ORSA
NAIC Insurance Summit
May 16, 2016 Kansas City
Presented by: Pat Tracy and LeeAnne Creevy

Agenda

• Global Approaches: ORSA Regimes
• EU–U.S. Insurance Project—Key Elements of Regulations and Supervisory Practices in Respect to Group ORSA
• ABC Company Example: Use of “ORSA Information” on Examination
• ORSA and Supervisory Colleges
• APPENDIX: ORSA and Examination Considerations
Learning Objectives

During today’s session, participants will learn about:

• Valuable background information about various approaches to ORSA regimes around the globe
• How the EU-U.S. Insurance Project has evolved and what an ORSA needs to cover under Solvency II in the European Union
• A high level comparison of the Solvency II three pillars as contrasted to the U.S. ORSA’s three sections
• An example (based on “ABC P&C Co.”) of how ORSA was integrated effectively into the risk-focused examination, leveraging international “ORSA-like” filings
• How ORSA can and should be incorporated into the Supervisory College process

Global Approaches: ORSA Regimes
<table>
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<th>Region/Country</th>
<th>Regulator</th>
<th>ORSA Regime</th>
<th>Guidance</th>
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<tr>
<td>Europe</td>
<td>European Insurance and Occupational Pensions Authority (&quot;EIOPA&quot;)</td>
<td>Solvency II</td>
<td>EIOPA-BoS-14/259, &quot;Final Report on Public Consultation No. 14/017 on Guidelines on own risk and solvency assessment&quot; (28 January 2015)</td>
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<td>U.K.</td>
<td>Prudential Regulation Authority (&quot;PRA&quot;)</td>
<td>Solvency II</td>
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<td>Australia</td>
<td>Australian Prudential Regulation Authority (&quot;APRA&quot;)</td>
<td>Internal Capital Adequacy Assessment Process (&quot;ICAAP&quot;)</td>
<td>Prudential Practice Guide CPG 110 – Internal Capital Adequacy Assessment Process and Supervisory Review</td>
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<td>Bermuda</td>
<td>Bermuda Monetary Authority</td>
<td>Commercial Insurer’s Solvency Self Assessment (&quot;CISSA&quot;)</td>
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<td>Switzerland</td>
<td>Swiss Financial Market Supervisory Authority (&quot;FINMA&quot;)</td>
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Global Approaches: ORSA Regimes

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<tr>
<td>Singapore</td>
<td>The Monetary Authority of Singapore (&quot;MAS&quot;)</td>
<td>ORSA</td>
<td>Notice 126 requires all licensed insurers in Singapore to establish the necessary processes and procedures to undertake an ORSA by 1 January 2014</td>
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<td>Japan</td>
<td>Japan Financial Services Authority (&quot;JFSA&quot;)</td>
<td>ORSA</td>
<td>The JFSA has been working to install a practice of ORSA reporting and to encourage insurance company management to simultaneously implement and upgrade its ERM framework</td>
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<td>China</td>
<td>China Insurance Regulatory Commission (&quot;CIRC&quot;)</td>
<td>China Risk Oriented Solvency System Conceptual Framework (&quot;C-ROSS&quot;)</td>
<td>The conceptual framework for C-ROSS consists of three components: Institutional Characteristics, Supervisory Pillars and Supervisory Foundation</td>
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Discussion Question

Q: Do you believe that foreign prospective risk filings should be supported by a common structure (e.g., the ERM foundation)?
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A: Yes! It makes sense to confirm that the same underlying risk policies, same overall risk appetite, and other similar key ERM components supporting global risk filings are in place.
Background Information on EU

- In the European Union (“EU”), insurance supervision is performed in each Member State by a relevant national supervisory authority.
- The pursuit of insurance and reinsurance business is harmonized at the EU level by the Solvency II regime, which will apply from 1 January 2016.
- The European Commission, the executive branch of the EU, is responsible for proposing new European laws to the Parliament and the Council. The core responsibilities of European Insurance and Occupational Pensions Authority (“EIOPA”) are to support the stability of the financial system, transparency of markets and financial products as well as the protection of policyholders, pension scheme members and beneficiaries.
- EIOPA is inter alia empowered to issue guidelines in order to ensure consistent application of the EU law.
- In the EU, all groups that fall under Solvency II group supervision regime are required to conduct an ORSA.

EIOPA’s Guidelines on ORSA

EIOPA’s Guidelines are addressed to competent authorities to:

- Provide for a sound and prudent risk management of undertakings through a better understanding of the undertaking’s overall solvency needs and capital allocation as well as the interrelation between risk and capital management in a forward looking perspective;
- Provide an additional perspective on solvency assessment by assessing the undertaking’s risk profile against the assumptions underlying the calculation of its regulatory capital requirements with a view to checking whether the risk profile is adequately covered by the Solvency Capital Requirement.
EU–U.S. Insurance Project

Nature of ORSA:
• In both regimes ORSA means the process of assessing the risk profile and capital needs necessary to address those risks in a forward-looking perspective. It is expected in both the U.S and the EU that ORSA is the group’s own assessment, therefore certain flexibility is provided as to the process to perform the exercise.
• The ORSA process should be unique to each group, reflecting its specific business, strategy, organizational structure and approach to risk management systems. It should also be appropriate to the group’s nature, scale and complexity of its risk profile.

Content of the ORSA:
• Under Solvency II, the ORSA needs to cover at least:
  – the overall solvency needs taking into account the group’s capital needs with regard to its specific risk profile, approved risk tolerance limits and the forward looking business strategy of the group;
  – the compliance, on a continuous and forward-looking basis, with regulatory capital requirements;
  – the significance with which the risk profile of the group deviates from the assumptions underlying the solvency capital requirement (SCR);
  – the group’s business actions taking into account the results from the above mentioned assessments.
Solvency II

• Solvency II is Europe’s risk-based solvency regime
• Based on three pillars:
  – quantitative capital requirements (Pillar 1)
  – governance and risk management (Pillar 2)—the ORSA is a key component
  – disclosure requirements (Pillar 3)
• ORSA guidance provided by EIOPA is deliberately non-prescriptive (similar to in the U.S., the ORSA is a customized assessment rather than a compliance exercise)
• The ORSA doesn’t serve as a regulatory capital requirement but might influence the capital held under Pillar 1, although the extent of that impact is unclear.
• By comparison, in the U.S., the ORSA Summary Report should address three major areas:
  – description of the Risk Management framework,
  – assessment of the risk exposure under normal and stressed conditions,
  – group assessment of risk capital and prospective solvency assessment.

ABC Company Example:
Use of “ORSA Information” on Examination
EU–U.S. Insurance Project

“In order for an ORSA report to be considered appropriate, both EU and U.S. supervisors will expect to bring the inputs and outputs from the ORSA together and provide the links and analysis between them (e.g., interconnectedness between the group business strategy and the group risk profile).” (page 6)

Discussion Question

Q: If a company is performing key stress tests (e.g., CAT modeling) at the U.S. level, would you expect to see the same key stress tests used consistently in both the U.S. and foreign filings?
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A: Yes! It’s hard to say a global CAT model is in place if the company is not doing broad-based stresses. Some jurisdictions have mandated stresses, but overall you should expect them to be consistent (e.g., ten ton truck bomb).

Discussion Question

Q: Is verifying consistent inputs and outputs supported by a common ERM process and stress testing consistent with the EU-U.S. guidance?
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Q: Is verifying consistent inputs and outputs supported by a common ERM process and stress testing consistent with the EU-U.S. guidance?

A: Yes! An effective ORSA bring the inputs and outputs together and links strategy to the ERM process at an enterprise-wide level.

BMA’s CISSA—Background Info.

BMA requires insurers to perform an assessment of their own risk and solvency requirements via the annual Commercial Insurer Solvency Self-Assessment (CISSA) Report.

The CISSA provides particulars on:

- Insurer’s comparison of CISSA capital to regulatory capital.
- Insurer’s plans for raising additional capital.
- Contingency arrangements impacting the available capital.
- Information on an insurer’s risk management and governance program.
- The review and approval of CISSA, and integration of CISSA into the strategic decision making process.
- Insurer’s assessment of material risks.
- Determination of both the quality and quantity of capital required to cover its risks.
- Forward looking analysis, ability to manage capital needs, and governance & controls surrounding models/tools used to compute the CISSA capital.

From BMA CISSA Return 2014 Instruction Handbook For Class 4, 3B & 3A (Re)Insurers.
FINMA’s SST—Background Info.

Swiss Financial Market Supervisory Authority (FINMA)’s Swiss Solvency Test (SST)

- Designed to capture the economic risk situation of insurance companies.
- Goal is to protect policyholders from the consequences should an insurance company become insolvent.
- Defines the minimum amount of economic capital that an insurer must have based on risks assumed (Target Capital).
- The insurer determines its available capital by assigning a value to each position of the assets and liabilities in its balance sheet on a market-consistent basis.
- The insurer then assesses whether the identified available capital can meet the SST requirements.
- The insurer must be clear about the risks that its balance sheet is exposed to and their effect on the available capital in the event of a worst case scenario (i.e. under stress).
- Considers all the relevant market, credit and insurance risks. Pays particular attention to scenarios where multiple risk factors could deteriorate simultaneously.
- Insurers can use a standard model prescribed by FINMA to assess their risks or they can use internal models upon FINMA’s approval.

From FINMA Swiss Solvency Fact Sheet dated October 1, 2014.

ORSA

ABC Company (P&C) Example

- ORSA assisted with the identification of prospective solvency risks and the related mitigating controls
  - A Risk Register was provided at the Supervisory College as part of CRO’s “Group ORSA Summary” presentation
- ORSA was utilized by the examination team in the following critical areas of the examination:
  - Reserves
  - Pricing/Underwriting
  - Reinsurance
  - Capital Management
  - Liquidity Risk
  - Credit Risk
  - Model Risk
  - CAT Risk
  - Rating Agency Risk
  - Cyber Risk
  - U.S. Drought/Climate Change
  - Economic Downturn Risk

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ORSA
ABC Company (P&C) Example

- Assessed economic capital and liquidity in multiple areas under stress, including run-off operations and financing of ABC Company’s acquisition of another entity.
- Performed testing of various areas to verify and validate the information
- Gained an understanding of the assumptions used in the global capital management process
- Gained an understanding of the outputs from ABC Company’s economic capital model
- Utilized the information provided to address various significant risks (e.g., testing a “dirty bomb” stress scenario as part of stress testing)

Critical information and conclusions were obtained based on preliminary review; for example:

- **Excess (undeployed) capital at December 31st of $3.1 billion**
  - This amount compares tangible capital of $13.8 billion to the $10.7 billion needed to maintain the S&P rating.
  - ABC Co. estimates it needs $9.6 billion to fulfill existing claim obligations and future business operations but they used the higher S&P amount of $10.7 billion.
  - It’s noteworthy that this $10.7 billion is substantially higher than the $7.2 billion of regulatory entity required capital.
  - The $3.5 billion excess over statutory minimums reduces prospective solvency risk.
ORSA
ABC Company (P&C) Example

• International coordination and leverage of U.S. ORSA to foreign prospective risk filings
  – Showcases strength of U.S. framework regarding verification of ERM and stress tests on examinations
  – Assessed the financial strength of each
  – Reviewed solvency reports filed with other regulators: BMA (Bermuda) and FINMA (Switzerland)
  – Tied the information in those solvency reports into ORSA to ensure consistency

ORSA
ABC Company (P&C) Example

• Reviewed solvency reports filed with two international regulators: FINMA (Switzerland) and the BMA (Bermuda) to increase international coordination and leverage on the examination

• Conclusions:
  – Same global ERM process in the U.S. was utilized for filings with FINMA and BMA
  – Common Risk Management Framework utilized, which was customized to risks/controls specific to the legal entity
  – Same stress tests used, where appropriate, with ABC Co.'s ERM foundation as the base
Incorporating ORSA into the Supervisory College Meeting

EU–U.S. Insurance Project

“ORSA is thus an integral part of the ERM for both European and U.S. insurers and groups. It should also be an essential element of the business strategy and the process of taking strategic decisions at the level of the group and of an individual undertaking. These commonalities should help both European and the U.S. groups meet expectations of supervisory authorities as they operate on a transatlantic basis..” (page 5)
Supervisory Colleges

- ORSA clearly is the subject of interest of Supervisory Colleges; exchange of relevant information in different formats (in some cases the whole ORSA report, in others only a report of the supervisory review)
- If an ORSA report is done well, it should provide supervisors with:
  - information on the key risks facing the firm,
  - risk tolerances, and
  - the capital the firm holds against risks and management actions they can take on a forward-looking basis.
- In judging the quality of an ORSA report, the supervisors are expected to take into account the ORSA report itself but also their own knowledge of the group’s business.


Supervisory Colleges

- Lead State presents highlights of ORSA at Supervisory College
  - Judgement as to whether the ORSA report is an adequate assessment of the own risks and solvency both at solo and at group level
  - Outputs from the ORSA utilized in relevant decision-making processes
  - Discussion related to areas of potential regulatory concern or major issues regarding the risk profile of the group and/or of specific entities
  - Identification of future follow up/enhancement areas for Company’s next ORSA filing
- Differentiating between good risk management and good ENTERPRISE risk management
- Coordination is needed to properly test and understand a global ORSA (new report for U.S. regulators but perhaps not for foreign regulators)
- As more inputs/outputs are reviewed and vetted, users can better assess what tools/reports do the best job at identifying key prospective solvency risks and concerns
Supervisory Colleges

• ORSA report provides valuable information to regulators, allowing for a better assessment of an insurer’s risk management approach and an understanding of where individual insurers fall in the spectrum of ERM practices.

• American Academy of Actuaries Paper, “ORSA and the Regulator” (February 2016)—Key concepts:
  – Why ORSA is different from other filings
  – Insight on risk exposures
  – Insight on capital adequacy
  – View on industry wide risks
  – Insight on assessing the maturity of a company’s ERM process

Questions?

Thank you for attending and for your participation!
APPENDIX:
ORSAs and Examination Considerations

Examination Considerations

• Value of ORSA to examination
  – Can objectively demonstrate the effectiveness of the insurance model under stress
  – Can clearly articulate, with verifiable data, how the assets and liabilities are expected to react under stress
  – The stressing required by ORSA can be reviewed using this existing framework
  – Can speed up Phases 1 & 2, particularly related to risk identification and assessment

• The discipline of relating the risk to the capital needed is an area of strength of the U.S. ORSA process
Examination Considerations

- Can improve examination and speed up exam work
  - P&C company example: used ORSA documentation to:
    - Assess reserve and underwriting risk content to reduce time spent testing 12/31 balances,
    - address A&E risk,
    - Assist with certified reinsurance testing,
    - Evaluation of run-off businesses,
    - Test adverse reserve development

Use of ORSA in Phases 1, 2 and 3

- If mature, the ORSA Summary Report is a great source of identifying key prospective risks facing the Company
  - Review prior to conducting C-level management interviews and before completing Exhibit DD on Critical Risk Categories
- High inherent risks identified by the Company can be compared to the following:
  - Supervisory College input
  - Lead state’s and participating states’ specifically identified risk areas
  - Financial analysis key documents (e.g., Holding Company Analysis and Group Profile Summary)
- Risk mitigation insight:
  - What has the Company done to mitigate key risk areas? Has this been validated? Can the examiner leverage that work?
Other Examination Considerations

• The examination process—future ORSA considerations
  – The ability and strength of the U.S. State-based process to understand, test and verify should be applied to ORSA
  – Practitioner guidance will continue to develop in this area
  – Continued emphasis on testing key prospective solvency risks
• Eventually, examiners can compare results of current year’s ORSA to past 1-2 years’ ORSA reports and identify questions relative to emerging risk trends and other analytical variations