legal**—Non-conformance with laws, rules, regulations, prescribed practices or ethical standards in any jurisdiction in which the entity operates will result in a disruption in business and financial loss.

• **Strategic**—Inability to implement appropriate business plans, to make decisions, to allocate resources or to adapt to changes in the business environment will adversely affect competitive position and financial condition.

• **Reputational**—Negative publicity, whether true or not, causes a decline in the customer base, costly litigation and/or revenue reductions.

Finally, Section III is also unique in that it provides a specific means for assisting the analyst in evaluating group capital. Although the Financial Analysis Handbook contains procedures that require the overall financial condition (which some people think of capital as a large piece of that) of an insurer to be evaluated, it only contains traditional methods for making such assessments (e.g. debt to equity ratios, interest coverage ratios, profitability ratios). Although such methods are generally at the core of making any ultimate conclusion, Section III of the ORSA Summary Report is intended to be more informative by providing specific information on the amount of capital the group needs to run its current business model. This section is similar to Section I in that it is expected to use the output of Section II to provide a better understanding of group capital. Much of the guidance in this section is centered on the information provided in Section II, or other work completed by the insurer to provide a capital cushion. This section also discusses the other part of the equation, which is the capital itself or, more specifically, the quality of capital. This section also centers on how the calculation, and its underlying assumptions, may vary from one year to the next, and the need for the analyst to understand such changes. Similar to Section I, the analysis of this section may be incomplete until some specific work is done to understand the details of the calculation, which in some cases, may require an on-site inspection. Pending the onsite inspection, the outcome of this assessment is expected to be used by the Lead State in the holding company analysis.
Review of Section I - Description of the Insurer’s Risk Management Framework

The ORSA Guidance Manual requires the insurer to discuss the below key principles in Section I of the ORSA Summary Report. For purpose of evaluating the ORSA Summary Report, and moreover, the analyst’s responsibility to assess the insurer’s risk management framework, the analyst should review the ORSA Summary Report to ascertain if the framework meets the principles. Additional guidance is included to provide further information on what may be contemplated when considering such principles as well as examples of attributes that may indicate the insurer is more or less mature in its handling of key risk management principles. These attributes are meant to assist the analyst in reaching an initial assessment of the insurer’s maturity level for each key principle as Leadership, Managed, Repeatable, Initial, Ad hoc or Non-existent.

Key Principles
A. Risk Culture and Governance
B. Risk Identification and Prioritization
C. Risk Appetite, Tolerances and Limits
D. Risk Management and Controls
E. Risk Reporting and Communication

Consideration When Reviewing for Key Principles
As previously mentioned, those entities that have mature and effective processes are able to help reduce risk in ways that they are more manageable or where the impact is more likely to be less pronounced. For most insurers, its largest risk is either directly, or at least indirectly, determined based upon the design of its insurance products. There are a significant number of insurance products in the marketplace and, although many of the basic perils of such products change very little over many years, this is not to suggest the risks are stagnant. Perhaps the easiest example for regulators to consider the context of this may be in the area of weather-related events, such as hurricane, tornado or hail, which all became elevated in recent years. Many insurers use risk management techniques to help mitigate the change in risk that appears to be occurring in various geographies related to these perils. Those risk management techniques can vary materially, but most of them involve the above principles. As the analyst reviews the following information, perhaps the most important consideration is how, collectively, the insurer’s techniques help to mitigate the risks associated with the insurer’s risks or changes in risk.

When reviewing the ORSA Summary Report, the analyst should consider the extent to which the above principles are present within the organization. In reviewing these principles, examples of various attributes/traits associated with various maturity levels (e.g. Leadership practices, management practices) are provided for each principle in the following sections. The intent providing these practices is to assist the analyst in assessing the risk management framework. However, these attributes only demonstrate common practices associated with each of the various maturity levels and practices of individual insurers may vary significantly from the examples provided. For that reason, it may be helpful to engage the insurer in discussing how they believe they meet the principles set forth in the ORSA Guidance Manual. Their responses to such inquiries may assist the analyst in reaching an assessment for each of the relevant principles and may be something the insurer wants to incorporate into future ORSA Summary Reports.

A. Risk Culture and Governance
It’s important to note some organizations view risk culture and governance as the cornerstone to managing risk. The ORSA Guidance Manual defines this item to include a structure that clearly defines and articulates roles, responsibilities and accountabilities; and a risk culture that supports accountability in
risk-based decision making. Therefore, the objective is to have a structure in place that creates a top-driven atmosphere and rigor within the organization that manages risk in a way that is continuously improved.

**Leadership Practices**
Risk culture is analyzed and reported as a systematic view of evaluating risk. Executive sponsorship is strong and the tone from the top has sewn an ERM Process into the corporate culture. The Board of Directors establishes the framework and the risk culture and approves the risk appetite statement in collaboration with the chief executive officer (CEO), chief risk officer (CRO) where applicable, and chief financial officer (CFO). Those officers translate the expectations into targets through various practices embedded throughout the organization. Risk management is embedded in each business function. Internal audit, information technology, compliance, controls and risk management are highly integrated and coordinate and report risk issues. All areas use risk-based best practices. The risk management lifecycle for each business process area is routinely improved.

**Managed Practices**
Risk culture is associated with career development. The organization is self-governed with shared ethics and trust; promise-makers are held accountable. Risk management issues are understood at all levels and risk plans are conducted in all business process areas. The Board of Directors, CEO and Chief Risk Officer expect a risk management plan to include a qualitative risk assessment for significant projects, new products, business practice changes, acquisitions, etc. with reporting to the Board on priorities. All areas use the ERM Process to enhance their functions via the ERM framework, with frequent and effective communication on risk issues. Process owners incorporate managing their risks and opportunities within regular planning cycles. All areas create and evaluate far-sighted scenarios and follow-up activities.

**Repeatable Practices**
ERM risk plans are understood by management and the organization. Senior management expects that a risk management plan includes a qualitative risk assessment for significant projects, new products, business practice changes, acquisitions, etc. Most areas use the ERM Process and report on risk issues. Process owners take responsibility for managing their risks and opportunities. Risk management creates and evaluates far-sighted scenarios.

**Initial Practices**
Risk culture is enforced by policies interpreted primarily as compliance in nature. An executive champions ERM management to develop an ERM Process. One area has used the ERM Process, as shown by the department head and team activities. Business processes are identified and ownership is defined. Risk management is used to consider risks in a far-sighted manner.

**Ad Hoc Practices**
Corporate culture has little risk management accountability. Risk management is not interpreted consistently. Policies and activities are improvised. Programs for compliance, internal audit, process improvement and IT operate independently and have no common framework, causing overlapping risk assessment activities and inconsistencies. Controls are based on departments and finances. Business processes and process owners aren’t well defined or communicated. Risk management focuses on past events. Qualitative risk assessments are unused or informal. Risk management is considered a quantitative analysis exercise.
Non-existent Practices
No recognized need for an ERM Process and no formal responsibility for ERM. Internal audit, risk management, compliance and financial activities might exist but aren’t integrated. Business processes and risk ownership aren’t well defined.

B. Risk Identification and Prioritization
The ORSA Guidance Manual defines this as key to the organization; and responsibility for this activity should be clear; and the risk management function is responsible for ensuring the process is appropriate and functioning properly at all organizational levels. Therefore, the objective is to have a process in place that identifies risk and prioritizes such risks in a way that all potential reasonably foreseeable and relevant material risks are addressed in the framework.

Leadership Practices
Internal and external best practices, support functions, business lines and regions are systematically gathered and maintained. A routine, timely reporting structure directs risks and opportunities to senior management. The ERM Process promotes frontline employees’ participation and documents risk issues’ or opportunities’ significance. Process owners regularly review and recommend risk indicators that best measure their areas’ risks. The results of internal adverse event planning are considered a strategic opportunity.

Managed Practices
Process owners aggressively manage a growing list of business area specific risks locally to create context for risk assessment activities as a foundation of the ERM Process. Risk indicators deemed critical to their areas are regularly reviewed in collaboration with the ERM team. Measures ensure downside and upside outcomes of risks and opportunities are aggressively managed. Standardized evaluation criteria of impact, likelihood and controls’ effectiveness are used to prioritize risk for follow-up activity. Risk mitigation is integrated with assessments to monitor effective use.

Repeatable Practices
An ERM team manages a growing list of business area specific risks, creating context for risk assessment as a foundation of the ERM Process. Risk indicator lists are collected by most process owners. Upside and downside outcomes of risk are understood and managed. Standardized evaluation criteria of impact, likelihood and controls’ effectiveness are used, prioritizing risk for follow-ups. Enterprise level information on risks and opportunities are shared. Risk mitigation is integrated with assessments to monitor effective use.

Initial Practices
Formal lists of risks for each department and discussions of risk are part of the ERM Process. Corporate risk indicators are collected centrally, based on past events. Departments might maintain their own informal risk checklists that affect their areas, leading to potential inconsistency, inapplicability, lack of sharing or under-reporting.

Ad Hoc Practices
Risk is owned by specialists, centrally or within a department. Risk information provided to risk managers is probably incomplete, dated or circumstantial, so there’s high risk of misinformed decisions, with potentially severe consequences. Further mitigation, supposedly completed, is probably inadequate or invalid.
Non-existent Practices
There might be a belief that the most important risks are known, although there is probably little documentation.

C. Risk Appetite, Tolerances and Limits
The ORSA Guidance Manual states that 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. Not included in the manual, but widely considered, is that risk appetite statements should be easy to communicate and for stakeholders to understand, and closely tied to the organizations strategy and address its reasonably foreseeable and relevant material risks. It should be used to help set boundaries and expectations by using quantitative limits and statements for risk that are difficult to measure. These boundaries may be expressed in terms of earnings, capital, or other metrics (growth, volatility). The objective is to put mechanisms in place to measure the risk the organization is willing to accept. For example, the risk appetite statement may require the organization to maintain sufficient capital to cover a 1 year horizon with 99.97% confidence, or maintain an “AA” solvency standard.

After the overall risk appetite for the organization is set, the underlying risk tolerances and limits can be selected and applied to individual business units and risk areas. The risk tolerances/limits provide direction outlining the Company’s tolerance for taking on certain risks, which sometimes can be established and communicated in the form of the maximum amount of such risk the entity is willing to take (e.g. no more than 10% of the new business written/invested assets). However, in many cases these will be coupled with more specific and detailed limits or guidelines the company uses (e.g. equity securities not to exceed 5% of assets, counterparty exposure to a specific reinsurance not to exceed a specific dollar amount, catastrophe risk (1 in 500 year event) not to exceed more than 20% of required capital). The limits should be measurable and should be monitored as often as needed in order to prevent a company from unknowingly breaching its limits. The effectiveness of these items may be best measured by the impact they have on the organization, which can be difficult to demonstrate in a written report. Due to the varying level of detail and specificity different organizations incorporate into their risk appetites, tolerances and limits, regulators should consider these elements collectively to reach an overall assessment in this area.

Leadership Practices
A risk appetite statement has been developed to set clear boundaries and expectations for the organization to follow by establishing quantitative limits and qualitative statements. A process for delegating authority to accept risk levels in accordance with the risk appetite statement is communicated throughout the organization. Risk management uncovers risk, reduces uncertainty and costs and increases return on equity in accordance with this statement. The management team and risk management committee define tolerance levels and limits for all business units and significant risk areas in accordance with the risk appetite. A mechanism compares and reports actual assessed risk versus risk tolerance. The organization manages business areas and has a diverse portfolio collection to balance risk positions. Management prioritizes resource allocation based on the gap between risk appetite and assessed risk and opportunity. The established risk appetite is examined periodically. Example: Take more risk and gain more market share versus a conservative hold position and protect the brand.
Managed Practices
Risk appetite is considered in each ERM Process step. Resource allocation decisions consider the evaluation criteria of business areas. The organization forecasts planned mitigation’s potential effects versus risk tolerance as part of the ERM Process. Portfolio views are dynamic and risk tolerance is evaluated based on different views. Risk is managed by process owners. Risk tolerance is evaluated as a decision to increase performance and measure results. Risk-reward tradeoffs within the business are understood and guide actions.

Repeatable Practices
Risk assumptions within management decisions are clearly communicated. There’s a structure for evaluating risk on an enterprise-wide basis and for gauging risk tolerance. Risks and opportunities are routinely identified, evaluated and executed in alignment with risk tolerances. The ERM framework quantifies gaps between actual and target tolerances as part of the ERM Process. Portfolio views to balance risk positions are created and risk tolerance is evaluated based on portfolio analysis.

Initial Practices
Risk assumptions are only implied within management decisions and aren’t understood outside senior leadership with direct responsibility. There's no ERM framework for resource allocation. Defining different views of business areas from a risk perspective can’t be easily created and compared.

Ad Hoc Practices
Risk management might lack a portfolio view of risk. Risk management might be viewed as risk avoidance and meeting compliance requirements or transferring risk through insurance. Risk management might be a quantitative approach focused on the analysis of high-volume and mission-critical areas.

Non-existent Practices
The need for formalizing risk tolerance and appetite isn’t understood.

D. Risk Management and Controls
The ORSA Guidance Manual stresses managing risk is an ongoing ERM activity, operating at many levels within the organization. This principle is discussed within the governance section above from the standpoint that a key aspect of managing and controlling the risks of the organization is the governance process put in place. For many companies, the day to day governance starts with the business units, but those units put mechanisms in place to identify, quantify and monitor risks, which is reported up to the next level based upon the risk reporting and risk limits put in place. In addition, controls are also put in place on the backend, by either the internal audit team, or some independent consultant, which is designed to ensure compliance and a continual enhancement approach. Therefore, the objective is to put controls in place to ensure the organization is abiding by its limits.

Leadership Practices
ERM, as a management aspect, is embedded in all business processes and strategies. Roles and responsibilities are process driven with teams collaborating across central and field positions. Risk and performance assumptions within qualitative assessments are routinely revisited and updated. The organization uses an ERM process of sequential steps that improves decision-making and performance. A collaborative, enterprise-wide approach is in place to establish a risk management committee staffed by all relevant supporters. Accountability for risk management is
woven into all processes, support functions, business lines and geographies as a way to achieve goals. To evaluate and review the effectiveness of ERM efforts and related controls, the organization has implemented a ‘Three Lines of Defense’ model or similar system of checks and balances that is highly effective and fully integrated into the insurer’s business processes. The first line of defense may consist of business unit owners and other front line employees applying internal controls and risk responses in their areas of responsibility. The second line of defense could consist of risk management, compliance and legal staff providing oversight to the first line of defense and establishing framework requirements to ensure risks are actively and appropriately managed. The third line of defense may consist of auditors performing independent reviews of the efforts of the first two lines of defense to report back independently to the board of directors.

Managed Practices
Management is clearly defined and enforced at every level. A risk policy articulates management’s responsibility for risk management, according to established risk management processes. A risk management committee exists and management develops and reviews risk plans. The ERM Process is coordinated with managers’ active participation. Opportunities associated with risk are part of risk plans’ expected outcome. Authentication, audit trail, integrity and accessibility promote roll-up information and information sharing. Periodic reports measure ERM progress for stakeholders, including the Board of Directors. The organization has implemented a “Three Lines of Defense” model to review and assess its control effectiveness, but those processes may not yet be fully integrated or optimized.

Repeatable Practices
The ERM Process accommodates all business and support areas’ needs. ERM is a process of steps to identify, assess, evaluate, mitigate and monitor. ERM Process includes the management of opportunities. A risk management committee exists and senior management actively reviews risk plans. The ERM Process is collaborative and directs important issues to senior management. The “Three Lines of Defense” are generally in place, but are not yet performing at a highly effective level.

Initial Practices
Management recognizes a need for an Enterprise Risk Management Process. Agreement exists on a framework, which describes roles and responsibilities. Evaluation criteria are accepted. Risk mitigation activities are sometimes identified but not often executed. Qualitative assessment methods are used first in all areas and determine what needs deeper quantitative methods, analysis, tools and models. The “Three Lines of Defense” are not yet fully established, although some efforts have been made to put these processes in place.

Ad Hoc Practices
Management is reactive and ERM might not yet be seen as a process. Few processes and controls are standardized and are instead improvised. There are no standard risk assessment criteria. Risk management is involved in business initiatives only in later stages or centrally. Risk roles and responsibilities are informal. Risk assessment is improvised. Standard collection and assessment processes aren’t identified.

Non-existent Practices
There’s little recognition of the ERM Process’s importance or controls in place to ensure its effectiveness.
E. Risk Reporting and Communication
The ORSA Guidance Manual indicates risk reporting and communication provides key constituents with transparency into the risk-management processes and facilitates active, informal decisions on risk-taking and management. The transparency is generally available because of reporting that can be made available to board members or compliance departments. However, most important is how the reports are being utilized to identify and manage risk at either the business unit level or some other level within the organization where decisions are made. The reporting provides the current measure of risk used to monitor such risk. Therefore, the objective is to have reporting in place that allows various decisions to be made throughout the organization and by the appropriate people, with ultimate ownership by the Board of Directors.

Leadership Practices
The ERM Process is an important element in strategy and planning. Evaluation and measurement of performance improvement is part of the risk culture. Measures for risk management include process and efficiency improvement. The organization measures the effectiveness of managing uncertainties and seizing risky opportunities. Deviations from plans or expectations are also measured against goals. A clear, concise and effective approach to monitor progress toward risk management goals is communicated regularly with business areas. Individual, management, departmental, divisional and corporate goals are linked with standard measurements. The results of key measurements and indicators are reviewed and discussed by senior management and board (or committee) members on a regular basis and as frequently as necessary to address breaches in risk tolerances or limits in a timely manner.

Managed Practices
The ERM Process is an integrated part of strategy and planning. Risks are aggressively considered as part of strategic planning. Risk management is a formal part of goal setting and achievement. Investment decisions for resource allocation examine the criteria for evaluating opportunity impact, timing and assurance. The organization forecasts planned mitigation’s potential effect on performance impact, timing and assurance prior to use. Employees at all levels use a risk-based approach to achieve goals. The results of key measurements and indicators are shared with senior management and board (or committee) members on a regular basis.

Repeatable Practices
The ERM Process contributes to strategy and planning. All goals have measures and all performance measures are linked with goals. While compliance might trigger reviews, other factors are integrated, including process improvement and efficiency. The organization indexes opportunities qualitatively and quantitatively, with consistent criteria. Employees understand how a risk-based approach helps them achieve goals. Accountability toward goals and risk’s implications are understood, and are articulated in ways frontline personnel understand. The results of key measurements and indicators are shared with senior management and board (or committee) members.

Initial Practices
The ERM Process is separate from strategy and planning. A need for an effective process to collect information on opportunities and provide strategic direction is recognized. Motivation for management or support areas to adopt a risk-based approach is lacking.
Ad Hoc Practices
Not all goals have measures and not all measures are linked with goals. Strategic goals aren’t articulated in terms the frontline management understands. Compliance focuses on policy and is geared toward satisfying external oversight bodies. Process improvements are separate from compliance activities. Decisions to act on risks might not be systematically tracked and monitored. Monitoring is done and metrics are chosen individually. Monitoring is reactive.

Non-existent Practices
No formal framework of indicators and measures for goals and management exists.

More Specific Considerations for Reviewing Section I
The following are further considerations the analyst may want to use either in the review of the ORSA Summary Report, or as a follow up to the review.

1. The ORSA Summary Report is intended to be a summary of the insurer’s internal assessment of its material and relevant risks associated with its current business plan and the sufficiency of capital resources to support those risks. Because such an assessment may be complex and difficult to communicate in one concise report, the analyst may find it useful to organize an in-person meeting or conference call between a team of insurance department members (analyst, examiner, actuary, etc.) and the insurer’s Chief Risk Officer(s) or other responsible employees to allow company personnel to walk through the ORSA and ERM process. A face to face meeting at the beginning of the process can assist the analyst in understanding and reading of the ORSA.

   a. Set up a meeting (e.g. 1 to 3 hours depending upon complexity) with the insurer to discuss the ORSA Summary Report. Allow for additional time for questions between the insurance regulator and the insurer.

      i. The questions from the regulator could result from any item the analyst or other department staff failed to completely understand from reading the ORSA report, but in particular, would focus on any lack of understanding needed in order to complete an assessment of the five principles included in Section I of the ORSA Guidance Manual, as well as any other questions that arise in reading the entire report. Regulators should consider asking questions designed for the purpose of engaging in a conversation to allow the regulator to fully understand the extent to which various positive risk management techniques are utilized by the insurer. Following are questions that may be used to help engage in this type of conversation. These shouldn’t be used as a list, but rather tailored by the state insurance regulator based upon those questions are appropriate for the insurer and pertinent to what was presented in the ORSA Summary Report.

         • Provide us a summary of “your story” in terms of risk management.
         • Describe how your risk management is tied to your overall business strategy.
         • Describe positive aspects of your company culture that demonstrate the use of risk management.
         • Describe your board of directors’ review of the ORSA process Summary Report and their reaction. What else is used by the board
that may not be reflected in the ORSA Summary Report and related appendices.

- Describe as you discuss the ORSA Summary Report the maturity you feel has been achieved in meeting the 5 principles set forth in the ORSA Guidance Manual.

- What are the most useful aspects of ERM since it’s been developed by the insurer? How has that changed over the years? Discuss any changes in tolerances and risk limits you would have put in front of the board of directors for their approval.

- Describe the timing of the ORSA Summary Report and when it’s presented in relation to the rest of the business strategy development. Discuss if you believe the department can expect to receive the ORSA Summary Report at the same time of year in all subsequent years. If not, explain the need for them to notify the department so they can adjust their schedule.

- Describe how management reflects risk and reward in strategic decision making.

- Describe how risk management is integrated into business operating plans. Are the business objectives driven only from the top of the organization, or are they also driven from the individual business units? Can such facts be available during an on-site examination for validation?

- Describe your use of a CRO position or some other similar position and how that position is intertwined with senior management, but at the same time, has an independent voice to the Board of Directors.

- Describe if applicable, how risk management is integrated into compensation practices. Describe who is covered under such practices, the portion of their compensation tied to such, or if other variable compensation exists (management or board) that is dependent upon other factors.

- What reports go to the audit committee, risk committee, other committees responsible for risk and what reports go to the full board of directors? Can the reports used by the board of directors be listed on one sheet and available upon request by either the analyst or an on-site examiner? What other similar type of information used in the day to day and month to month monitoring of risks and decision making process could be made available to demonstrate the rigor involved in the insurer’s ERM process? Describe how such are used to make day to day decisions that help achieve the objectives of the insurer.

- Describe your communication strategy related to such reports, since the reports themselves are less important than the communication that occurs as the result of such reports.

- Describe the attitude towards risk limits. Are they intended to be challenged in a way that maximizes risk taking but used as a caution? Or are they meant to be strict limitations that shall not be overridden?
• Describe how you are able to develop risk tolerance statements and risk limits that are easily measured.
• How does management reflect risk in performance measurement systems in the insurer? Are such systems available for closer review during an on-site examination?
• Are legal entities within the group monitored by the same ERM program?
• Identify how the insurer identifies changes in the insurer’s risk profile due to economic changes or changes in business strategy. How is new risk information incorporated into the risk profile?

Required Documentation for Section I

The analyst
Lead State analyst
should prepare a summary of Section I by developing an assessment of each of the five principles set forth in the ORSA Guidance Manual as follows. Each assessment should be followed by a narrative that supports that assessment. The assessment, along with the analyst
Lead State analyst’s findings from Section II and Section III, will be the primary basis on which non-Lead states will consider the ORSA in their review of their domestic company. See the maturity level definitions previously presented in this guidance on ORSA.

A. Risk Culture and Governance—Governance structure that clearly defines and articulates roles, responsibilities and accountabilities; and a risk culture that supports accountability in risk-based decision making.

☐ 5 – Leadership ☐ 4 – Managed ☐ 3 – Repeatable ☐ 2 – Initial ☐ 1 – Ad Hoc ☐ 0 – Non-existent

Analyst Supporting Documentation

B. Risk Identification and Prioritization—Risk identification and prioritization process is key to the organization; responsibility for this activity is clear; the risk management function is responsible for ensuring the process is appropriate and functioning properly at all organizational levels.

☐ 5 – Leadership ☐ 4 – Managed ☐ 3 – Repeatable ☐ 2 – Initial ☐ 1 – Ad Hoc ☐ 0 – Non-existent

Analyst Supporting Documentation

C. Risk Appetite, Tolerances and Limits—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. (e.g. relationship between risk tolerances and the amount and quality of risk capital)

☐ 5 – Leadership ☐ 4 – Managed ☐ 3 – Repeatable ☐ 2 – Initial ☐ 1 – Ad Hoc ☐ 0 – Non-existent

Analyst Supporting Documentation

D. Risk Management and Controls—Managing risk is an ongoing ERM activity, operating at many levels within the organization. (e.g. monitoring processes and methods)
Analyst WP Documentation

E. Risk Reporting and Communication— Provides key constituents with transparency into the risk-management processes and facilitate active, informal decisions on risk-taking and management. (e.g. risk assessment tools, feedback loops, used to monitor and respond to changes in risks, operations, economic environment, & strategies, and includes new risk information)

☐ 5 – Leadership ☐ 4 – Managed ☐ 3 – Repeatable ☐ 2 – Initial ☐ 1 – Ad Hoc ☐ 0 – Non-existent

Overall Assessment

After considering the assessment of each of the five previously identified principles, develop an overall assessment of the insurer’s Risk Management Framework with the same risk maturity model followed by any factors outside of those already identified by the analyst Lead State analyst in each of the above sections. The assessment, along with the analyst Lead State analyst’s findings from Section II and Section III, will be the primary basis on which non-Lead states will consider the ORSA in their review of their domestic company. The assessment will be continuously reviewed either by the analyst Lead State analyst during an annual review, or through an updated review by the examiner.

☐ 5 – Leadership ☐ 4 – Managed ☐ 3 – Repeatable ☐ 2 – Initial ☐ 1 – Ad Hoc ☐ 0 – Non-existent
Review of Section II - Insurer’s Assessment of Risk Exposure

Section II of the ORSA Summary Report is required to provide a high level summary of the quantitative and/or qualitative assessments of risk exposure. There may be a great deal of variation in how this information is displayed from one insurer to the next, but in most cases, insurers tend to organize this information around the main risks of the insurer. The ORSA Guidance Manual doesn’t require the insurer include specific risks, but does give possible examples of relevant reasonably foreseeable and relevant material risk categories (credit, market, liquidity, underwriting, and operational risks).

Notwithstanding the fact that Section II also requires the risk exposure to be provided in both normal and stressed environments, some analysts and examiners may find the information regarding the risk exposures the most beneficial aspect of the ORSA Summary Report. Part of that can be attributed to the fact that Section II provides risk information on the entire insurance group, which will often be grouped in categories similar to the NAIC’s 9 branded risk classifications. However, this is not to suggest the analyst or examiner should expect the insurer to address each of the 9 branded risk classifications. It’s reasonable for the state to ask questions as to how the insurer considers the 9 branded risk classifications. A fair number of an insurer’s risks may not be easily quantified, or are grouped differently than these 9 classifications, and therefore it’s possible the insurer doesn’t view them as significant or relevant. However, the insurer may be able to describe how they consider and manage the risks in the 9 branded risk classifications, but the analyst or examiner should NOT expect the insurer to modify their ORSA Summary report for such classifications since that would go against the purpose of such report.

Therefore Section II provides the analyst of the Lead State an opportunity to better understand the risks of the insurer. The analyst should document their understanding of the insurer’s risks by summarizing the most relevant information available on all of the insurer’s identified risks into the below (See below in terms of information that may be the most relevant). In addition, the analyst should assess whether the information provided on each risk category, if relevant, is sufficient to describe the impact and treatment of significant risks within the category. This assessment, along with the analyst findings from Section I and Section III, will be the primary basis on which non-lead states will consider the ORSA in their review of their domestic company.

Required Documentation for Section II

1. Based on your knowledge of the insurer, did they include in their ORSA a discussion of risks within each of the branded risk classifications below you consider appropriate for the insurer? [Note the ORSA Summary Report is based on the insurer’s own risks and is not required to include or be in a format that aligns with branded risk classifications.]

   Analyst Summary of Risk

   - Credit—Amounts actually collected or collectible are less than those contractually due.

     □ Yes, discussion of risks appears appropriate □ Yes, but limited discussion □ Not discussed, but appears applicable □ Not discussed but does not appear applicable

   Analyst Summary of Risk


- **Market**—Movement in market rates or prices (such as interest rates, foreign exchange rates or equity prices) adversely affects the reported and/or market value of investments.

  □ Yes, discussion of risks appears appropriate □ Yes, but limited discussion □ Not discussed, but appears applicable □ Not discussed but does not appear applicable

  **Analyst Summary of Risk**

- **Pricing/Underwriting**—Pricing and underwriting practices are inadequate to provide for risks assumed.

  □ Yes, discussion of risks appears appropriate □ Yes, but limited discussion □ Not discussed, but appears applicable □ Not discussed but does not appear applicable

  **Analyst Summary of Risk**

- **Reserving**—Actual losses or other contractual payments reflected in reported reserves or other liabilities will be greater than estimated.

  □ Yes, discussion of risks appears appropriate □ Yes, but limited discussion □ Not discussed, but appears applicable □ Not discussed but does not appear applicable

  **Analyst Summary of Risk**

- **Liquidity**—Inability to meet contractual obligations as they become due because of an inability to liquidate assets or obtain adequate funding without incurring unacceptable losses.

  □ Yes, discussion of risks appears appropriate □ Yes, but limited discussion □ Not discussed, but appears applicable □ Not discussed but does not appear applicable

  **Analyst Summary of Risk**

- **Operational**—Operational problems such as inadequate information systems, breaches in internal controls, fraud or unforeseen catastrophes resulting in unexpected losses.

  □ Yes, discussion of risks appears appropriate □ Yes, but limited discussion □ Not discussed, but appears applicable □ Not discussed but does not appear applicable

  **Analyst Summary of Risk**

- **Legal**—Non-conformance with laws, rules, regulations, prescribed practices or ethical standards in any jurisdiction in which the entity operates will result in a disruption in business and financial loss.

  □ Yes, discussion of risks appears appropriate □ Yes, but limited discussion □ Not discussed, but appears applicable □ Not discussed but does not appear applicable

  **Analyst Summary of Risk**
DRAFT

V. Group-wide Supervision—E. ORSA Procedures

- **Strategic**—Inability to implement appropriate business plans, to make decisions, to allocate resources or to adapt to changes in the business environment will adversely affect competitive position and financial condition.

  □ Yes, discussion of risks appears appropriate □ Yes, but limited discussion □ Not discussed, but appears applicable □ Not discussed but does not appear applicable

**Analyst Summary of Risk**

- **Reputational**—Negative publicity, whether true or not, causes a decline in the customer base, costly litigation and/or revenue reductions.

  □ Yes, discussion of risks appropriate □ Yes, but limited discussion □ Not discussed, but appears applicable □ Not discussed but does not appear applicable

**Overall Risk Assessment Summary**

After considering the various risks identified by the insurer through Section II, as well as the **analystLead State analyst**’s summary of the risks from each of the previously identified 9 branded risk classifications, develop an overall risk assessment summary that best identifies the major risks of the insurer. The understanding and assessment, along with the **analystLead State analyst**’s findings from Section I and Section III, will be the primary basis on which non-lead states will consider the ORSA in its review of their domestic company. Such an assessment will be continuously reviewed either by an annual review by the **analystLead State analyst**, or through an updated review by the examiner.

**Most Relevant Information Documented by the Analyst from Section II**

The **analystLead State analyst** should not be reviewing the ORSA for the purpose of specifying to the company the risks it believes are appropriate, despite the fact the **analystLead State analyst** may infer this is appropriate because of the above use of the 9 branded risk classifications format. Such an approach goes against the previously disclosed purpose of the ORSA Summary Report, which is 1) to foster an effective level of ERM at all insurers, and 2) to provide a group-level perspective on risk and capital as a supplement to the existing legal entity view. However, to the extent the **analystLead State analyst** believes the ORSA Summary Report does not reflect the key risks of the insurer, the **analystLead State analyst** should engage the company in a conversation to better understand why the company takes the approach it does. The primary purpose of the review of Section II should be to document the insurer’s risks and risk management processes. Since the Financial Analysis Handbook requires the **analystLead State analyst** to develop a narrative assessment of each of the 9 branded risk classifications, the **analystLead State analyst**’s documentation should be focused on grouping the information into the above format to serve as an input into a separate comprehensive analysis of the insurance group in the holding company analysis discussed elsewhere in this handbook.

As the **analystLead State analyst** considers what is most relevant, some insurers will focus on the handful of risks identified in the ORSA Guidance Manual (credit, market, liquidity, underwriting, and operational risks) as they generally represent the most material and most quantifiable risks. This is particularly true for those insurers that utilize economic capital models. Such insurers tend to describe these risks in general terms within Section II, and may quantify the results of their capital model within this same section and then pull the same data forward into Section III. Other insurers will only describe the risks in general terms within Section II and not quantify any of the results in that same section but include within Section III only. The biggest advantage to the former is, in most cases, these insurers will also provide some general discussion of how the model captures the risks and the related key assumptions that drive
such results. Insurers that don’t utilize economic capital models may perform stress tests that contemplate more extreme situations than considered by insurers using economic capital models and, in some cases, will quantify both in dollar terms as well as, within the context of the potential impact on its perceived view of the rating agency capital requirements. These quantifications can be very helpful to the analyst as they can use the information to compare to the areas they see as the most material risks.

Most of the time, the ORSA Summary Report can be informative and directive as to how the analyst considers such risks in an ongoing analysis of the insurer. Regulator do not believe there is a standard set of stress conditions each insurer should test. It may be helpful for the analyst to understand the type of information that may be routinely displayed in the ORSA Summary Report to give the analyst a better sense of what to expect. Following are examples of stresses an analyst may see in an ORSA Summary Report. This list is neither exhaustive, nor meant to be used in any other way other than to have a sense of the type of information that may be common. The analyst should NEVER specify the stresses to be performed and what should be included in insurer’s summary report, as this would eliminate the “Own” aspect of the ORSA and defeat its purpose of allowing the regulator to better understand the risk from the perspective of the insurer. This is not to suggest the analyst should’t consider asking questions about the extent to which insurers consider particular risks, as such questions may provide the insurer an opportunity to discuss the robustness of its processes and considerations, either in specifically identified stresses, or the inclusion of similar risks within a stochastic economic capital model for a particular risk.

Categories of Risk/Example Risks & Stresses Included in ORSA Summary Reports

1. **Credit**
   - Counterparty exposure (loss of specified amount to reinsurer, derivatives party, supplier)
   - Equity securities (40%/50% drop, no growth in stocks in 3 years)
   - General widening of credit spreads (increase in defaults)
   - Other risk assets

2. **Market**
   - 300 basis point pop up in interest rates
   - Prolonged low interest rates (10 year treasury of 1%)
   - Material drop in GDP & related impacts
   - Stock market crash or specific extreme condition (Great Depression)
   - Eurozone collapse
   - U.S. Treasury collapse
   - Foreign currency shocks (e.g. percentages)
   - Municipal bond market collapse
   - Prolonged multiple market downturn (e.g. 2008/2009 crisis/or 1987 stock market drop-or 50% drop in equities, 150bp of realized credit losses)

3. **Pricing/Underwriting**
   - Significant drop in sales/premiums due to varying reasons
   - Impact of 20% reduction in mortality rates on annuities
   - Material product demonstrates specific losses (e.g. 1 in 20 year events)
• Severe pandemic (e.g. Avian bird flu based upon World Health Organization mortality assumption)
• California and New Madrid earthquakes, biological, chemical or nuclear terrorist attacks in locations of heaviest coverage (consider a specified level of industry losses)
• Atlantic hurricane (consider a specified level of industry losses previously unseen/may consider specified levels per different lines of coverage) in different areas (far northeast, northeast, southeast, etc.)
• U.S. tornado over major metropolitan area with largest exposure
• Japanese typhoon/earthquake (consider a specified level of industry losses previously unseen)
• Major aviation/marine collision
• Dirty bomb attack
• Drop in rating to BB

4. **Reserving**
   • Specified level of adverse development (e.g. 30%)
   • Regulatory policy change requires additional reserves (e.g. 30%)

5. **Liquidity**
   • Catastrophe results in material immediate claims of 3X normalized amounts
   • Call on any existing debt
   • Material spike in lapses (e.g. 3X normal rates)
   • Drop in rating to BB

6. **Operational**
   • Loss of systems for 30 days
   • Terrorist act
   • Cybercrime
   • Loss of key personnel
   • Specified level of fraud within claims

7. **Legal**
   • Material adverse finding on pending claim
   • Worst historical 10 year loss is multiplied at varying levels

8. **Strategic**
   • Product distribution breakup

9. **Reputational**
   • PR crisis
   • Drop in rating to BB

In addition to the above, the following items are best practice examples/disclosures viewed to be favorable in terms of demonstrating strong risk management techniques.

• Summary of major legal entity stress test performance
• Available liquid assets for sale by type in the context of liquidity management (as well as other liquidity available)
• Qualitative discussion regarding sources of liquidity/contingent financing
• Heat map of risk priorities

More Specific Considerations for Reviewing Section II

Similar to Section I, the following are questions the analyst may want to consider, not simply to obtain a specific response, but rather to engage in a conversation designed to allow the analyst to more fully understand the risks and approaches to risks used by the insurer. How is new risk information incorporated into the risk profile?
• How is liquidity risk measured and monitored?
• How is credit risk assessed? Is there a risk appetite tolerance statement documented to address credit risk?
• Discuss how the insurer thinks about and manages asset liability management.
• Discuss how the insurer thinks about and manages operational risk.
Review of Section III - Group Assessment of Risk Capital

Section III of the ORSA is unique in that it is required to be completed at the insurance group level, although in many cases, insurers will choose to also complete Sections I and II at the group level as well. This requirement is important because it provides the means for insurance regulators to assess the sufficiency of capital of the entire insurance group based upon its existing business plan. Although it’s not a group capital requirement, which does exist in other countries, U.S. regulators view it more valuable than a requirement that may establish arbitrary rules that do not reflect the economic realities the group faces. Additionally, it’s expected to be used similar to business plans, wherein the forward looking statement is used to test the ongoing ability of the group to accurately capture its risks and required capital levels to absorb such risks. It’s envisioned that as it’s used, the regulator will better understand how the group manages its capital in relation to its business risks, and will likely develop a better sense of the amount of capital for the business plan of the group. More importantly, it will help groups and regulators to develop the best options to take when risks begin to cross the predefined threshold amounts. It is for this reason that U.S. state regulators refer to the calculation derived from the ORSA as a group capital assessment. It will result in a continual assessment by both the group and the regulator as to the appropriate amount of capital for the group to operate its current business plan and what actions, if any, are appropriate to better align the risks to the amount of available capital.

In reviewing Section III of the ORSA Summary Report, the analyst should recognize that perhaps more than Sections I or II, this section is generally presented in a summarized form. Although this section requires disclosure of aggregate available capital compared against the various risks that may adversely affect the enterprise, the report generally will not provide sufficient detail to fully evaluate the group capital position. More specifically, the report may provide information on the amount of capital needed for each of the major risks identified in Section II. It typically will be difficult for an analyst to analyze the appropriateness of such amounts. This is because most companies will only summarize how the insurer combines the qualitative elements of its risk management policy with the quantitative measures of risk exposure in determining the level of capital needed. This may particularly be the case for those insurers that use internal capital models to develop their internal capital requirement because the details associated with such model would simply be too voluminous to be summarized into the ORSA Summary Report.

Section III, unlike Section I, where the analyst’s assessment is generally not a time sensitive assessment (unless it suggests material weaknesses in risk management) will be directly used as part of the Holding Company Analysis evaluation of group capital. For this reason, the analyst must come to some preliminary assessment, but such assessment will be limited to those things that can be concluded with some assistance from the group, and a final assessment is dependent upon an on-site examination where the models and other supporting documentation can be further evaluated. In situations where the next full-scope examination is not scheduled to occur for some time, the analyst may recommend conducting a limited-scope examination to provide sufficient evidence to reach a final assessment. To the extent either a full scope or limited-scope examination has been performed in the past for certain models or certain areas, the analyst should use judgment in determining if additional or updated work is needed depending upon micro and macroeconomic changes since that work was done, as well as the relative materiality of such risk for the insurer. Because capital is a time sensitive figure, and because many groups choose to update their various internal capital targets on a periodic basis (e.g. quarterly), it may be appropriate to request the most recent quarter’s calculated amounts (required capital and available capital) in assessing the group capital, but only if the insurer actually performs these quarterly calculations. Even if such amounts were
not available at the time of the finalization of the report, it would be reasonable to obtain these amounts verbally from the group if they are available.

In making an evaluation of capital, the analyst may want to consider the source for the group’s internal capital assessment. As previously mentioned, some insurers will develop a group capital assessment based upon an internal model. In most cases, the insurer will actually use a series of models designed to quantify the necessary capital for different risks using different broad assumptions with respect to that specific risk. The most common methods attempts to develop an estimated amount of economic capital needed to satisfy policyholder claims and other group obligations at a particular confidence level (e.g. 99.5% probability the insurer will be able to meet its obligations over the next 12 months).

Economic capital is often a comparison of the required capital per the calculation of various types of material risks to the amount of capital available to pay claims. The calculations for available capital are generally based upon a market consistent (fair value) balance sheet, wherein GAAP equity may be used as a starting point with modifications for market consistent data (to mark the entire balance sheet to market), but with further subtractions for accounting assets that have no economic value (e.g. goodwill, intangible assets, deferred tax assets). Most economic capital models also consider the likely, or unlikely, possibility that all of the modeled events will happen at the same time. This factor is referred to as correlation, or diversification, since it refers to the belief insurers can diversify their risks in a way that serve as a natural hedge against such risks happening simultaneously. The concept of correlation is generally not disputed and, in fact, it’s used within the NAIC’s risk-based capital formula. From this standpoint, it’s recognized that diversification of risk should theoretically reduce the amount of capital an entity may need to hold at one time. However, what can be disputed is the extent such diversification will bear out in reality, especially given the recent financial crisis, and especially considering the extent to which these diversification benefits can reduce the otherwise extremely high capital requirements. In many cases, the diversification benefit can range from 40%-60% of the 99.5% probability. When this is combined with the inherent risks that exists with any model (e.g. inaccurate data inputs, risk factors, incorrect model specification), it is difficult for an analyst to place too much reliance on an economic capital figure, even though it can be extremely informative.

Most insurers that utilize economic capital models may also use them as much for day to day decisions as they do for group capital management. This includes day to day decisions related to pricing of products, catastrophe risk management, investment portfolio management, liquidity management, etc. From this standpoint, the use of economic capital models can be extremely beneficial in terms of their impact on managing risk and allocation of resources to specific products. In addition, because economic capital models are the basis for which such groups manage their capital levels to the action or inaction by companies in response to material changes or immaterial changes can be revealing with respect to how such models are informative to manage in their day to day decisions. With some testing during an on-site inspection of the reasonableness of the assumptions, and how well the models have performed in the past and are, in turn, back tested by the company for further refinement, the use of economic models can be seen as a strength in demonstrating a robust enterprise risk management system.

Most state regulators believe it is appropriate for examiners to test some inputs/aspects of some models, but that its more appropriate to review the workpapers for backtesting of the models, either completed by internal audit, a third party consultant, or some other party. What is most important is whether the group has a mechanism for gaining the necessary assurance, since it is making business decisions on such facts. Also it’s widely considered a fact that the output of every model is inaccurate, and it’s much more
important to consider the reasonableness of the inputs and outputs and the processes used by the group. The analyst should be aware many international regulators expect the group wide supervisor to perform a fair amount of testing on such models so they can be relied upon. Many of these other countries with this view actually require a specified group capital calculation for insurance groups based in their countries, where specified assumptions are required to be used. It may be important for the U.S. regulator to discuss these facts with the group and determine if other involved supervisors (countries) of this internationally active US based insurer have such expectations in planning the examination of the group. Expectations may warrant the Lead State conducting a limited-scope exam or expanding exam procedures in Section III of a full scope exam to test or validate the internal models used in group capital calculations.

Similarly, if the group is an internationally active insurer where the group-wide supervisor is not U.S. based, and the ORSA submitted to the U.S. regulator is for U.S. business only, it’s important to recognize the U.S. ORSA requires the group to submit a group capital calculation of the entire insurance group. Therefore, to the extent the ORSA submitted in the U.S. does not contain the group capital of the entire insurance group (e.g. only represents the U.S. operations); the U.S. regulator has the authority to require the entire group ORSA eventhough it’s in a different form. This authority exists to avoid any unnecessary duplication assuming the group ORSA meets the basic parameters of the IAIS core principle dealing with ORSA (currently ICP 16).

For purposes of evaluating capital, the more appropriate capital measure considered by the analyst may be the rating agency capital. Rating agencies measure capital in ways similar to economic capital, in that it attempts to develop a higher level of required capital than what may be required under regulatory capital models (e.g. RBC). Typically deterministic assumptions or factor based approaches are used, which may not be as accurate in capturing particular specifics of each insurers business mix. Although these models also typically include a diversification benefit, the models are applied universally to all companies, and therefore provide a benchmark for relative comparisons. It must be understood such models are generally just one input in determining an insurer’s financial strength rating, and other items are considered (e.g. market position, financial flexibility, debt ratios). More importantly, virtually all insurers are rated by such agencies, and the ratings can have a material impact on the perception of the insurer and the ability of the insurer to write business. Most notably, many commercial property/casualty products and many traditional life and annuity products require a fairly high rating (e.g. A or A-), and the loss of such rating can actually cause the specific insurer’s business model and related plans to completely fall apart. For this reason, even insurers that use internal capital models will usually track their perceived capital requirements from such models and will include them in the ORSA Summary Report.

Some insurers will also perform similar tracking of RBC, as well as other consolidated figures regarding regulatory capital. This type of analysis can also be helpful, and is extremely beneficial since it provides a hard line consolidated capital that must be maintained. This may be more valuable for some insurers than others (e.g. insurers that are less highly capitalized and do not sell rating sensitive business), however for most insurers, this cannot replace similar disclosure of rating agency capital since it is usually set at a higher level since an inability to retain a particular rating may create an inability to carry out the current business model. Regardless of whether economic, rating agency or regulatory capital is used individually, or collectively, what is most important is how the insurers use this information to make decisions. Some insurers will rely exclusively on one or more of these measures for making various types of decisions. Other insurers will utilize other important metrics and tools for making decisions. The analyst’s assessment of group capital should document these qualitative items that are important in understanding why the group has chosen the method it is using.
In addition to disclosure of economic capital and/or rating agency capital and/or consolidated regulatory capital, insurers are required to disclose within Section III, its capital levels after considering the impact of stresses. Most commonly, and for the reasons described above, such stresses are usually considered in the context of rating agency capital. This is because the insurer has a much better sense of the type of events they could withstand before potentially losing its very important rating. As previously stated, in Section I, the analyst should consider all three sections of the insurer’s ORSA when assessing the robustness of the insurer’s risk management function as presented in the ORSA. There are a number of ways this can be demonstrated including the rigor the insurer applies to its stress scenarios. In general, the more holistic view the insurer can capture and present under various stress scenarios, the more favorable view the analyst should give to such work when evaluating the entirety of the insurer’s risk management. The same can be said with respect to the overall evaluation of the adequacy of group capital, as required below. This is not to suggest that the use of economic capital models calibrated to a certain level do not provide adequate cushion. After all, such models consider numerous probability weighted thresholds in coming to such conclusions. However, in most cases such facts are not transparent to the regulator, and due to the previously identified concerns with diversification benefits, it may be more valuable to consider individual stresses at lower confidence levels (e.g. 75th or 90th percentiles) and combining several plausible stresses together to give a more realistic view of the magnitude or events the insurer may be able to withstand. The analyst shouldn’t feel compelled to understand technical statistical measures such as confidence level in detail but rather understand the approach the company uses to try and capture extreme risks that the business model is subject to. This should be considered in the context in particular in terms of the specific methods the insurer uses to capture such risks. These can include things such as confidence levels required by TVar (tail value at risk) or CTE (conditional tail expectation), which consider the average of all of the tail (extreme) events, for certain types of risks (e.g. multiple lower severity hurricanes or lower severity hailstorms). These are items the analyst may consider when they are evaluating the overall strength of the insurer’s enterprise risk management function. Either approach can demonstrate a rigor that supports the findings and transparency. Various scenarios can further demonstrate the type of stress the insurer can withstand and continue to run its current business model without material strategic changes.

**Required Documentation for Section III**

1. **Summarize the overall assessment of capital by completing the following table.**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Economic group capital required after diversification</td>
</tr>
<tr>
<td>2</td>
<td>Available group consolidated capital</td>
</tr>
<tr>
<td>3</td>
<td>Rating agency capital required (identify agency &amp; present multiple, if multiple are tracked and reported)</td>
</tr>
<tr>
<td>4</td>
<td>Available group consolidated capital used by agency</td>
</tr>
<tr>
<td>5</td>
<td>Consolidated group regulatory capital (all countries)</td>
</tr>
<tr>
<td>6</td>
<td>Available group consolidated capital (ignoring different accounting basis)</td>
</tr>
<tr>
<td>#</td>
<td>If not applicable, mark as such</td>
</tr>
</tbody>
</table>

Answer the following:
Because the risk profile of each insurer is unique, U.S. insurance regulators do not believe there is a standard set of stress conditions that each insurer should run, however, the Lead State regulator may have input regarding the level of stress that the insurer should consider for each risk category. The ORSA Summary Report should demonstrate the insurer’s process for model validation, including factors considered and model calibration. Unless a particular assumption is stochastically modeled, the group’s management will be setting their assumptions regarding the expected values based on their current anticipated experience studies and what they expect to unfold over the next year. The Lead State regulator may provide input to an insurer’s management on a stress factor that should be applied for a particular assumption that is not stochastically modeled. For assumptions that are stochastically modeled, the Lead State regulator may provide input on the level of the measurement metric to use in the stressed condition or may specify particular parameters under in the economic scenario generator. The aforementioned input provided by Lead State regulators will likely occur during either the financial analysis process and/or the financial examination process.

Support the above by developing a narrative that addresses the following:

**Actual Capital Amount**
Discuss the extent to which the actual group capital amount exceeds the relative available group capital amount per the ORSA Summary Report. In the rare situation where the calculation revealed group capital was not sufficient compared to internal/rating agency/regulatory capital, immediately contact the group to determine what steps it’s taking to address the issue. Consider in that discussion, the below section that requires the analyst to consider the controls the group has in place relative to this issue. Consider a similar discussion for any other group where there is reason to suggest there could be issues in the future based upon recent trends. For all other groups, when considering if group capital is either well in excess of internal/rating capital or currently sufficient, consider all of the follow considerations, but paying particular attention to the cushion based upon the use of economic capital scenarios and/or stress testing.

**Cushion Based Upon Use of Economic Capital Scenarios and/or Stress Testing**
Perhaps the most subjective determination when considering group capital is determining the sufficiency of such amount above a predefined minimum. That minimum, be it regulatory, rating agency, or economic, uses certain assumptions, including assumptions that already provide a cushion. In determining adequate additional cushions, one approach would suggest a cushion that is either unlikely to be necessary, or is developed in a manner that attempts to capture some precision in that cushion that may be deemed most desirable by the company. The above discusses the use of economic capital and how such approach captures an estimate of capital for a given security standard; for example, a 1 in 100 year event some level of precision since it sets aside capital for numerous scenarios unlikely to commonly occur. The above also discusses the value of stress testing for providing similar value and more easily transparent scenarios. It’s difficult to suggest one method and approach is better than another, just as it’s difficult to suggest certain stresses are more important and relevant than others. The Lead State analyst shall bear in mind the “Own” in ORSA, noting that each insurer’s methodology and stress testing will vary. However, the Lead State analyst should be able to develop and document the general methodology applied and how outputs from the prospective solvency calculations level of precision that can be obtained, how that compares with recent trends for the group, and in general, be able to determine if the cushion is either sufficient, or well in excess of internal or rating agency capital.
Method of Capital Measurement
Discuss the method used (e.g., internal, rating agency) by the insurer in assessing group capital and their basis for such decision. If no information on this issue exists within the ORSA Summary Report, consider asking the insurer the question for documenting into the file. Document the extent to which the analyst believes the approach used by the insurer is appropriate for the nature, scale and complexity of the group and if this has any impact on the analyst’s assessment of the insurer’s overall risk management.

Quality of Capital
If the company uses an internal capital model, evaluate the quality of available capital included in the report from the standpoint of whether that capital is freely available to absorb losses and is permanent in form. This would typically exclude things such as goodwill, intangible assets, deferred tax assets, etc. In addition, determine if there is any double counting of capital through the stacking of legal entities. If the insurer used rating agency capital, verify capital used internally in the ORSA Summary Report meets such firm’s requirements. If no information on this issue exists within the ORSA Summary Report, consider asking the insurer the question for documenting into the file.

Prior Year Considerations
Some insurers will provide qualitative information in the ORSA Summary Report that describes their movement of required capital from one period to the next, the drivers of such change, and any decisions made as a result of such movement. If no information on this issue exists within the ORSA Summary Report, consider asking the insurer questions for purposes of documenting into the file. This information, as well as the analyst’s existing knowledge of the group, and its financial results, should be used to determine the overall reasonableness of the change in group capital, the overall general accuracy of prior year figures, and should be an input into evaluating the group capital calculation.

Quantification of Material Risks
Discuss and document if the group capital fails to recognize any reasonably foreseeable and relevant material risks the analyst is aware of. Making this determination may be unnecessary for rating agency capital or if the insurer considers both economic capital and rating agency capital in assessing its capital needs since rating agency models are universally applied to all companies. The analyst is not expected to know the details of the rating agency models to know if certain risks are not captured in such models.

Controls over capital
Discuss the extent to which the ORSA Summary Report demonstrates the group has a strategy, including board oversight, for ensuring adequate group capital is maintained over time and individual insurers are either well above regulatory requirements or have processes in place designed to alert the group if such amounts are only marginally above such requirements. In the case of the latter, this includes plans for obtaining additional capital or for reducing risk where required. If no information on this issue exists within the ORSA Summary Report, consider asking the insurer the question for documenting into the file.

Controls over Model Validation and or Independent Reviews
If the company uses an internal capital model, discuss the extent to which the group uses model validation and independent review to provide additional controls over group capital. If no information on this issue exists within the ORSA Summary Report, consider asking the insurer the question for documenting into the file.
More Specific Considerations for Reviewing Section III-Group Capital

The following represents additional questions the analyst may want to consider either in their review of the ORSA Summary Report, or more likely, its discussion with the insurer. Similar to Section I, the purpose of these questions is not simply to obtain a specific response, but rather to engage in a conversation designed to allow the analyst to understand the insurer’s capital management techniques, either those specifically identified in the questions, or those utilized by the insurer to help the overall strength of the program. Many of these questions may be inapplicable for many insurers since these are predominately related to the use of internal models.

- Describe your view on the common belief that models are only an approximation of what could occur based upon numerous assumptions, regardless of the perceived precision some suggest it may have.
- Describe the models used to assess capital adequacy and do those models accurately reflect the possible outcomes of a given risk? This could include deterministic models and/or stochastic models. Such models may use simple, historical assumptions with the same frequency and severity as past events but may be susceptible to errors caused by changing trends. Alternatively, complex theoretical models may be used to calculate risk, in which case there may be well documented algorithms, data sources, and testing. Finally, modules may pass a use test where output is actively reviewed and used to manage the business, and models are supplemented by stress tests and robust management dialogue.
- With respect to models, do the data series or model inputs look back far enough to cover all possible events or if the output is extrapolated beyond the time period originally intended for the model? Or does the data go back less than 5 years?
- Describe the use of aggregation and correlation. Are the correlations between modeled risks fixed, or do correlations between modeled risks change with the severity of individual outcomes? Are correlation assumptions and risk of those assumptions failing explicitly explored?
- How often do you stress your risk diversification/correlation patterns and do you have any recent back testing available for review or any that may have been conducted in the past (e.g. after the financial crisis, after the U.S. Treasury almost defaulted)?
- Describe your risk aggregation tool used to accumulate data from various types of different models and how to synch them up in a consistent manner.
- Describe how models are maintained. Are models owned by 1 or 2 subject matter experts with no documentation for model algorithms, assumptions, data sources or operations? Or is written documentation regularly updated for changes to the models, data sources or operations and cross training been conducted to ensure accurate ongoing maintenance and updating? Further, is there a formal testing plan for any changes to the models, data sources or operations? Model construction, updates and standards are well established and broadly understood. Finally, is there strict version control, code checkout procedures and validation overseen by separate administration?
- Describe any back testing done after recent events (e.g. Superstorm Sandy, the financial crisis).
- Describe the limitations of using an internal capital model to measure risks associated with inflation, where the model may be calibrated to a short-time period (e.g. 1 year). How does the insurer address this risk in other ways in their management of capital?
Review of Section III – Prospective Solvency Assessment
The ORSA Guidance Manual requires the insurer to consider the prospective solvency. Many insurers will include in the ORSA Summary Report, information developed as part of their strategic planning and will typically include proforma financial information that displays possible expected results as well as projected capital adequacy in those future periods. However, the analyst should understand the impact such an exercise has on the ongoing business plans of the insurer. For example, to the extent such an exercise suggests that under expected outcomes, the group capital position will weaken, or recent trends may result in certain internal limits being breached, the analyst should understand what actions the insurer expects to take as a result of such an assessment (e.g. reduce certain risk exposure, raise additional capital, etc.). The analyst should document its findings/review of this section.

Other Required Documentation – Suggested Follow up by the Examination Team
During each full-scope financial condition examination, the exam team will be expected to review and assess the insurer’s risk management function through utilization of the most current ORSA Summary Report received from the insurer. The examination team will take steps to verify information included in the report and test the operating effectiveness of various risk management processes on a sample basis (e.g. reviewing certain supporting documentation from Section I, testing the reasonableness of certain inputs into stress testing from Section II, and reviewing certain inputs, assumptions and outputs from internal models). See the ORSA section of the Financial Condition Examiners Handbook for more information on exam procedures expected to be performed in this area.

However, if there are specific reports, information and/or control processes addressed in the ORSA Summary Report that the analyst feels should be subject to additional review and verification by the examination team, the analyst is expected to provide direction as to its findings of specific items and/or recommended testing. The initial review and walkthrough of the ORSA Summary Report should involve a multi-functional team of department staff (e.g. analyst, examiner, actuary) and as such, the findings/suggestions may be discussed by the multi-functional team before its documented and referred to the financial examination staff. Please include a list of suggested verification/areas of focus for the financial examination as well as the purpose of such suggestions at the end of this summary (such as the following-example only):

<table>
<thead>
<tr>
<th>#</th>
<th>Description</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Walkthrough of risk tracking process and documentation in use</td>
<td>Verification</td>
</tr>
<tr>
<td>2</td>
<td>Interview select board member(s) for corroboration on risk committee responsibilities</td>
<td>Verification</td>
</tr>
<tr>
<td>3</td>
<td>Discuss assumptions, inputs, outputs of internal capital model as well as use and walkthrough change in any of the above</td>
<td>Understanding and documentation</td>
</tr>
</tbody>
</table>