THE ORSA JOURNEY HAS BEGUN

By Elisabetta Russo, NAIC ERM Advisor, and Shanique (Nikki) Hall, CIPR Manager

◆ INTRODUCTION
The Own Risk and Solvency Assessment (ORSA) is a new regulatory reporting tool intended to foster effective enterprise risk management (ERM) and provide a group level perspective on risk and capital. An ORSA is an internal process undertaken by an insurer or insurance group to evaluate its own risk management framework and current and prospective solvency positions under normal and severe stress scenarios. It requires companies to regularly evaluate and describe their risk management strategies and how they align with their overall business objectives. The ORSA will become an important additional tool for state insurance regulators to carry out risk-focused surveillance as it provides additional information on the key risks insurers are exposed to, how they manage and control them and ultimately on the financial resources available to cover unexpected losses.

As part of the NAIC Solvency Modernization Initiative, the NAIC adopted the Risk Management and Own Risk and Solvency Assessment Model Act (#505) in 2012. Model #505, which went into effect on Jan. 1, 2015, requires insurers above a specified premium threshold to maintain a risk management framework, complete an ORSA, and file a confidential annual ORSA Summary Report with their lead state supervisor. The NAIC ORSA Guidance Manual was also formerly adopted in 2012 and provides guidance to insurers on performing an ORSA and presenting its findings in an ORSA Summary Report.

Since the ORSA Guidance Manual and Model #505 were introduced, the NAIC and a number of state departments of insurance carried out three ORSA Feedback Pilot Projects (Pilot Projects). The Pilot Projects provided a small number of insurers an opportunity to voluntarily take a “dry run” at completing an ORSA Summary Report prior to formal submission. The participating companies in the Pilot Projects received high-level feedback regarding their ORSA Summary Report to help them in preparing their first formal filings. The observations from the reviews also helped fine-tune the ORSA Guidance Manual, with amendments and enhancements made to the manual over the past several years.

The majority of states have now formally enacted Model #505. All states are expected to adopt Model #505 by the end of 2017, as the Model becomes a standard for accreditation of the state departments. Most of the adopting states required an ORSA Summary Report to be filed by the end of 2015. The remainder of states require the first filing to be made by the end of 2016 or 2017, depending on the state. State departments of insurance around the country have now received ORSA Summary Reports from qualifying insurance companies (27 of the 35 states that have adopted Model #505 received ORSA Summary Reports in the second half of 2015, mostly towards the end of the year.) The NAIC estimates about 300 reports will be filed every year, once all states have adopted Model #505, of which approximately 200 will be at group level and 100 at single-entity level.

As regulators gear up to review these reports, the remainder of this article provides an overview of the observations for improving the quality of an ORSA Summary Report.

◆ NAIC ORSA FEEDBACK PILOT PROJECTS
The three ORSA Pilot Projects occurred in 2012, then again in 2013, and most recently during October 2014–June 2015. The number of states participating in the Pilot Projects grew from 12 in 2012, 16 in 2013, to 26 in 2014. The number of voluntary ORSA submissions from various insurers/groups also grew from 14 in 2012, 22 in 2013 and to 28 in 2014.

All three Pilot Projects were very informative and beneficial for both regulators and industry. The findings of the last Pilot Project helped the development of regulatory guidance to financial analysts and financial examiners of state insurance departments for reviewing the ORSA filings. Moreover, they helped regulators provide more specific guidance to the industry on their expectations as the industry prepared for the first filings of the ORSA Summary Reports. The ORSA Guidance Manual provides insurers with general guidance on completing an ORSA Summary Report. The manual is deliberately non-prescriptive as each ORSA will be unique and will vary depending on risks unique to each company. During each Pilot Project, regulators went through each report line-by-line to provide additional insight to the individual companies submitting the reports, and also to address improvements to the ORSA Guidance Manual.

(Continued on page 11)

1 Much has been written on the basics of ORSA and the benefits of the ORSA process. For additional information see the October 2012 CIPR Newsletter article “Insurers, Are You Ready? The Own Risk and Solvency Assessment (ORSA) Is On Its Way.” www.naic.org/cipr_newsletter_archive/orsa_ora.pdf.
2 The NAIC Solvency Modernization Initiative (SMI) began in June 2008. It is a critical self-examination of the U.S. insurance solvency regulation framework and includes a review of international developments regarding insurance supervision, banking supervision and international accounting standards and their potential use in U.S. insurance regulation.
3 An ORSA Summary Report is a high-level summary of the assessment to be submitted to the insurer’s domiciliary commissioner.
4 General feedback, observations and summarized results were published and made available to the public at the conclusion of each Pilot Project. The 2014 Pilot Project results are available at: www.naic.org/documents/committees_e忐ff_group_solvency_related_ora_feedback_pilot_project.pdf and all results are available on the NAIC website at: www.naic.org/cipr_topics/topic_own_risk_solvency_assessment.htm.
5 As of March 1, 2016.
THE ORSA JOURNEY HAS BEGUN (CONTINUED)

<table>
<thead>
<tr>
<th>Industry</th>
<th>NAIC/State Insurance Regulators</th>
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| 2012     | • North American CRO Council actively involved in drafting of NAIC ORSA Guidance Manual | • RMORS Model Act  
|          | • A number of insurers participated in the ORSA Pilot Preparation for first ORSA filings | • ORSA Model Act  
|          | • First ORSA filings in 27 states (approx. 200) | • Second and third ORSA Pilot Programs  
|          | • Second ORSA submissions in 27 states | • Enhancements to the ORSA Guidance Manual  
|          | • First ORSA filings in five states | • ORSA sections of Financial Condition Examiners Handbook and Financial Analysis Handbook  
|          | • Second ORSA submission | • Initial ORSA feedback to companies  
|          | • ORSA Training for state insurance regulators | • ORSA Training for state insurance regulators  
|          | • Ongoing review of ORSA filings | • Implementation of ORSA handbooks processes  

A feedback report was prepared by the NAIC and made public at the conclusion of each Pilot Project, which included the observations of state insurance regulators reviewing the filings. Because many companies did not participate in the Pilot Projects, the feedback and observations provided in the feedback reports offered more granular guidance to companies. The Pilot Projects also helped guide the development of ERM educational materials for state insurance regulators. The NAIC has been providing national hands-on training since 2015 to prepare states for the review and utilization of the ORSA Summary Report in the regulatory process.

In addition, the NAIC conducted an “ORSA Pilot Key Results and Recommendations to Industry” webinar in August 2015 to share key results from the Pilot Project. The webinar, which is available on the NAIC website, reviewed ORSA best practices and provided additional insights, beyond the published observations, for improving the quality of the ORSA—or more specifically, detailing attributes of what makes a “good” ORSA summary report in the eyes of a regulator.

2014 PILOT PROJECT OBSERVATIONS FOR IMPROVING ORSA
The ORSA Guidance Manual requires insurers to detail the elements of their ERM framework and ORSA results in a three-section ORSA Summary Report. The three-section structure includes: Section 1—Description of the Insurer’s Risk Management Framework; Section 2—Insurer’s Assessment of Risk Exposure and Section 3—Group Risk Capital and Prospective Solvency Assessment. Overall, regulators found the ORSA Summary Reports submitted were generally in compliance with the requirements with regard to the organization of the reports in the three sections.

The following six observations were noted as opportunities for improving the quality of an ORSA Summary Report:
1. Providing additional explanation of the risk management strategy in the context of the key business strategy objectives.
2. Highlighting the maturity of the ERM process and status of development by covering what has been developed and embedded in the organization and what is still in development.
3. Offering additional information and clarity regarding the legal entities included in the scope of the group ORSA.
4. Maintaining consistency between the key risks identified in Section 1, those assessed in terms of exposure in Section 2 and those quantified in terms of risk capital in Section 3.
5. Providing additional support for the methodologies and assumptions selected in Section 2 for assessing and stress testing the exposures for key risks and to quantify risk capital in Section 3.
6. Offering additional evidence regarding how the management team utilizes the information provided in the ORSA Summary Report to pursue its business strategy objectives and how the board of directors utilizes it to oversee the company.

The following highlights some of the features state insurance regulators found in a “good” ORSA Summary Report.

Section 1
• Provides a description of each of the five building blocks of the ORSA Guidance Manual (risk governance and culture, risk identification and prioritization, risk appe-

(Continued on page 12)
**THE ORSA JOURNEY HAS BEGUN (CONTINUED)**

- **Rationale for current solvency position**: Provides a robust and detailed process of identifying the priorities and tools used (e.g., meetings, targeted questionnaires, enterprise-wide questionnaires, etc.), as well as the participants in the process.
- **Risk appetite, tolerances and limits**: Articulates tolerances and limits for each of the key risks and provides explanation for the selection of the tolerances and limits and for setting the overall risk appetite at insurer/group level. Limits, tolerances and appetite should make sense in the context of the business objectives pursued by the insurer/group.
- **Risk management and controls**: Provides a detailed description of the assessment of the exposures for each key risk identified in Section 1 with an explanation of the methodology selected (whether qualitative or quantitative), the assumptions and underlying data used (i.e. description, source, valuation date/period), and the rationale for the selection of the methodology.
- **Risk reporting and communications**: Provides a detailed description of the process in place to manage, monitor and control both key and non-key risks, setting out the key activities, the key risk controls and key mitigation activities and escalation activities in case of breaches. Examples of breaches occurred and actions taken are included in the best ORSA Summary Reports.

### Section 2

- **Risk appetite, tolerances and limits**: Comparison of risk exposures against limits, tolerances and risk appetite
- **Risk management and controls**: Stress testing of risk exposure
- **Risk reporting and communication**: Validation of results

<table>
<thead>
<tr>
<th><strong>SECTION 1</strong></th>
<th><strong>SECTION 2</strong></th>
<th><strong>SECTION 3</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DESCRIPTION OF THE RISK MANAGEMENT FRAMEWORK</strong></td>
<td><strong>INSURERS’ ASSESSMENT OF RISK EXPOSURE</strong></td>
<td><strong>GROUP RISK CAPITAL AND PROSPECTIVE SOLVENCY ASSESSMENT</strong></td>
</tr>
<tr>
<td>Risk culture and governance</td>
<td>Detailed description of material risks, assessment methodology and assumptions, risk mitigation activities</td>
<td>Quantification of required risk capital at group level against available capital</td>
</tr>
<tr>
<td>Risk identification and prioritization</td>
<td>Assessment (qualitatively or quantitatively) of risk exposures for each material risk</td>
<td>Stress testing of current solvency position</td>
</tr>
<tr>
<td>Risk appetite, tolerances and limits</td>
<td>Comparison of risk exposures against limits, tolerances and risk appetite</td>
<td>Prospective assessment of risk profile and solvency position</td>
</tr>
<tr>
<td>Risk management and controls</td>
<td>Stress testing of risk exposure</td>
<td>Stress testing of prospective solvency positions</td>
</tr>
<tr>
<td>Risk reporting and communication</td>
<td></td>
<td>Validation of results</td>
</tr>
</tbody>
</table>

*(Continued on page 13)*
Section 3
With regard to the group assessment of risk capital:

- The assessment is conducted for each of the key risks identified and assessed in Sections 1 and 2.
- The metric used to define risk capital and provide a rationale for its selection is described.
- The methodology used to aggregate individual risk capitals to obtain one group risk capital amount (before any diversification benefit) is explained.
- The accounting basis used to measure the available capital that is compared with the aggregate risk capital to show the current solvency position of the insurer is stated.
- The correlations between key risks and provide robust support to the methodology selected to determine the “diversification benefit” are analyzed.
- The validation framework (i.e. governance, testing of models, data and results, documentation) and the current state of validation of the models used is described.

With regard to the prospective assessment of risks and capital adequacy:

- The changes in the insurer/group’s risk profile (i.e. the key risks) over the time horizon of the business plan in light of the changes to the insurer/group’s business strategy objectives are explained.
- The future risk capital needed at aggregate level to cover unexpected losses from these key risks are estimated.
- The estimated projected risk capital against the estimated projected available capital to determine future solvency positions are compared.
- In case of potential insolvency, additional sources of capital available to cover any shortfall (in particular: access to capital markets, liquidity of existing assets, and fungibility of capital within the group) are identified.

*CONCLUSION*

The year 2016 will be an important year as regulators review the first ORSA Summary Reports that were submitted in 2015. State insurance regulators will decide the regulatory value of these reports and to what extent the information provided enhances their risk-focused surveillance of insurance groups. They will also provide feedback to the insurance companies. The NAIC will continue training state departments of insurance on how to utilize the ORSA Summary Reports in their financial exams and financial analysis.

As the ORSA is brought onto the agenda of international and domestic supervisory colleges, the discussion over regulatory expectations from ORSA Summary Reports will broaden to include the views of other regulators. How these expectations converge and how they are communicated to the insurance companies will be key to the development of the next round of ORSA reports.

For the time being, it is crunch time for both regulators to dig into the reports, and for companies to soon collect the feedback and implement it into the 2016 filings.

ABOUT THE AUTHORS

**Elisabetta Russo** is a risk actuary. She joined the NAIC in July 2014 to be the ERM Advisor to the state insurance departments. Ms. Russo is currently focusing on helping the state Departments of Insurance to be ready to supervise the ORSA submissions. At the NAIC, she is also involved in international issues such as the development of a global international capital standard. Prior to joining the NAIC, for nearly 3 years, Ms. Russo led the Deloitte Solvency practice and P&C risk modeling team for the Unites States in New York City. Prior to that, she worked for nearly 15 years for PwC in London and in Moscow. She set up the actuarial practice for Central Eastern Europe and she served as member of the Global Solvency II Steering Committee for Europe, advising the largest European insurance groups on all 3 pillars (capital assessment, ERM and ORSA and risk reporting). During her consulting career, Ms. Russo worked with other non-US regulators as advisor, model validator and trainer.

**Shanique (Nikki) Hall** is the manager of the NAIC Center for Insurance Policy and Research (CIPR). She joined the NAIC in 2000 and currently oversees the CIPR’s primary work streams, including: the CIPR Newsletter; studies; events; webinars and website. Ms. Hall has extensive capital markets and insurance expertise and has authored copious articles on major insurance regulatory and public policy matters. She began her career at J.P. Morgan Securities as a research analyst in the Global Economic Research Division. At J.P. Morgan, Ms. Hall analyzed regional economic conditions and worked closely with the chief economist to publish research on the principal forces shaping the economy and financial markets. Ms. Hall has a bachelor’s degree in economics from Albany State University and an MBA in financial services from St. John’s University. She also studied abroad at the London School of Economics.

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6 Supervisory colleges are joint meetings of interested regulators with company officials and include detailed discussions about financial data, corporate governance, and enterprise risk management functions. They are intended to facilitate oversight of internationally active insurance companies at the group level.
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