Insurance Regulation – On the Move
ORSA – How to be prepared

With the announcement of the Own Risk and Solvency Assessment (ORSA) by the National Association of Insurance Commissioners (NAIC), some of the key questions on the minds of management at insurance companies include:

- What is an ORSA?
- Will our firm be part of the NAIC ORSA pilot program?
- If we produce an ORSA in another country, can we use this to meet our U.S. requirements?
- How might it affect our firm?
- What does an ORSA require?

What is an ORSA?

In a nutshell, the ORSA will be a mandatory reporting requirement applicable to many reinsurance undertakings. It is a new concept aimed at enhancing awareness and understanding of all significant risks, their interdependencies and impact on the company's available capital and its own view of capital needs. One of the critical requirements of the ORSA is that a company should not only demonstrate current capital needs are appropriate but also that future capital needs will be met over a specified assessment timeframe. It is the forward-looking nature of the ORSA and the group assessment requirements that present the most likely challenges for insurers.

What is the expected timing in the United States?

With a number of fundamental elements in the ORSA Guidance Manual having been approved in November 2011 by the NAIC's Group Solvency Issues Working Group, the ORSA is very close to being adopted.

The NAIC hopes to have an ORSA requirement in place by the end of 2012 and to give insurers a year to vet the process before the 2014 Financial Sector Assessment review. The current effective date for the requirement is January 1, 2015, with insurers expected to file their first ORSA Summary Report (as discussed below) during that year. However, in order to be able to do that, insurers must already be tracking and collecting appropriate data during the 2013 calendar year.

What has to be done to comply?

The key questions at hand are: what do I have to do to comply and what does this require?

A key lesson to be learned from other jurisdictions that are implementing ORSA is that firms must take time to decide what the ORSA will deliver and how it can be done right the first time. Establishing a program to deliver may not be the right approach and may lead to the "road being dug up" more than once.

The ORSA has a number of components required to be included in it such as:

The past and present solvency requirements of the insurer, involving analysis of:

- Technical provisions
- Decision-making
- Overall solvency needs
- Capital deviations

Future solvency requirements, involving:

- The insurer's risk profile
- Solvency projections
- Strategy links
- Stress and scenario tests

The ORSA design:

- Risk-based model
- Integration – multidisciplinary requirements
- Frequency – metrics
- Group capital assessment

Application across the business:

- Proportionality
- Valuation
- Independent challenge
- Documentation/ORSA report

Since compliance with any new requirement as expansive as the ORSA entails significant lead time in preparation of people, systems and processes, now is as good a time as any to get started. In considering this, it is important to engage:

Actuarial – to perform calculations and assist with the use of models, if used

Risk – to assist with the development of the ERM framework

Underwriting – provide input into the underwriting risks and assist with the future business plans

Internal Audit – provide an independent oversight to the ORSA process

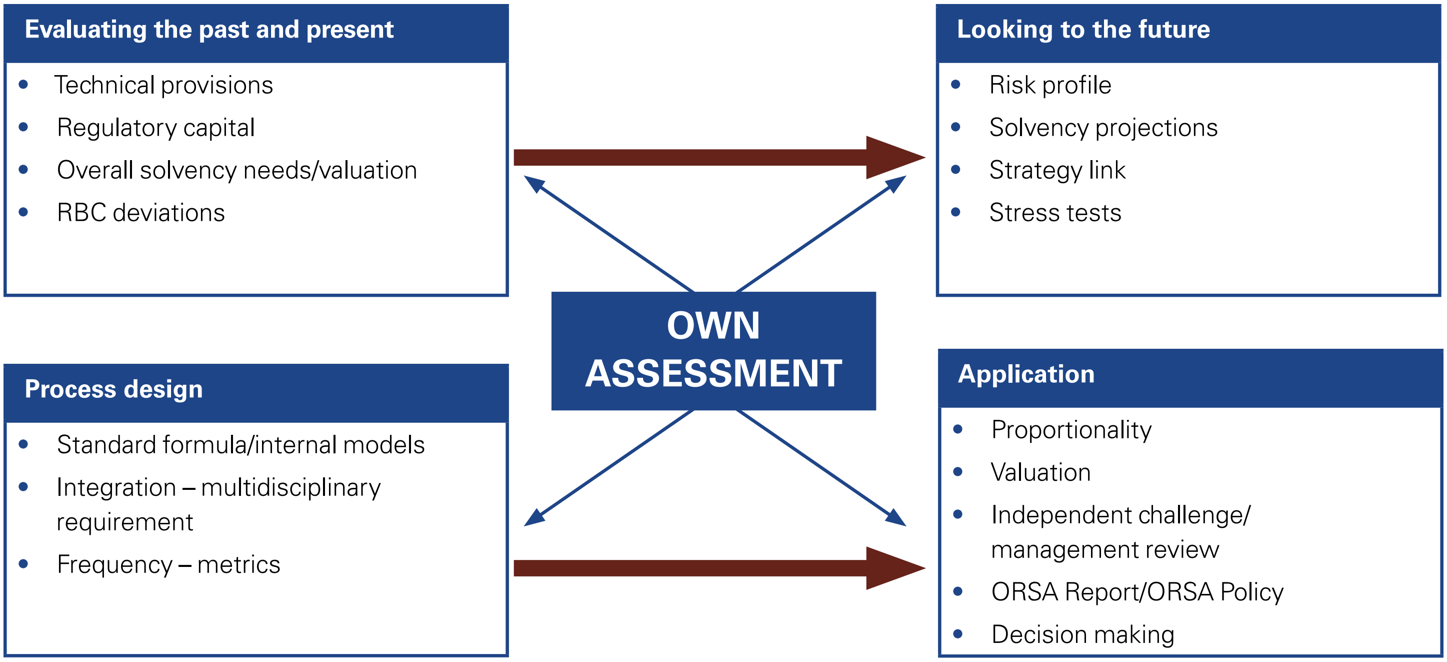
Information Technology – to enhance systems required for ORSA production (quality data and accuracy of production environment) and if needed assist with filing process

Compliance – consider ORSA compliance risks and the nature of the exposure, provide a mechanism to identify changing regulations

Finance – production of financial reporting numbers and the projecting forward metric within the business plan, help develop consolidation process

Investments – provide ALM details into the ORSA process and investment data, as required.

The critical components of an ORSA are:



Elements of the NAIC's ORSA requirements

What is required and what does it look like? In practical terms, it is envisioned that the ORSA will require the development of procedures, processes and governance to provide for a continuous forward-looking assessment of all risks (present and future) that could materially impact the firm's financial standing. This process should demonstrate the links between the company's own view of risks and overall own view of capital needs and form an integral part of the way the business is managed, be comprehensively documented and subject to oversight and challenge by the management body as part of their annual planning cycle.

Although each year insurers will need to conduct the full ORSA process, only an annual ORSA Summary Report will be filed with regulators. To the extent that regulators request additional information, insurers will have to provide backup documentation and materials regarding the ORSA process that they undertook. It is unclear at present whether the Summary Report will be filed only with the lead state regulator or with all pertinent regulators at the same time. There has also been discussion of a central repository for filings or the sharing of filings with the NAIC, both of which the industry has opposed on confidentiality grounds.

The ORSA Summary Report to be filed with regulators will contain three sections:

- Section 1 – Description of the Risk Management Policy
- Section 2 – Quantitative Measurements of Risk Exposure in Normal and Stressed Environments
- Section 3 – Group Economic Capital and Prospective Solvency Assessment

Section 1 discusses the insurer's risk culture and governance; risk identification and prioritization; risk appetite, tolerances and limits; risk management and controls; risk reporting and communication. The insurer's risk policies should also be included in this section of the document to evidence it has a well-thought-out and comprehensive risk framework in place.

While Section 1 focuses upon the more qualitative aspects of an insurer's risk framework, Section 2 is expected to contain hard numbers with respect to measurements of risk exposure in normal and stressed environments. Companies should be prepared to discuss expected values in normal and stressed environments, reverse stress test factors, measurement types, etc.

Section 3 contains an assessment of economic capital at the group level and a prospective solvency assessment. As part of the economic capital assessment, insurers should explain and calculate, as necessary, their definition of solvency, time horizon of risk exposure, risks to be modeled, how risks are quantified, measurement metric and target capital level. The prospective solvency assessment should be approximately a two-to-five-year forward assessment with a demonstration of the linkage between the insurer's strategy and business planning and the amount and quality of its capital. It is important here to note that regulators may critique and dictate elements of an insurer's stress tests as well as provide input on the parameters utilized in stochastic risk analyses. However, the regulators will not dictate on what basis the modeling for the ORSA Summary Report should be performed as GAAP, Statutory, IFRS or other basis is permitted.

Specific world-case studies regarding ORSA implementation are limited; however, let's look at how we can approach ORSA in the practical arena:

- Performance Enhancement: A new product launch comes with much risk. From risk inherent to the product itself such as product pricing, to external risk stemming from distribution channels and regulatory risk, a new product launch may be the perfect time to initiate the ORSA process, especially if the new product is outside of the typical products offered by the insurer. Going through the ORSA process would entail a rigorous review of the current risks facing the company, projections of prospective risks incident to the product launch and combining the two to feedback into the insurer's business plan for the product. In addition, the insurer would also need to factor in the expected effect from the product on company capital and to take the appropriate steps to safeguard capital. It would thus be embedded in corporate processes and culture to conduct thorough risk identification, evaluation and optimization before taking significant actions.
- Capital Management: Effective capital management is one of the cornerstones of insurer solvency. In this regard, the ORSA process can be employed as a key tool in identifying current and prospective risks to an insurer's capital base. For example, during the annual ORSA process, an insurer may come to understand that its current capital base is inadequate when compared against its risk profile. As such, it may decide to enter into alternative risk transfer transactions such as reinsurance agreements, which themselves may undergo an ORSA process. The insurer may then rigorously evaluate the operational, credit, market risk, reinsurance, regulatory and capital risk inherent in any such transaction and decide whether it should move forward with the transaction or not. This ensures that all significant actions taken by the insurer are within risk tolerances and in alignment with its risk profile.
- Prospective Risk: An integral aspect of the ORSA is the creation of a rigorous process around the identification and assessment of prospective risk. A process such as this could have been useful in the identification of unclaimed benefits risk for life insurers. For example, as part of a rigorous and robust ORSA, insurers would have reviewed their claims payment processes and could have identified a gap with respect to processes and procedures related to death benefits that were never paid. Once this gap was identified, insurers would likely have addressed it since it would have been part of a report to regulators.

A key question that has arisen for multinational insurers, who will be complying with ORSA requirements in other jurisdictions, is whether such other ORSA may be used to comply with the U.S. ORSA requirement. Although the NAIC has at various times expressed the intention to allow for another jurisdiction's ORSA to satisfy U.S. requirements, insurers should keep in mind that there may be jurisdictional differences in the ORSA standards and the consideration of what a group is. There will be an ORSA Feedback Pilot Project in 2012 consisting of five to ten insurance groups who will work with the NAIC with respect to conducting the ORSA process and creating an ORSA Summary Report. Insurers will want to be a part of the pilot which may provide them with the opportunity to shape what the final ORSA requirement looks like, as well as allowing them to receive regulator feedback on their individual ORSA reports.

ORSA in practice

As explained, the ORSA is about the entirety of the processes and procedures to both assess risks and determine the level of capital needed to ensure both the firm/group's capital needs and its regulatory requirements are met at all times. Some in the industry have said that it is the continuous, forward-looking nature of the requirements that makes this effort more complicated.

Although there are few real world case studies with respect to ORSA implementation due to its recent acceptance, it is helpful to look at what a robust ORSA may look like in a real world setting. This involves:

- Looking back at historic information and determining what has driven changes in the level of technical provisions and capital
- Considering the impact of this on both current and future risk profile and capital position
- Assessing the impact of the business plans on the risk profile, including considering the impact of internal or external stressed events
- Ensuring that the economic capital calculation basis remains appropriate given the risk profile
- Developing monitoring tools and reporting metrics
- Embedding the ORSA across the business
- Dynamic reassessment of impact of changes in risk profile and clear understanding of ad hoc ORSA triggers and processes.

Lessons from the EU implementation of ORSA

Drawing on previous experience, we have highlighted the following key challenges:

- A clear strategic view is required by the board and senior management to establish sponsorship and ownership of the ORSA. Setting clear deliverables and assigning responsibilities for delivery are essential.
- A clear and well-articulated program plan is necessary to obtain key stakeholder buy-in and support in order to deliver a high-quality roadmap for continued stakeholder input and contribution.
- Failing to appropriately manage the various cultural perspectives and appreciate the differences in approach, input and emphasis amongst group entities is a considerable weakness of many large group change programs.
- Good planning and project management are essential in being able to bring together the necessary interactions and linkages between regulatory capital, own assessment of capital needs, and reporting.
- Identification of key resources and specific skill sets across all relevant business units will be required in order to ensure that appropriate personnel are fully engaged—including, as a minimum: risk, finance, strategy, actuarial, audit, compliance, HR and treasury operations.
- The ultimate success of an ORSA is in being able to demonstrate a smooth integration of the process and outputs within business as usual activities such as board oversight and responsibilities, strategic planning, risk and capital management, governance and internal controls and reporting and disclosure elements.
- The requirement to evidence the ORSA will make documentation extremely important particularly for external reporting purposes.
- Given the ORSA inputs will come from a multitude of stakeholders and the outputs will be in varied formats, ensuring appropriate and timely management information is therefore critical in providing a firm the ability to adequately report on its current status.
- Data and system issues are likely to present significant challenges.
- The issue of reporting and confidentiality is still critical. It is possible that the rating agency community will utilize the ORSA. It is therefore essential that firms aim to capture all the risk management processes within their organization in order to convey the most compelling evidence for external purposes.

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