IX. REVIEWING AND UTILIZING THE RESULTS OF AN OWN RISK AND SOLVENCY ASSESSMENT

This section of 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 Lead State examiners in reviewing, assessing and utilizing the results of Enterprise Risk Management (ERM) activities performed by all insurers that are required to file an ORSA Summary Report. 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. Background Information

The NAIC’s Risk Management and Own Risk and Solvency Assessment Model Act (#505), requires insurers above a specified premium threshold, and subject to further discretion, to submit an 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).

The initial review of information provided in an ORSA Summary Report should be led by the assigned Lead State financial analyst, with additional support provided by Lead State financial examiners and actuaries as deemed appropriate. As each ORSA is expected to result in a unique ongoing dialogue between the insurer and the Lead State regulator, coordination between the Lead State analyst, Lead State examiner and Lead State actuary in the initial review and ongoing dialogue with the insurer is expected to be beneficial. This is due to the fact that this same team will be part of the ongoing monitoring of the insurer and an ORSA Summary Report is expected to be at the center of an additional data element that will be considered as part of solvency monitoring processes.

After participating in the initial review of information provided in the ORSA Summary Report, the Lead State examiner is expected to incorporate a review of ORSA information into ongoing onsite examination activities. Examiners are reminded that ORSA information is highly sensitive, proprietary and confidential, and examiners should exercise caution to ensure that no ORSA or ORSA-related materials is inadvertently made public in any way, including in any Exam Report. Depending upon the full-scope examination schedule, the Lead State examiner may consider performing a limited-scope exam to conduct onsite examination activities related to ORSA information on a timely basis. In incorporating a review of ERM/ORSA information into financial exam activities, the Lead State examiner should seek to utilize existing resources (CPA workpapers, internal audit workpapers, third-party assessments, etc.) to avoid duplication of efforts and provide exam efficiencies. In addition, although the use of an actuary is strongly recommended in specific areas of the ERM/ORSA assessment guidance (i.e. internal model validation), the use of actuaries throughout the overall ERM/ORSA assessment process may significantly improve examination efforts in this area.

In cases where one insurer provides an ORSA Summary Report, the domestic state Lead State is responsible for verifying, assessing and utilizing the information received to facilitate and gain efficiencies in conducting onsite examinations. In cases where a group of insurers provides an ORSA Summary Report (or multiple legal entities within an insurance group provide separate ORSA Summary Reports), the Lead State is expected to coordinate the review, assessment and utilization of the information received to facilitate and gain efficiencies in conducting coordinated examinations in accordance with Section 1, Part I of the Handbook. To the extent that an insurance group is organized into subgroups for examination purposes, the review, assessment and utilization of various aspects of the
insurance group’s ORSA Summary Report may require delegation of responsibilities to an Exam Facilitator. However, in all cases, examination teams should seek to avoid duplication and utilize existing work in reviewing, assessing and utilizing the ORSA Summary Report to conduct examinations of entities that are part of an insurance group. Throughout the remainder of this document, the term Lead State is used before the term examiner or regulator with the understanding that in most situations, the ORSA Summary Report will be prepared on a group basis, and therefore primarily reviewed by the Lead State. However, this does not remove the requirement for the domestic state to perform these responsibilities in the event of a single-entity ORSA Summary Report.

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 framework, and discusses how the ORSA Summary Report may assist in determining the scope, depth and minimum timing of risk-focused analysis and examination procedures. Therefore, it may be necessary to adjust the extent of regulatory review procedures up or down in various areas depending upon regulators’ assessment of how well the insurer identifies, measures and manages its risk exposures.

These determinations can be documented as part of each insurer’s ongoing supervisory plan. However, the Guidance Manual also states that each insurer’s ORSA will be unique, reflecting the insurer’s business model, strategic planning and overall approach to ERM. As regulators review ORSA Summary Reports, they should understand that the level of sophistication for each group’s ERM program will vary depending upon size, scope and nature of business operations. Understandably, less complex organizations may not require intricate processes to possess a sound ERM program. 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. However, the ORSA Summary Report will not serve this function or have this direct impact until the Lead State becomes fairly familiar with and comfortable with each insurer’s report and 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 to fully understand certain aspects of the processes used to develop the report.

B. General Summary of Guidance for Each Section

This section provides general guidance regarding how each section of the ORSA Summary Report is expected to be reviewed and assessed during a financial examination. This guidance is expected to evolve over the years, with the first couple of years focused on developing a general understanding of ORSA and ERM. 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 Lead State 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 Lead State 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 so doing, 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 may be assessed in a number of ways, one of which is through the incorporation of concepts developed within Risk and Insurance Management Society’s (RIMS) Risk Maturity Model (RMM). While insurers or insurance groups may utilize various frameworks in developing, implementing and reporting on their ORSA processes (e.g. COSO Integrated Framework, ISO 31000, IAIS ICP 16, other regulatory frameworks, etc.), elements of the RMM have been incorporated into this guidance to provide a consistent methodology for use in reviewing and assessing ERM/ORSA practices. However, as various frameworks may be utilized to support effective ERM/ORSA practices, Lead State regulators should be mindful of differences in frameworks and allow flexibility in assessing maturity levels. The RMM, which is only one of a number of processes which may be used to determine maturity levels, 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.
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- 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 design of ERM/ORSA practices should appropriately reflect the maturity level, nature, scale and complexity of the RMM with the general principles and elements outlined in Section I of the Guidance Manual to assist company. Lead State regulators in reaching an overall assessment of the should understand the level of maturity that is appropriate for the company based on its unique characteristics. Attainment of “Leadership” level maturity of an insurer’s risk management for ERM/ORSA practices is not appropriate, nor should be expected, for all companies or for all components of the framework.

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 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. Much of the Section II guidance has been developed around the nine branded risk classifications outlined in Exhibit L of this handbook, which are used as a common language in the risk-focused surveillance process. The primary reason for this approach is that insurers typically may utilize similar risk classifications in their ORSA Summary Reports. However, Lead State regulators should not restrict their focus to only the nine branded risk classifications; as such, an approach may not encourage judgement in understanding the risk profile of the insurer. Therefore, the use of the nine branded risk classifications provides a methodology to organize the Lead State’s summary, but should not discourage regulators from documenting other risks or excluding branded risk categories that aren’t relevant. From this standpoint, Section II will also provide regulators with information to better understand current insurance market risks, changes in those risks as well as macroeconomic changes and the impact they have on insurers risk identification and risk management processes. Under no circumstances, should the Lead State examiner view the nine branded risk classifications as a guide to any individual insurer’s, or insurance group’s risks as identified by the ORSA Summary Report.

As part of evaluating the information presented on reasonably foreseeable and relevant material risks, the Lead State examiner may be required to consider the appropriateness of the stress scenarios identified and stress testing performed by the insurer. However, regulators do not believe there is a standard set of stress conditions each insurer should test. Therefore, guidance consistent with the language on page 7 of the 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. 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 and to facilitate discussion with the insurer. 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 nor 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 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 insurer’s risk management framework by considering and evaluating each of the key principles. An initial, high-level assessment 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 the 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
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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 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/trait 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. 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 to have a structure in place that encourages 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](#) is responsible for and oversees Management establishes the framework and the risk culture established by senior management and approved by the Board of Directors reviews 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. Material business functions use risk-based best practices. The risk management lifecycle for business process areas are routinely evaluated and improved (when necessary).

   **Managed Practices**
   Adherence to risk culture is associated with career development. The company’s ERM function 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 material business process areas. The Board of Directors, CEO, Chief Risk Officer (if applicable) and CFO expect a risk management plan to include a qualitative risk assessment for reasonably foreseeable and relevant material risks with reporting to management and the Board on priorities, as appropriate. All relevant areas use the ERM framework to enhance their functions, with frequent and effective communication on risk issues as appropriate. Process owners incorporate managing their risks and opportunities within regular planning cycles. The company creates and evaluates scenarios consistent with its planning horizon and product timelines, and follow-up activities occur accordingly.

   **Repeatable Practices**
   ERM risk plans are understood by management and other relevant members of the organization. Senior management expects that a risk management plan captures reasonably foreseeable and relevant material risks in a qualitative manner. Most areas use the ERM framework and report on risk issues. Process owners take responsibility for managing their risks and opportunities. Risk management creates and evaluates 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 framework. One area has used the ERM 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.

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 relevant organizational levels. Therefore, the objective an approach for risk identification and prioritization may be 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
Information from internal and external sources on reasonably foreseeable and relevant material risks, including all relevant business units and functions is systematically gathered and maintained. A routine, timely reporting structure directs risks and opportunities to senior management. The ERM 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 manage an evolving list of reasonably foreseeable and relevant material risks locally to create context for risk assessment activities as a foundation of the ERM 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 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 an evolving list of reasonably foreseeable and relevant material risks, creating context for risk assessment as a foundation of the ERM 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 relevant business unit or function are kept and discussions of risk are part of the ERM Process. Corporate risk indicators are collected centrally, based on past events. Relevant business units or functions might maintain their own informal risk checklists that affect their areas, leading to potential inconsistency, inapplicability, and lack of sharing or under-reporting.

Ad Hoc Practices
Risk is owned by specialists, centrally or within a 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 reasonably foreseeable and relevant material 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; understanding of the risk appetite statement ensures alignment with the risk strategy set by senior management and/or the board of directors. Not included in the manual, but widely considered, is that risk appetite statements should be easy to communicate, should be understood, and should be closely tied to the organization’s strategy in addressing its reasonably foreseeable and relevant 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 to put mechanisms in place to measure the risk the organization is willing to accept.

After the overall risk appetite for the organization is set, the underlying risk tolerances and limits can be selected and applied to business units and risk areas as deemed appropriate by the company. The company may apply appropriate quantitative limits and qualitative statements to help set boundaries and expectations for risks that are hard to measure. These boundaries may be expressed in terms of earnings, capital, or other metrics (growth, volatility) individual business units and risk areas. The risk tolerances/limits provide direction outlining the Company’s tolerance for taking on certain risks, which sometimes cannot be established and communicated in the form of the maximum amount of such risk the entity is willing to take. However, in many cases these will be coupled with more specific and detailed limits or guidelines the company uses. Due to the varying level of detail and specificity different organizations incorporate into their risk appetites, tolerances and limits, Lead State 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. The management team and risk
management committee, if applicable, **may** define tolerance levels and limits for all on a quantitative and/or qualitative basis for relevant business units and functions in accordance with the defined risk appetite and reasonably foreseeable. As part of its risk management framework, the company may compare and relevant material risks identified. A mechanism compares and report actual assessed risk versus risk tolerance. The organization seeks to balance risk positions across business units and functions/limits. Management prioritizes resource allocation based on the gap between risk appetite and assessed risk and opportunity. The established risk appetite is examined periodically.

**Managed Practices**

Risk appetite is considered throughout the ERM framework. 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 framework. The company’s risk appetite is frequently reviewed and updated as appropriate and risk tolerances are evaluated from various perspectives, as appropriate. 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. The company’s risk appetite is regularly reviewed and updated as deemed appropriate by the company and risk tolerances are evaluated from various perspectives as appropriate.

**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 relevant business units, 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 tool, 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. 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 material 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 may 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 relevant level. A risk management framework articulates management’s responsibility for risk management, according to established risk management processes. Management develops and reviews risk plans through involvement of relevant stakeholders. The ERM framework is coordinated with managers’ active participation. Opportunities associated with reasonably foreseeable and relevant material risks are part of the 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 senior management over the 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 framework supports all-relevant business units’ and functions’ needs. ERM is a process of steps to identify, assess, evaluate, mitigate and monitor all reasonably foreseeable and relevant material risks. ERM frameworks include the management of opportunities. 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 an effective level.

Initial Practices
Management recognizes a need for an Enterprise Risk Management 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 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 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, as appropriate. However, most important is how the reports are being utilized to identify and manage reasonably foreseeable and relevant material risks at either the group, business unit or other level within the organization where decisions are made.

Leadership Practices
The ERM 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 relevant 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/or 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 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 relevant levels use a risk-based approach to achieve strategic goals. The results of key measurements and indicators are shared with senior management and/or board (or committee) members, as appropriate, on a regular basis.

Repeatable Practices
The ERM framework contributes to strategy and planning. All strategic goals have performance measures. 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\textsuperscript{under} board (or committee) members, as appropriate.

Initial Practices
The ERM 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 to adopt a risk-based approach is lacking.

Ad Hoc Practices
Not all strategic goals have measures. 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 exists.

Examination Procedures for Section I
The following table provides example test procedures that could\textsuperscript{may} be performed by the Lead State examiner to verify 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.

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<thead>
<tr>
<th>Principle</th>
<th>Possible Test Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Culture and Governance</td>
<td>• Obtain and review management, board or committee minutes/packets for the director group responsible for ERM oversight and evaluate the level of oversight provided</td>
</tr>
<tr>
<td></td>
<td>• Obtain and review formal ERM training materials provided by the company to relevant employees and directors</td>
</tr>
<tr>
<td></td>
<td>• Interview 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</td>
</tr>
<tr>
<td></td>
<td>• 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</td>
</tr>
<tr>
<td></td>
<td>• Obtain and review information on the company’s compensation plans to determine that risk management decision making isn’t undermined by compensation structure</td>
</tr>
<tr>
<td></td>
<td>• Obtain and review job descriptions or performance review criteria for select management positions to determine whether risk management elements are incorporated</td>
</tr>
<tr>
<td>Principle and Prioritization</td>
<td>Possible Test Procedures</td>
</tr>
<tr>
<td>-----------------------------</td>
<td>--------------------------</td>
</tr>
</tbody>
</table>
| Risk Identification and Prioritization | - Obtain a current copy of the organization’s risk listing/universe and review for adequacy/appropriateness.  
- Determine whether appropriate external sources have been used to assist in risk identification (e.g. rating agency information, competitor 10K filings, etc.) *(where applicable as determined by the group)*.  
- Verify that the organization’s risk listing/universe is updated/reviewed on a regular basis by requesting copies at various dates.  
- Assess the company’s process and scale by which it prioritizes the key risks identified.  
- Review the approach for and results of the company’s likelihood, severity and speed of onset risk assessments.  
- 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. |

<table>
<thead>
<tr>
<th>Risk Appetite, Tolerances and Limits</th>
<th>Possible Test Procedures</th>
</tr>
</thead>
</table>
| Risk Appetite, Tolerances and Limits | - Review management committee and/or board minutes and supporting materials to verify that the organization’s risk appetite is reviewed and approved on a regular basis as appropriate.  
- Review and evaluate how risk appetite, tolerances and limits are set for both the group and legal entity levels *(where applicable as determined by the group)*.  
- Determine whether the company considers legal entity regulations and capital requirements in setting its overall risk appetite *(where applicable, as determined by the group)*.  
- Review and evaluate steps taken to address breaches in risk limits on a sample basis (if applicable).  
- Verify that, as applicable, as determined by the group, whether top risks are assigned risk owners to monitor risks and oversee mitigation plans.  
- 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. |

<table>
<thead>
<tr>
<th>Risk Management and Controls</th>
<th>Possible Test Procedures</th>
</tr>
</thead>
</table>
| 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.  
- Review and evaluate how specific controls are mapped to legal entities (where appropriate) as determined by the group. |
### Principle

<table>
<thead>
<tr>
<th>Possible Test Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>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 risk areas</td>
</tr>
<tr>
<td>Verify the frequency with which risk information is accumulated and reported by selecting a sample of historical risk dashboards (or equivalent reports) to review</td>
</tr>
<tr>
<td>Test the accuracy and reasonableness of information included on the risk dashboard (or equivalent report) on a sample basis</td>
</tr>
<tr>
<td>Determine whether risk reporting information is used by directors and senior management for strategy and planning purposes</td>
</tr>
<tr>
<td>Review and evaluate the timeliness with which breaches in risk limits are reported and communicated to the appropriate authority</td>
</tr>
</tbody>
</table>

**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 using the template at the end of this section. 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.

After considering the assessment of each of the five previously identified principles and taking into account any additional factors identified by the examiner during the review of ERM framework, the Lead State examiner should 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, should assist the 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 exposure to reasonably foreseeable and relevant material risks. 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 reasonably foreseeable and relevant material risks of the insurer. The Guidance Manual does give possible examples of relevant material risk categories (credit, market, liquidity, underwriting, and operational risks). In reviewing the information provided in this section of the ORSA, Lead State regulators may need to pay particular attention to risks and exposures that may be emerging or significantly increasing over time.

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 Lead State examiners and...
companies alike, these categories will provide the format for the Lead State examiner’s review and assessment of the information provided by the company in Section II.

**Stress Testing**

In addition to providing background information on each reasonably foreseeable and relevant material risks the insurance company is facing, Section II also requires that the risk exposures be analyzed under both normal and stressed environments. Therefore, as part of evaluating the information presented, the Lead State examiner is expected to consider the appropriateness of the stress scenarios identified and stress testing assessment techniques performed by the company. In so doing, the Lead State examiner should evaluate the reasonableness of the assumptions and methodologies used by the company in conducting stress scenarios/testing. Before such an evaluation is designed, the Lead State examiner should obtain information from the Lead State analyst to determine the extent to which the 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 company to develop assumptions and methodologies.

The Lead State examiner should consider whether stress testing the assessment techniques the company has been performed utilized to evaluate the impact that all reasonably foreseeable and relevant material risks facing the company could have on its ongoing operations, compared to the company’s specified solvency standard. In reviewing the company’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 reviewing the insurer’s stress testing assessment techniques for each of the nine branded risk classifications (if applicable) and other relevant risks, 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 stress testing assessment techniques?
- Were all scenarios utilized to evaluate/stress the impact of such risks, were they appropriately described and justified?
- Were techniques utilized to perform stress testing assessment techniques in accordance with company standards and industry best practices?
  - Did the time horizon or duration of the risks identified have an impact on the nature and extent of the stress testing assessment techniques selected?
- Did the results of the stress testing assessment techniques used indicate that the insurer had appropriately mitigated the impact that the risk might have on the insurer?
- Do the stress testing assessment techniques utilized address holding company and legal entity issues from both a capital and liquidity perspective?

**Required Examples of Supporting 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, documentation should be provided by the Lead State examiner to discuss whether the insurer included an appropriate discussion of reasonably foreseeable and relevant material risks. The nine branded risk classifications should be discussed within this summary, as well as any additional risk categories deemed relevant by the Lead State examiner. In addition, the Lead State examiner should provide an assessment of the corresponding stress assumptions and test results presented for each of the risk categories discussed, keeping in mind that a company is not required to solely focus on the nine branded risk classifications.

**E. Review of Section III - Group Assessment of Risk Capital**

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Comment [AEK5]: Edits are necessary to ensure consistency with the Manual and the concept of “Own” in ORSA.

Comment [AEK6]: This concept is more in keeping with Section III (not II) of the Manual.
5/30/14 DRAFT – Financial Condition Examiners Handbook

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 Lead State insurance regulators to assess the reasonableness 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 reasonableness of capital held at the entire 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 company 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 company.

Insurance Groups will use different means to measure risk (required) capital and they will use different accounting and valuation frameworks. The Lead State examiner, in conjunction with the Lead State analyst, may need to request management to discuss their overall approach to both of these items—the accounting and valuation frameworks and the reasons and details for each—so that they can be considered as a whole. A different accounting basis can be used to create a result in a significant difference in perceived risk exposures and capital needs.

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 to determine risk capital. However, the Lead State regulator may have input regarding the level of stress that the insurer should consider for certain risk categories. 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.

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 may develop a group capital assessment based upon external models developed by third-party vendors, regulators or rating agencies while other insurers may also consider and assess the results of an internal capital model. While the insurer is free to select whichever approach or combination of approaches are 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. In addition, the Lead State examiner should evaluate the work performed by the insurer to validate the approach and model utilized.

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 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. This is an important step, because the Lead State examiner is encouraged to look to the insurer’s own process by which they assess the accuracy and robustness of their models, as well as how they govern model changes and parameter or assumption setting, and limit Lead State examiner’s validation of reports to more targeted instances where conditions warrant additional analysis. However, the examiner should be aware that many international regulators expect the group-wide supervisor to perform testing on such models so they can be relied upon. 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 consider and involve actuarial assistance in the evaluation. When involving an actuary, the primary focus of this review would be on evaluating the reasonableness of the inputs and outputs of the models. An actuary may be able to provide input on the reasonableness of the inputs while the outputs may be more easily tested by performing a walkthrough in which the inputs are modified and the Lead State examiner or Lead State actuary 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. The Lead State examiner may 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 some companies, the group capital assessment may be based upon external capital models. If a company presents its standing in relation to external capital models, the company may provide information showing its potential standing after considering the impact of stresses. This information may be beneficial as it can demonstrate what types of events a company could withstand before potentially losing its 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 required, should 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 third-party vendor tools, 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 company’s reasonably foreseeable and relevant material risks. In addition, the Lead State examiner should consider...
whether the company has applied reasonable 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/company to consider the prospective solvency of the group. Many companies will include information developed as part of their strategic planning including pro forma 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 Lead State 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. However, 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

The Lead State examiner should summarize exam conclusions regarding the insurer/company’s assessment of group risk capital by describing the method used (e.g. internal, external, combination) by the insurer/company to assess its overall group capital target and its basis for such a decision.

If internal capital models are utilized in the process to assess group risk capital, a discussion of material assumptions and methodologies utilized in calculating capital allocated to individual risk components should be provided. In addition, material assumptions and methodologies utilized in calculating a diversification credit should be discussed. Finally, controls over model validation and/or results of independent testing performed in this area should be discussed.

If external capital models are utilized in the process to assess group risk capital, the Lead State examiner should describe the external capital models utilized and their importance to the insurance group. In addition, a discussion of the stress scenarios and testing applied to the external capital model to account for a wide range of potential events should be provided.

The Lead State examiner should also summarize exam conclusions regarding the prospective solvency assessment provided by the insurance group. This summary should discuss the group’s prospective solvency projections and projected changes in risk exposures. For example, the Lead State examiner should discuss the material assumptions and methodologies utilized by the insurer in performing a prospective solvency assessment and whether the assumptions are consistent with the insurer’s overall business plan and strategy. Finally, the Lead State examiner should discuss any material changes in individual risk exposures outlined by the insurer and whether any of the information provided present concerns to be addressed in the remaining phases of the examination.
Prepare documentation summarizing the results of the risk management framework assessment by addressing each of the five principles set forth in the Guidance Manual. 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 final Lead State exam assessment for each principle. The final Lead State exam assessment should provide adequate rationale for any deviation from the Lead State analyst’s initial assessment of the principle.

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 relevant business unit and functional 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.

   | 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 |
4. **Risk Management and Controls**—Managing risk is an ongoing ERM activity, operating at many levels within the organization.

   - **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

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.

   - **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

**Overall Section I Assessment**

After considering the assessment of each of the five previously identified principles and taking into account any additional factors identified by the examiner during the review of the 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.

   - **Overall Assessment Rationale:**
     - ☐ 5 – Leadership
     - ☐ 4 – Managed
     - ☐ 3 – Repeatable
     - ☐ 2 – Initial
     - ☐ 1 – Ad Hoc
     - ☐ 0 – Non-existent

**Section II**

Prepare documentation summarizing a review and assessment of information provided by the insurer on its reasonably foreseeable and relevant material risks and corresponding stress assumptions and test results.

1. Based on your knowledge of the group, did the insurer include in its ORSA a discussion of risks and related stresses that you consider appropriate for the group?

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

   - **Lead State Examiner Summary of Risks and Stress Testing**
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b. **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.

  \[\text{Lead State Examiner Summary of Risks and Stress Testing}\]

c. **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.

  \[\text{Lead State Examiner Summary of Risks and Stress Testing}\]

d. **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.

  \[\text{Lead State Examiner Summary of Risks and Stress Testing}\]

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

  \[\text{Lead State Examiner Summary of Risks and Stress Testing}\]

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

  \[\text{Lead State Examiner Summary of Risks and Stress Testing}\]

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

  \[\text{Lead State Examiner Summary of Risks and Stress Testing}\]

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

  \[\text{Lead State Examiner Summary of Risks and Stress Testing}\]

i. **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.

  \[\text{Lead State Examiner Summary of Risks and Stress Testing}\]

j. **Other**—Discuss any other reasonably foreseeable and relevant material risks facing the company that do not fit into one of the 9 branded risk classifications identified above.

  \[\text{Lead State Examiner Summary of Risks and Stress Testing}\]

**Overall Risk Assessment Summary**

After considering the various risks identified by the insurer, as well as an analysis of such risks, develop an overall risk assessment summary of possible concerns that may exist.
Section III

Prepare documentation summarizing a review of the group capital assessment and prospective solvency assessment provided by the group as follows:

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.
   
   **Lead State Examiner Summary**
   
   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.
      
      **Lead State Examiner Summary**
      
      ii. Stress scenarios and testing applied to individual risk components.
      
      **Lead State Examiner Summary**
      
      iii. Material assumptions and methodologies utilized in calculating a diversification credit based on the correlation between risk components.
      
      **Lead State Examiner Summary**
      
      iv. Controls over model validation and/or results of independent testing performed in this area.
      
      **Lead State Examiner Summary**
      
   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.
      
      **Lead State Examiner Summary**
      
      ii. Stress scenarios and testing applied to the external capital model to account for a wide range of potential events.
      
      **Lead State Examiner Summary**
      
2. Summarize Lead State exam conclusions regarding the prospective solvency assessment provided by the insurance group by discussing each of the following elements:
G. 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 Lead State 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>Lead State Examination team may place a high degree of reliance on the insurer’s general ERM framework 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>Lead State Examination team may place a moderate-high degree of reliance on the insurer’s general ERM framework and related controls, while considering additional testing for significant individual controls/strategies. ORSA conclusions should be utilized to reduce and focus the scope of remaining examination activities.</td>
</tr>
<tr>
<td>3 - Repeatable</td>
<td>Lead State Examination team may place a moderate degree of reliance on the insurer’s general ERM framework 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.</td>
</tr>
<tr>
<td>2 - Initial</td>
<td>Lead State Examination team may place a low degree of reliance on the insurer’s general ERM framework 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.</td>
</tr>
<tr>
<td>1 - Ad-Hoc</td>
<td>Lead State Examination team should not place reliance on the insurer’s ERM framework 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.</td>
</tr>
</tbody>
</table>
| 0 - Non-Existent | Lead State Examination team should not place any reliance on nor consider
the results of the insurer’s ERM/ORSA framework in scoping examination activities.

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 Lead State examination to meet the needs of the insurer being reviewed.

While the results of the ERM maturity assessment can be broadly utilized in customizing Lead State 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 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 Lead State 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. The overall ERM maturity level assessment discussed above should be completed during the planning stage of an exam.</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 Lead State examiner in identifying and assessing reasonably foreseeable and relevant material risks to be reviewed during the exam.</td>
</tr>
<tr>
<td>Section I – Risk Appetites Tolerances and Limits; Section II – Insurer’s Assessment of Risk Exposure</td>
<td>Phase 3 – Identify and Evaluate Risk Mitigation Strategies/ Controls; Exhibit V – Prospective Risk Assessment</td>
<td>Risk tolerances and limits set by the company may represent strategies/ controls that can be relied upon to mitigate reasonably foreseeable and relevant material risks in Phase 3 of the examination process or to address overarching prospective risks reasonably foreseeable and relevant material risks.</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. However, the documentation should discuss reasonably foreseeable and relevant material risks.</td>
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| Section III – Group Assessment of Risk Capital | Exhibit DD – Critical Risk Categories (Capital Management) | 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 reasonably foreseeable and relevant material risks related to capital management required to be considered by Exhibit DD – Critical Risk Categories. |
| Section III – Prospective Solvency Assessment | Phase 6 – Update Prioritization & Supervisory Plan; Phase 7 – Draft Exam Report & Management Letter | 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. |