

## Financial Analysis Handbook - 2014 Annual

### V. Group-wide Supervision - ORSA Guidance & Procedures

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## ORSA Summary Report

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

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. 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.

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. Similarly, throughout the remainder of this document, the term Lead State is used before the term analyst with the understanding that in most situations, the ORSA Summary Report will be prepared on a group basis, and therefore reviewed by the Lead State.

## 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 Enterprise Risk Management (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.

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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.

There is no expectation with respect to specific information or specific action that the Lead State regulator is to take as a result of reviewing the ORSA Summary Report. Rather, each situation is expected to result in a unique ongoing dialogue between the insurer and the Lead State regulator focused on the key risks of the group. For this reason, as well as others, the Lead State analyst may want to consider including the Lead State examiner or any other individual acting under the authority of the commissioner or designated by the commissioner with special skills and subject to confidentiality that may be of assistance in their initial review of the ORSA Summary Report and possible dialogue with the insurer since the same team will be part of the ongoing monitoring of the insurer and an ORSA Summary Report is expected to be at the center of the regulatory processes. A joint review such as this prior to the Lead State analyst documenting their summary of the ORSA report may be appropriate.

These determinations can be documented as part of each insurer's ongoing supervisory plan. However, the Guidance Manual also states that each insurer's ORSA will be unique, reflecting the insurer's business model, strategic planning and overall approach to ERM. As regulators review ORSA Summary Reports, they should understand that the level of sophistication for each group's ERM program will vary depending upon size, scope and nature of business operations. Understandably, less complex organizations may not require intricate processes to possess a sound ERM program. Therefore, regulators should use caution before using the results of an ORSA review to modify ongoing supervisory plans, as a variety of practices may be appropriate depending upon the nature, scale and complexity of each insurer.

Collectively, the goals above are the basis upon which the guidance is established. However, the ORSA Summary Report will not serve this function or have this direct impact until the Lead State becomes fairly familiar with and comfortable with evaluating each insurer's report and its processes. This could take more than a couple of years to occur in practice, since the Lead State would likely need to review at least one or two ORSA Summary Reports to fully understand certain aspects of the processes used to develop the report.

### General Summary of Guidance for Each Section

The guidance that follows is designed to assist the Lead State analyst in the review of the ORSA and to allow for effective communication of analysis results with the non-lead states. It is worth noting that this guidance is expected to evolve over the years, with the first couple of years focused on developing a general understanding of ORSA and ERM. It should be noted that each of the sections can be informative to the other sections. As an example, Section II affords an insurer the opportunity to demonstrate the robustness of its process through its assessment of risk exposure. In some cases, it's possible the Lead State 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 Lead State analyst to conclude it was at Level 5 (defined below), but in practice by review of Section II, it appears to meet the level. Likewise, the Lead State analyst may assess Section II as Level 5 but may be unable to see through Section III how the totality of the insurer's system is Level 5 because of a lack of demonstrated rigor documented in Section III. Therefore, the assessment of each section requires the Lead State analyst to consider other aspects of the ORSA Summary Report. This is particularly true of Section I, because as discussed in the following page (or paragraphs), the other two sections have very distinct objectives whereas the assessment of Section I is broader.

Section I procedures are focused on assessing the insurer's maturity level with respect to its overall risk management framework. The maturity level may be assessed through a number of ways, one of which is through the incorporation of concepts developed within Risk and Insurance Management Society's (RIMS) Risk

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Maturity Model (RMM). While insurers or insurance groups may utilize various frameworks in developing, implementing and reporting on their ORSA processes (e.g., COSO Integrated Framework, ISO 31000, IAIS ICP 16, other regulatory frameworks, etc.), elements of the RMM have been incorporated into this guidance to provide a framework for use in reviewing and assessing ERM/ORSA practices. However, as various frameworks may be utilized to support effective ERM/ORSA practices, Lead State regulators should be mindful of differences in frameworks and allow flexibility in assessing maturity levels. The RMM, which is only one of a number of processes that may be used to determine maturity levels, provides a scale of six maturity levels upon which an insurer can be assessed. The six maturity levels can generally be defined as follows:

- Level 5: 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 the Board of Directors or the appropriate committee thereof (hereafter referred to as the “Board” for this chapter) and management.
- Level 4: 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: The insurer has risk management processes in place designed and operated in a timely, consistent and sustained way. The insurer takes action to address issues related to high priority risks.
- Level 2: 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: 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: The insurer has not recognized a need for risk management and risks are not directly identified, monitored or managed.

The guidance developed for use in this Handbook integrates the concepts of RIMS maturity level scale of the RMM with the general principles and elements outlined in Section I of the ORSA Guidance Manual to assist Lead State regulators in reaching an overall assessment of the maturity of an insurer’s risk management framework. The design of ERM/ORSA practices should appropriately reflect the nature, scale and complexity of the insurer. Lead State regulators should understand the level of maturity that is appropriate for the company based on its unique characteristics. Attainment of “Level 5” level maturity for ERM/ORSA practices is not appropriate, nor should be expected, for all insurers or for all components of the framework.

Section II takes a much different approach. It provides guidance to allow the Lead State 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 Lead State analyst to better understand the information in this section. Section II guidance has been developed around the nine branded risk classifications contained elsewhere in this handbook, which are used as a common language in the risk-focused surveillance process. The primary reason for utilizing this approach is that it is not uncommon for insurer’s to identify within its ORSA Summary Report, many of the same types of risks, therefore the Lead State analyst can leverage this information in their analysis of the insurer. However, Lead State regulators should not restrict their focus to only the nine branded risk classifications; as such an approach may not encourage independent judgment in understanding the risk profile of the insurer. Therefore, the reference to the nine branded risk classifications provides a

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framework to organize the Lead State’s summary, but should not discourage regulators from documenting other risks or excluding branded risk categories that are not relevant. From this standpoint, Section II will also provide regulators with information to better understand current insurance market risks, changes in those risks as well as macroeconomic changes and the impact they have on insurers risk identification and risk management processes.

Finally, Section III is also unique in that it provides a specific means for assisting the Lead State analyst in evaluating the insurer’s determinations of the reasonableness of its group capital. Section III of the ORSA Summary Report is intended to be more informative regarding capital than other traditional methods of capital assessment since it sets forth the amount of capital the group determines is reasonable to sustain its current business model.

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

The ORSA Guidance Manual requires the insurer to discuss the key principles below in Section I of the ORSA Summary Report. For purposes of evaluating the ORSA Summary Report, and moreover, the Lead State analyst’s responsibility to assess the insurer’s risk management framework, the Lead State 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 Lead State analyst in reaching an initial high-level assessment of the insurer’s maturity level for each key principle as “Level 5” through “Level 0”.

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:

When reviewing the ORSA Summary Report, the Lead State 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. “Level 5” practices) are provided for each principle in the following sections. The intent in providing these attributes or traits is to assist the Lead State 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.

**A. Risk Culture and Governance**

It is important to note some insurers 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 within the insurer that manages reasonably foreseeable and relevant material risk in a way that is continuously improved.

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- Level 5

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 Framework into the corporate culture. Management establishes the framework and the risk culture and the Board reviews the risk appetite statement in collaboration with the chief executive officer (CEO), chief risk officer (CRO) where applicable, and chief financial officer (CFO). Those officers translate the expectations into targets through various practices embedded throughout the insurer. Risk management is embedded in each material business function. Internal audit, information technology, compliance, controls and risk management processes are integrated and coordinate and report risk issues. Material business functions use risk-based best practices. The risk management lifecycle for business process areas are routinely evaluated and improved (when necessary).

- Level 4

The insurer's ERM processes are self-governed with shared ethics and trust; Management is held accountable. Risk management issues are understood and risk plans are conducted in material business process areas. The Board, CEO, CRO (if applicable) and CFO expect a risk management plan to include a qualitative risk assessment for reasonably foreseeable and relevant material risks with reporting to management or the Board on priorities, as appropriate. Relevant areas use the ERM framework to enhance their functions, communicating on risk issues as appropriate. Process owners incorporate managing their risks and opportunities within regular planning cycles. The insurer creates and evaluates scenarios consistent with its planning horizon and product timelines, and follow-up activities occur accordingly.

- Level 3

ERM risk plans are understood by management. Senior management expects that a risk management plan captures reasonably foreseeable and relevant material risks in a qualitative manner. Most areas use the ERM framework and report on risk issues. Process owners take responsibility for managing their risks and opportunities. Risk management creates and evaluates scenarios consistent with the business planning horizon.

- Level 2

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

- Level 1

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 are not 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.

- Level 0

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No recognized need for an ERM Process and no formal responsibility for ERM. Internal audit, risk management, compliance and financial activities might exist but are not integrated. Business processes and risk ownership are not well defined.

**B. Risk Identification and Prioritization**

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

- Level 5  
Information from internal and external sources on reasonably foreseeable and relevant material risks, including relevant business units and functions is systematically gathered and maintained. A routine, timely reporting structure directs risks and opportunities to senior management. The ERM framework promotes frontline employees' participation and documents risk issues or opportunities' significance. Process owners periodically review and recommend risk indicators that best measure their areas' risks. The results of internal adverse event planning are considered a strategic opportunity.
- Level 4  
Process owners manage an evolving list of reasonably foreseeable and relevant material risks locally to create context for risk assessment activities as a foundation of the ERM framework. Risk indicators deemed critical to their areas are regularly reviewed in collaboration with the ERM team. Measures ensure downside and upside outcomes of risks and opportunities are managed. Standardized evaluation criteria of impact, likelihood and controls' effectiveness are used to prioritize risk for follow-up activity. Risk mitigation is integrated with assessments to monitor effective use.
- Level 3  
An ERM team manages an evolving list of reasonably foreseeable and relevant material risks, creating context for risk assessment as a foundation of the ERM framework. Risk indicator lists are collected by most process owners. Upside and downside outcomes of risk are understood and managed. Standardized evaluation criteria of impact, likelihood and controls' effectiveness are used, prioritizing risk for follow-ups. Enterprise level information on risks and opportunities are shared. Risk mitigation is integrated with assessments to monitor effective use.
- Level 2  
Formal lists of reasonably foreseeable and relevant material risks exist for each relevant business unit or function and discussions of risk are part of the ERM Process. Corporate risk indicators are collected centrally, based on past events. Relevant business units or functions might maintain their own informal risk checklists that affect their areas, leading to potential inconsistency, inapplicability and lack of sharing or under-reporting.
- Level 1  
Risk is owned by specialists, centrally or within a business unit or function. Risk information provided to risk managers is probably incomplete, dated or circumstantial, so there is a high risk of misinformed decisions, with potentially severe consequences. Further mitigation, supposedly completed, is probably inadequate or invalid.

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- Level 0

There might be a belief that reasonably foreseeable and relevant material risks are known, although there is probably little documentation.

**C. Risk Appetite, Tolerances and Limits**

The Guidance Manual states that a formal risk appetite statement, and associated risk tolerances and limits are foundational elements of a risk management framework for an insurer; understanding of the risk appetite statement ensures alignment with the risk strategy set by senior management and reviewed and evaluated by the Board. Not included in the manual, but widely considered, is that risk appetite statements should be easy to communicate, be understood, and be closely tied to the insurer's strategy. After the overall risk appetite for the insurer is determined, the underlying risk tolerances and limits can be selected and applied to business units and risk areas as deemed appropriate by the company. The company may apply appropriate quantitative limits and qualitative statements to help establish boundaries and expectations for risks that are hard to measure. These boundaries may be expressed in terms of earnings, capital, or other metrics (growth, volatility). The risk tolerances/limits provide direction outlining the insurer's tolerance for taking on certain risks, which may be established and communicated in the form of the maximum amount of such risk the entity is willing to take. However, in many cases these will be coupled with more specific and detailed limits or guidelines the insurer uses. Due to the varying level of detail and specificity, different insurers incorporate into their risk appetites, tolerances and limits, Lead State regulators should consider these elements collectively to reach an overall assessment in this area and should seek to understand the insurer's approach through follow-up discussions and dialogue.

- Level 5

A risk appetite statement has been developed to establish clear boundaries and expectations for the insurer to follow. A process for delegating authority to accept risk levels in accordance with the risk appetite statements is communicated throughout the insurer. The management team and risk management committee, if applicable, may define tolerance levels and limits on a quantitative and/or qualitative basis for relevant business units and functions in accordance with the defined risk appetite. As part of its risk management framework, the insurer may compare and report actual assessed risk versus risk tolerances/limits. Management prioritizes resource allocation based on the gap between risk appetite and assessed risk and opportunity. The established risk appetite is examined periodically.

- Level 4

Risk appetite is considered throughout the ERM framework. Resource allocation decisions consider the evaluation criteria of business areas. The insurer forecasts planned mitigation's potential effects versus risk tolerance as part of the ERM framework. The insurer's risk appetite is updated as appropriate and risk tolerances are evaluated from various perspectives as appropriate.

Risk is managed by process owners. Risk tolerance is evaluated as a decision to increase performance and measure results. Risk-reward tradeoffs within the business are understood and guide actions.

- Level 3

Risk assumptions within management decisions are clearly communicated. There is a structure for evaluating risk and gauging risk tolerance on an enterprise-wide basis. Risks and opportunities are routinely identified, evaluated and executed in alignment with risk tolerances. The ERM framework quantifies gaps between actual and target tolerances. The insurer's risk appetite is periodically reviewed and updated as deemed appropriate by the insurer and risk tolerances are evaluated from various

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perspectives as appropriate.

- Level 2

Risk assumptions are only implied within management decisions and are not understood outside senior leadership with direct responsibility. There is no ERM framework for resource allocation. Defining different views of business units or functions from a risk perspective cannot be easily created and compared.

- Level 1

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.

- Level 0

The need for formalizing risk tolerance and appetite is not understood.

**D. Risk Management and Controls**

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

- Level 5

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

- Level 4

Risk management is clearly defined and enforced at relevant levels. A risk management framework articulates management’s responsibility for risk management, according to established risk management



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processes. Management develops and reviews risk plans through involvement of relevant stakeholders. The ERM framework is coordinated with managers' active participation. Opportunities associated with reasonably foreseeable and relevant material risks are part of the risk plans' expected outcome. Authentication, audit trail, integrity and accessibility promote roll-up information and information sharing. Periodic reports measure ERM progress on reasonably foreseeable and relevant material risks for stakeholders, including senior management or the Board. The insurer 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.

- Level 3

The ERM framework supports material business units' and functions' needs. ERM is a process of steps to identify, assess, evaluate, mitigate and monitor reasonably foreseeable and relevant material risks. ERM frameworks include the management of opportunities. Senior management actively reviews risk plans. The ERM Process is collaborative and directs important issues to senior management. The "Three Lines of Defense" are generally in place, but are not yet performing at an effective level.

- Level 2

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

- Level 1

Management is reactive and ERM might not yet be seen as a process and management tool. 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 are not identified.

- Level 0

There is little recognition of the ERM framework's importance or controls in place to ensure its effectiveness.

### **E. Risk Reporting and Communication**

The Guidance Manual indicates risk reporting and communication provides key constituents with transparency into the risk-management processes and facilitates active, informal decisions on risk-taking and management. The transparency is generally available because of reporting that can be made available to management, the Board, or compliance departments, as appropriate. However, most important is how the reports are being utilized to identify and manage reasonably foreseeable and relevant material risks at either the group, business unit or other level within the insurer where decisions are made. Therefore, one approach may be to have reporting in place that allows decisions to be made throughout the insurer by appropriately authorized people, with ultimate ownership by senior management or the Board.

- Level 5

The ERM framework is an important element in strategy and planning. Evaluation and measurement of

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performance improvement is part of the risk culture. Measures for risk management include process and efficiency improvement. The insurer measures the effectiveness of managing uncertainties and seizing risky opportunities. Deviations from plans or expectations are also measured against goals. A clear, concise and effective approach to monitor progress toward strategic goals is communicated regularly with relevant business units or functional areas. Individual, management, departmental, divisional and corporate strategic goals are linked with standard measurements. The results of key measurements and indicators are reviewed and discussed by senior management or the Board, on a regular basis and as frequently as necessary to address breaches in risk tolerances or limits in a timely manner.

- Level 4

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

- Level 3

The ERM framework contributes to strategy and planning. Strategic goals have performance measures. While compliance might trigger reviews, other factors are integrated, including process improvement and efficiency. The insurer 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 or the Board.

- Level 2

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

- Level 1

Not all strategic goals have measures. Strategic goals are not 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.

- Level 0

No formal framework of indicators and measures for reporting on achievement of strategic goals exists.

### Documentation for Section I

The Lead State analyst should prepare a summary of Section I by developing an assessment of each of the five principles set forth in the ORSA Guidance Manual using the template at the end of these procedures. The Lead State analyst should understand that ORSA summary reports may not align with each of these specific principles. Therefore, the Lead State analyst must use judgment and critical thinking in accumulating information to support their evaluation of each of these principles. The Lead State analyst should be aware that the Lead State examiner is tasked to update the assessment by supplementing the Lead State analyst's

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assessment with additional onsite verification and testing. The Lead State analyst should direct the Lead State examiner to those areas where such additional verification and testing is appropriate, and could not be performed by the Lead State analyst. Where available from prior full scope or targeted examinations, the assessment from the Lead State examiner should be used as a starting point for the Lead State analyst to update. Consequently, the Lead State analyst update may focus as much on changes to the ORSA Summary Report (positive or negative) since the insurer was previously examined; and, similar to an initial assessment by the Lead State Analyst, they may want to direct targeted onsite verification and testing for changes that have occurred since the last examination.

The Lead State analyst, after completing a summary of Section I, should consider if the overall assessment, or any specific conclusions, should be used to update either the Group Profile Summary (if the ORSA is prepared on a group basis) or the Insurer Profile Summary (if the ORSA is prepared on a legal entity basis).

### 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 in both normal and stressed environments. The ORSA Guidance Manual does not require the insurer to include specific risks, but does give **possible examples** of reasonably foreseeable and relevant material risk categories (credit, market, liquidity, underwriting, and operational risks). In reviewing the information provided in this section of the ORSA, Lead State analysts may need to pay particular attention to risks and exposures that may be emerging or significantly increasing over time. To assist in identifying and understanding the changes in risk exposures, the Lead State analyst may consider comparing the insurer's risk exposures and/or results of stress scenarios to those provided in prior years.

Section II provides risk information on the entire insurance group, which may be grouped in categories similar to the NAIC's nine branded risk classifications. However, this is not to suggest the Lead State analyst or Lead State examiner should expect the insurer to address each of the nine branded risk classifications. In fact, in most cases, they will not align, but it is not uncommon to see some similarities for credit, market, liquidity, underwriting and operational risks. A fair number of insurer risks may not be easily quantified or are grouped differently than these nine classifications. Therefore, it is possible the insurer does not view them as significant or relevant. The important point is not the format, but for the Lead State analyst or Lead State examiner to understand how the insurer categorizes its own risks and contemplate whether there may be material gaps in identified risks or categories of risks.

### Documentation for Section II

Prepare a summary of Section II by identifying the significant reasonably foreseeable and material relevant risks of the insurer per the ORSA Summary Report, including those that correspond to the nine branded risk-classifications, if applicable. Following the documentation on each of the significant reasonably foreseeable and material relevant risks per the report, the Lead State analysts should include an analysis of such risk. In developing such analysis, the Lead State analyst is encouraged to use judgment and critical thinking in evaluating if the risks and quantification of such risks under normal and stressed conditions are reasonable and generally consistent with expectations. The Lead State analyst should be aware that the Lead State examiner is tasked to update the assessment by supplementing the Lead State analyst's assessment with additional onsite verification and testing. The Lead State analyst should direct the Lead State examiner to those areas where such additional verification and testing is appropriate, and could not be performed by the Lead State analyst.

After completing a summary of Section II, the Lead State analyst should use the information to update either the Group Profile Summary (if the ORSA is prepared on a group basis) or the Insurer Profile Summary (if the ORSA is prepared on a legal entity basis).

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**Overall Risk Assessment Summary**

After considering the various risks identified by the insurer through Section II, develop an overall risk assessment summary of possible concerns that may exist.

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

Section III of the ORSA is unique in that it is required to be completed at the insurance group level as opposed to the other sections that may be completed at a legal entity level. However, in many cases, insurers will choose to also complete Sections I and II at the group level. This requirement is important because it provides the means for Lead State regulators to assess the reasonableness of capital of the entire insurance group based upon its existing business plan.

In reviewing Section III of the ORSA Summary Report, the Lead State analyst should recognize this section is generally presented in a summarized form. Although this section requires disclosure of aggregate available capital compared against the enterprise’s risk capital, the report may not provide sufficient detail to fully evaluate the group capital position.

Section III will be directly used as part of the Lead State’s Holding Company Analysis evaluation of group capital.

**Documentation for Section III**

Insurance Groups will use different means to measure risk (i.e., required) capital and they will use different accounting and valuation frameworks. The Lead State analyst may need to request management to discuss their overall approach to both of these items and the reasons and details for each so that they can be considered in the evaluation of estimated risk capital.

The ORSA Summary Report should summarize the insurer’s process for model validation, including factors considered and model calibration. Because the risk profile of each insurer is unique, there is no standard set of stress conditions that each insurer should run; however, the Lead State regulator should be prepared to dialogue with management about the selected stress scenarios if there is concern with the rigor of the scenario. In discussions with management, the Lead State analyst should gain an understanding of the modeling methods used (e.g., stochastic vs. deterministic) and be prepared to dialogue about and understand the material assumptions that affected the model output, such as prospective views on risks. The aforementioned dialogue may occur during either the financial analysis process and/or the financial examination process.

The Lead State analyst, after completing a summary of Section III, should assess the overall reasonableness of the capital position compared to the group’s estimated risk capital. Additionally, the Lead State analyst should also consider if any of the information, or any specific conclusions, should be used to update either the Group Profile Summary or Insurer Profile Summary.

Support the assessment of the reasonableness of capital by developing a narrative that considers the following:

- Actual Capital Amount  
Discuss the extent to which the group available capital amount exceeds the group risk 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 is taking to address the issue. Consider in that discussion, the section below that requires the Lead State analyst to consider the controls the group has in place relative to this issue. For all

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other groups, when considering if group capital is either well in excess of internal/rating capital or currently sufficient, consider all of the following 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 compared to a predefined minimum. That minimum, be it regulatory, rating agency, or economic, uses certain assumptions, including assumptions that may already provide a cushion. The Lead State analyst shall bear in mind the “Own” in ORSA, noting that each insurer’s methodology and stress testing will vary. However, the Lead State analyst should be able to develop and document the general methodology applied and how outputs from the prospective solvency calculations compare with recent trends for the group, and in general, be able to determine the sufficiency of 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. Document the extent to which the Lead State analyst believes the approach used by the insurer is reasonable for the nature, scale and complexity of the group and if this has any impact on the Lead State analyst’s assessment of the insurer’s overall risk management.

- Quality of Capital

If the insurer 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 meet policyholder obligations. 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 if 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, the Lead State analyst should consider asking the insurer the question.

- 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, particularly if there have been material changes in the group capital position year over year or material changes to business plans, operations, market conditions, without a corresponding change in group capital position. This information, as well as the Lead State analyst’s existing knowledge of the group, and its financial results, should be used to determine the overall reasonableness of the change in group capital and should be an input into evaluating the group capital calculation.

- Quantification of Reasonably Foreseeable and Relevant Material Risks

Discuss and document if the group capital fails to recognize any reasonably foreseeable and relevant material risks the Lead State analyst is aware of.

- Controls over Capital

Discuss the extent to which the ORSA Summary Report demonstrates the group has a strategy, including senior management or the Board oversight, for ensuring adequate group capital is maintained over time. 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.

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- Controls over Model Validation and or Independent Reviews

If the insurer uses an internal capital model, discuss the extent to which the group uses model validation and independent review to provide additional controls over the estimation of group capital. If no information on this issue exists within the ORSA Summary Report, consider asking the insurer the question. Lead State analysts and Lead State examiners are encouraged to look to the insurer's own process by which they assess the accuracy and robustness of its models, as well as how they govern model changes and parameter or assumption setting, and limit Lead State examiner-lead validation of model output to more targeted instances where conditions warrant additional analysis.

### **Review of Section III – Prospective Solvency Assessment**

The ORSA Guidance Manual requires the insurer to estimate its prospective solvency. Insurers may include in the ORSA Summary Report information developed as part of their strategic planning and may include pro forma financial information that displays possible outcomes as well as projected capital adequacy in those future periods based on the insurer's defined capital adequacy standard. The Lead State 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 at the insurer's particular capital adequacy under expected outcomes the group capital position will weaken, or recent trends may result in certain internal limits being breached, the Lead State 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.). It should be kept in mind, however, that a mere "weakening" of a group capital position, or even trends, are less relevant than whether group available capital exceeds the group's risk capital over the forecast period. The Lead State analyst should document its findings/review of this section.

### **Suggested Follow up by the Examination Team**

As noted at the end of each section the Lead State analyst should direct the Lead State examiner to those areas where such additional verification and testing is appropriate, and could not be performed by the Lead State analyst. If there are specific reports, information, and/or control processes addressed in the ORSA Summary Report that the Lead State analyst feels should be subject to additional review and verification by the examination team, the Lead State analyst is expected to provide direction as to its findings of specific items and/or recommended testing and such amounts should be listed in the template by the Lead State analyst. During planning for a financial examination, the Lead State examiner and Lead State analyst should work together to develop a plan for additional testing and follow-up where necessary. The plan should consider that the Lead State examiner may need to expand work to address areas of inquiry that may not be identifiable by the Lead State analyst.

In addition to this specific expectation, during each coordinated financial condition examination, the exam team as directed by the Lead State examiner and with input from the Lead State analyst 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 Lead State will direct the examination team to 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).

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**Lead State Analyst Template for Summary of Review**

Lead State Regulator’s Analysis of ORSA Summary Report  
Insurer XYZ  
Using ORSA Summary Reported Dated XX/XX/XXXX

**Section I**

Prepare a summary of Section I by developing an assessment of each of the five principles set forth in the ORSA Guidance Manual followed by a narrative that supports the assessment.

- 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 4 3 2 1 0

Supporting Narrative

- 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.

5 4 3 2 1 0

Supporting Narrative

- 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 set by senior management and reviewed and evaluated by the board of directors. (*e.g., relationship between risk tolerances and the amount and quality of risk capital*)

5 4 3 2 1 0

Supporting Narrative

- D. **Risk Management and Controls** - Managing risk is an ongoing ERM activity, operating at many levels within the insurer. (*e.g., monitoring processes and methods*)

5 4 3 2 1 0

Supporting Narrative

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- 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 4 3 2 1 0

Supporting Narrative

**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 followed by any factors outside of those already identified by the Lead State analyst in each of the above sections.

5 4 3 2 1 0

Supporting Narrative

**Section II**

Prepare a summary of Section II by identifying the significant reasonably foreseeable and material relevant risks of the insurer per the ORSA Summary Report, including those that may correspond to the nine branded risk classifications, if applicable. Following the evaluation or assessment of the reasonably foreseeable and material and relevant significant risks per the report, include an assessment of the insurer's analysis of such risks.

[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.]

1. Based on your knowledge of the group, did the insurer include in its ORSA a discussion of risks and related stresses that you consider appropriate for the group? **Note whether the following are applicable or not.**

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

Lead State Analyst Summary of Risks

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

Lead State Analyst Summary of Risks



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

Lead State Analyst Summary of Risks

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

Lead State Analyst Summary of Risks

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

Lead State Analyst Summary of Risks

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

Lead State Analyst Summary of Risks

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

Lead State Analyst Summary of Risks

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

Lead State Analyst Summary of Risks

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

Lead State Analyst Summary of Risks

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

Lead State Analyst Summary of Risks

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**Overall Risk Assessment Summary**

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

**Section III**

**Capital Assessment**

The Lead State analyst should summarize the overall assessment of capital followed by a narrative that supports that assessment.

The Lead State examiner should supplement the assessment by incorporating their own assessment of controls, culture, and internal detailed calculations of an insurer if the Lead State analyst was not able to obtain such information by interacting and analyzing supporting information.

**Prospective Solvency Assessment**

Document any findings from review of this section.

**Analyst Suggested Follow Up by the Lead State Examiner**

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

#	Description	Purpose
1	Walkthrough of risk tracking process and documentation in use	Verification
2	Interview select management for corroboration on risk committee responsibilities	Verification
3	Discuss assumptions, inputs, outputs of internal capital model as well as use and walkthrough change in any of the above	Understanding and documentation

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