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 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 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 expectation of 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 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 regulator under-assessing the maturity of the insurer’s risk management practices. Ultimately, the goal of this guidance is to assist the 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 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 analyst 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.
- **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.
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- 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 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 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 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 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 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 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.
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- **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 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
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 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 regulators and the insurer.

   i. The questions from the regulators 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 regulators 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 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 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’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)*

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

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 in each of the above sections. The assessment, along with the 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 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 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.
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
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 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 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 analyst, or through an updated review by the examiner.

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

The 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 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 analyst believes the ORSA Summary Report does not reflect the key risks of the insurer, the 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 analyst to develop a narrative assessment of each of the 9 branded risk classifications, the 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 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. Regulators 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 shouldn’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 appropriate 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 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. 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 method 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 generally 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 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 commonly 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 insures, 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 of 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.**

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>Value (if applicable)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Economic group capital required after diversification</td>
<td>$*</td>
</tr>
<tr>
<td>2</td>
<td>Available group consolidated capital</td>
<td>$*</td>
</tr>
<tr>
<td>3</td>
<td>Rating agency capital required (identify agency &amp; present multiple, if multiple are tracked and reported)</td>
<td>$</td>
</tr>
<tr>
<td>4</td>
<td>Available group consolidated capital used by agency</td>
<td>$</td>
</tr>
<tr>
<td>5</td>
<td>Consolidated group regulatory capital (all countries)</td>
<td>$*</td>
</tr>
<tr>
<td>6</td>
<td>Available group consolidated capital (ignoring different accounting basis)</td>
<td>$*</td>
</tr>
</tbody>
</table>

* If not applicable, mark as such

Answer the following:

- [ ] Group capital is well in excess of internal/rating agency capital
- [x] Group capital is currently sufficient compared to internal/rating agency capital
- [ ] Group capital is not sufficient compared to internal/rating agency/regulatory capital

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 may be most desirable. The above discusses the use of economic capital and how such approach captures 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. However, the analyst should be able to develop and document the general 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 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 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 model 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
V. Group-wide Supervision—E. ORSA Procedures

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):

Suggested Additional Verification/Areas of Focus for the Financial Examination

<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>