ORSA – Lessons Learned from Both Sides of the Table

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Objectives

• Enhance understanding of the purpose and key contents of ORSA
• Gain insights from the Company perspective into ORSA process, reporting, and challenges
• Strengthen Examiner and Analyst ability to gain value from the ORSA Summary Report
Session Outline and Approach

• Enterprise risk management (ERM) – brief overview
• Observations regarding ORSA Sections 1, 2, and 3
  - Reference to NAIC ORSA Guidance Manual
  - Company experience, observations and challenges in implementation
  - Analyst and examiner insights
• Selected Do’s and Don’ts for company and regulators
• Summary
• Q&A
Fundamental Importance of ERM - Help Protect and Enhance Enterprise Value

• Contribute to enhanced risk governance
• Help ensure alignment of strategy with risk appetite
• Contribute to reducing unacceptable performance volatility; minimize surprises
• Contribute to confidence of stakeholders
• Support successful responses to changing business environment
Factors Affecting Corporate ERM Acceptance - Integration - Effectiveness

• Reporting channel within the organization
• Capability and adequacy of ERM resources
• Challenges in demonstrating ERM value
• Perception of ERM existing solely to say “no”
• Effectiveness of collaboration
• Board of Directors engagement
Do Companies Walk the ERM Talk?

Positive Indicators

• Widespread involvement of key personnel
• Evidence of senior management and Board attention to risk
• Examples of breach or near-breach of risk tolerances
• ERM success stories and lessons learned
• Areas identified for improvement
• Emerging risks identified and considered
• Examples of risk-based decision making and saying “no”
• Other …
Do Companies Walk the ERM Talk?

**Negative Indicators**

- Limited involvement of key personnel - paper exercise of a few people
- Minimal senior management or Board awareness
- Risk tolerances not operationalized
- Absence of lessons learned
- Few emerging risks identified or considered
- Minimal quantification of risk exposures
- Other …
ORSA has two primary goals

1) To foster an effective level of ERM at all insurers…

and

2) To provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view.
What is Required in the ORSA?

• **Section 1** - Description of the Insurer’s Enterprise Risk Management Framework
• **Section 2** - Insurer Assessment of Risk Exposures
• **Section 3** - Group Assessment of Risk Capital and Prospective Solvency Assessment
Section 1 of the ORSA

A high-level summary of the five key principles of the insurer’s ERM framework:

• Risk Culture and Governance
• Risk Identification and Prioritization
• Risk Appetite, Tolerances and Limits
• Risk Management and Controls
• Risk Reporting and Communication
• The governance structure should clearly define and articulate roles, responsibilities and accountabilities.

• Risk culture should support accountability in risk-based decision making.

• Proper calibration to the complexity of the business
• The risk identification and prioritization process is key to the organization
• Risk management function should ensure the process is appropriate and functioning properly at all organizational levels
• Use multiple sources for identifying risks
• Consider emerging and prospective risks
• Leverage existing risk information
• Prioritization factors

Section 1 - Risk Identification and Prioritization
• A risk appetite statement and associated tolerances and limits are foundational elements of ERM
• Should align with strategy set by senior management and the board of directors
• Often contain both quantitative and qualitative aspects
• Challenging to set and operationalize; expect continued refinement over time
• Avoid terminology concerns
• Ongoing monitoring and escalation process needed
• Managing risks is an ongoing fundamental ERM activity, operating at many levels within the organization

• Risk responses and treatment include:
  – Avoid
  – Reduce/mitigate through controls
  – Transfer/share
  – Accept
• Risk reporting and communication should facilitate the management of risks at the level within the organization where decisions are made

• Should provide key constituents with information about risk management processes and support decisions on risk-taking
ERM Framework Conversation Example

“We need an ERM framework!”
ERM Framework Conversation Example

“Yes, but you had losses”
Similarity of ERM Frameworks

- ORSA
- COSO
- ISO
- Proprietary

ALL HAVE SIMILAR COMPONENTS - TERMINOLOGY MAY VARY
Provide a high-level summary of the quantitative and/or qualitative assessments of risk exposure for each material and relevant risk category.
Section 2 - Insurer Assessment of Risk Exposures

• May include: descriptions and explanations of the material and relevant risks identified, the assessment methods used, key assumptions, risk mitigation activities, and outcomes of adverse scenarios assessed
• Methods of assessing risk vary
• Analyze results under both normal and stressed environments
• Generally consider likelihood and impact
• Consider impact of stresses on capital
Assessments of Risk Exposures

- Quantitative approaches and modeling
  - Deterministic
  - Stochastic
- Challenges to quantification
- Qualitative approaches to risk assessment
Is the risk assessment process and stress testing adequate?

- Linkage to risk identification in ORSA Section 1
  - Completeness of key risks
  - Reasonable coverage of NAIC Branded Risks
- Assessment approaches utilized
  - Quantitative and/or qualitative
  - Monitoring process and metrics
- Selection of normal and stress scenarios
  - Involvement of subject matter experts
  - Company and industry experience
Section 2 - Insurer Assessment of Risk Exposures

FCEH:

“If the Company has done a good job of identifying and addressing its risks in this section, examiners should be able to significantly leverage this information in completing the 7-phase exam process.”
Section 3 of the ORSA

• Assist regulators in assessing the quality of the insurer’s risk and capital management

• Describe how the insurer combines the elements of its risk management policy with the quantitative measures of risk exposure to determine the level of financial resources needed to manage its current business and over a longer term cycle
Capital Assessment Process - Link to Business Planning

Exhibit DD - Capital Management Critical Risk:

This category encompasses the company’s ability to assess, manage and maintain sufficient capital to sustain its business plan and solvency position. Considerations may also include a company’s ability to forecast its capital needs and obtain additional capital, if necessary.
Capital Assessment Process - Link to Business Planning

NAIC ORSA Guidance Manual:

The insurer’s capital assessment process should be closely tied to business planning. To this end, the insurer should have a robust capital forecasting capability that supports its management of risk over the planning time horizon in line with its stated risk appetite.
Capital Assessment Process - Link to Business Planning

- As a general rule, ERM should be an integral part of business planning
- Capital measurement, assessment, and planning are integral parts of ERM
- Capital adequacy should be a consideration in the company’s strategy
- Availability of financial resources to cover key risks
Multi-Year Prospective Solvency Assessment

• Closely tied to business planning
• Consider material and relevant changes
  - Internal operations
  - External business environment
• Should include a projection of future financial condition
  - Normal environment
  - Stressed environments
• Prospective risk discussion
Prospective Solvency Assessment

• Demonstrate that it has the financial resources to execute its multi-year business plan in accordance with risk appetite;

or

• Describe the plan (actions it has taken or will take) to meet its current and projected risk capital requirements.
  • May include additional sources of capital
  • May involve modifications to the business plan
Capital Models

Beware of false precision!

- Many aspects of these models are judgmental
- Difficult to assess true tail scenario likelihoods and severities
- Don’t get overly hung up on a 1-in-250 vs. a 1-in-500, etc.
- Focus on overall meaning, trends, and strength of process and monitoring
Insurance Company Value Derived from ORSA

• Should be “real to the business”, not just a compliance exercise
  - Improvements achieved and sought in ERM processes
  - Relevance to risk-based decision making

• Worthwhile insights provided by stress testing

• Critical linkage for the capital and prospective solvency assessment
  - Link to risk appetite, business, and strategic planning
  - Involve the right people

• Additional capital resources and/or business plan modifications
Company Perspective – Do

• View ORSA as a process
• Involve many contributors
• Operationalize risk metrics
• Select meaningful stress scenarios
• Consider diversification and concurrent stress events
• Link ORSA to business plan
• Emphasize Board awareness
Company Perspective - Don’t

- Treat ORSA as a mere compliance exercise
- Get hung up on terminology
- Fail to acknowledge ERM failings and opportunities for improvement
- Get trapped by the “illusion” of precision
Regulator Perspective - Do

• Use ORSA to learn about the Company
• Look for indicators of the ERM framework in use
• Consider company and industry history regarding stress environments
• Leverage ORSA for analysis and examinations
Regulator Perspective - Don’t

- Limit ORSA inquiry too narrowly
- Get too prescriptive or emphasize form over content
- Expect or rely on crystal ball precision
- Fail to recognize that ERM and ORSA are dynamic
Summary of Key Points

• Companies can derive benefits from the ORSA process and reporting
  - Discipline, documentation, communication

• The ORSA contains much information of value to analysts and examiners
  - Enhanced understanding of risks, stresses, and solvency considerations
Questions
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