Current insights for ORSA implementation
April 23, 215
Introductions

Dan Buttke, Baker Tilly

Dan is a senior manager with the financial services industry group and has been with the firm since 2005, prior to which he worked for a national firm. Dan specializes in providing audit and consulting services to health and P&C providers, with particular focus in statutory reporting, internal control compliance, and ORSA readiness. Dan is an IASA volunteer at the national level, and is currently working with a panel of industry representatives and regulators to develop the content for the accounting Super Session at the national conference, which will focus on ORSA.

Eric Moser, Illinois Department of Insurance

Eric is a Senior Financial Analyst at the Illinois Department of Insurance and has 17 years of experience working with Property and Casualty insurers. In addition to his analysis duties, he represents the Department on various National Association of Insurance Commissioners Task Forces and Working Groups, including the ORSA Subgroup, which has performed ORSA pilot review projects on volunteer companies and groups in 2012, 2013 and 2014.
I. What is ORSA?

II. What is enterprise risk management?

III. Key ERM challenges

IV. Sections of an ORSA Summary Report

V. Building the engine for the ERM process

VI. Risk assessment process

VII. Review process

VIII. Questions?
WHAT IS ORSA?
The Own Risk and Solvency Assessment (ORSA) is becoming a key part of the regulatory framework for US insurers.

The ORSA Guidance Manual states that ORSA is:

> A component of the insurer’s Enterprise Risk Management (ERM) framework

> A confidential internal assessment appropriate to the nature, scale, and complexity of an insurer conducted by that insurer of the material and relevant risks identified by the insurer associated with an insurer’s current business plan and the sufficiency of capital resources to support those risks
The ORSA Guidance Manual states that ORSA is required for those companies that do not qualify for an exemption:

> The individual insurer’s annual direct written and unaffiliated assumed premium, including international direct and assumed premium but excluding premiums reinsured with the Federal Crop Insurance Corporation and the National Flood Insurance Program, is less than $500 million

> If the insurer is a member of an insurance group and the insurance group’s (all insurance legal entities within the group) annual direct written and unaffiliated assumed premium, including international direct and assumed premium but excluding premiums reinsured with the Federal Crop Insurance Corporation and the National Flood Insurance Program, is less than $1 billion

*(this info is also in the Illinois RMORSA Law, which is Section 5/129)*
Overall, the ORSA is essentially an internal assessment of the risks associated with an insurer’s current business plan, and the sufficiency of capital resources to support those risks.
ORSA’s two primary goals

> To foster an effective level of enterprise risk management at all insurers, through which each insurer identifies and quantifies its material and relevant risks, 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

> To provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view
General guidance

The ORSA process is one element of an insurer’s broader Enterprise Risk Management (ERM) framework. It links the insurer’s risk identification, measurement, and prioritization processes with capital management and strategic planning.

Effective date: January 1, 2015 with the first Summary Report filing sometime in 2015, a date yet to be determined.

High-level ORSA Summary Report annually to the domiciliary regulator, if requested.
General guidance

> Each ORSA process will be unique

> The ORSA Summary Report will be used to gain a high-level understanding of the process

> The report will be supported by the insurer’s internal risk management materials

> Minimum the ORSA Summary Report should discuss:
  – Section 1: Description of the insurer’s risk management framework
  – Section 2: Insurer’s assessment of risk exposure
  – Section 3: Group risk capital and prospective solvency assessment
2013 ORSA guidance revisions

> Identify the basis of accounting for the ORSA Summary Report (e.g., GAAP, SAP, or IFRS)

> Explain the scope of the ORSA such that the ORSA Summary Report identifies which entities within the group are included, possibly accompanied by an organizational chart

> Include a summary of material changes to the ORSA from the prior year

> Provide a comparative view of risk capital from the prior year

> Included changes to synchronize guidance in the Manual with the requirements in the adopted Risk Management and Own Risk and Solvency Assessment Model Act (#505)
An ORSA program sets up a corporate governance structure.

> To obtain information regarding guidance and oversight provided by the board of directors and executive management, the examiner must understand the corporate governance structure and be able to assess the “tone at the top”.

> This information, along with information on how the insurer identifies, controls, monitors, evaluates, and responds to risks will enhance the examiner’s consideration of current and prospective risk areas and assist with the appropriate determination of detailed examination procedures that should be performed as described in the NAIC’s 2012 Financial Examination handbook.
WHAT IS ENTERPRISE RISK MANAGEMENT?
What is enterprise risk management?

Traditional risk management, risk-based regulation, and capital management are converging.

- **Compliance**
  - SOX, Model Audit Rule, regulation driven - if you manage controls you have managed risks

- **Asset protection**
  - Corporate insurance, loss prevention, fraud, privacy, health & safety, business continuity

- **Risk analytics**
  - Risk & control assessments, loss impact & probability and scenario analysis, risk dashboards

- **Financial modeling**
  - Catastrophe risk & economic capital modeling, capital allocation, financial forecasting rating agency & reg capital

- **Strategy and planning**
  - Key risks to meeting objectives; strategic, operational & emerging risks; risk appetite statements

Across all functional Business Units (e.g. Claims, Human Resources)
What is ERM?

The process by which organizations identify, measure, monitor, and exploit key risks for the purpose of meeting business objectives and increasing shareholder value.
What is enterprise risk management?

What is the ERM Value Proposition?

One perspective…

> To maximize return from an organizations chosen risk profile

> Achieved by use of a risk-based decision making processes that supports achievement of business objectives, and leverage the firms business acumen, analytics, and financial modeling capabilities
KEY ERM CHALLENGES
Some key ERM challenges

1) Insurers may not have effective ERM programs in place today & struggle to realize an **ERM Value Proposition**. This Value Proposition is simply to optimize return from a chosen risk-profile.

2) This Value Proposition can be achieved by employing an **ERM Framework** that enriches risk-based decision making processes, leveraging business and financial acumen across an organization.

3) This ERM Framework needs to be closely tied to the managing key business risks to be meeting strategic business objectives – the risks that really matter!

4) Some organizations struggle to clearly articulate **Key Risks to Meeting Business Objectives** - and their chosen **Risk Profile** - to key stakeholders such as: employees, management, board of directors, regulators, shareholders, policyholders, and rating agencies.

5) **Risk Profile** can be expressed as **Risk Appetite Statements** or **Risk Tolerance Levels**, and should be defined as the level of risk a company is willing to accept in pursuing its goals & objectives.

6) Some consider **Risk Appetite** to be a theoretical concept, but organizations already have a risk appetite; the question is whether a mutual understanding exists between the board, management, and employees as to what it is.

7) **Risk Appetites** should be clearly linked to risks to meeting business objectives and demonstrate these key risks are effectively being **Identified, Evaluated, Quantified, Monitored, and Mitigated**.

8) Output from **Financial Models** such as capital models, catastrophe models, and financial projections (whether stochastic, deterministic, or cash-flow driven) can be utilized to assess risk reward trade-offs and create a linkage between risk appetite and risk-based decision making.
SECTIONS OF AN ORSA SUMMARY REPORT
Section 1: Description of ERM Framework

> Risk culture and governance
> Risk identification and prioritization
> Risk appetite, tolerance, and limits
> Risk management and controls
> Risk reporting and communication

Section 2: Insurer Assessment of Risk Exposures

Section 3: Group Assessment of Risk Capital and Prospective Solvency Assessment

> Group assessment of risk capital
> Prospective solvency assessment
ORSA Summary Report: Table of contents

Section 1
1) Risk Management Policy Statement (objectives, approach, and culture)
2) Corporate and Risk Governance (management boards and risk committees)
3) Business and Financial Management Planning Cycles (business strategy)
4) Risk Management Communication and Reporting Cycles

Section 2
1) Risk and Control Assessment and Monitoring Framework
2) Identification, Classification, Quantification, and Prioritization of Business Risks
3) Risk Appetite Statements and Risk Tolerance Limits
4) Key Business Risk Mitigation and Management Action Plans

Section 3
1) Use Economic Capital Models (BCAR, ECM, RBC) and Financial Models (EAR)
2) Independent Assurance (actuarial review, internal and external audit)
## COSO 2013 Framework

<table>
<thead>
<tr>
<th>Control Objective</th>
<th>Principle</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Control Environment</strong></td>
<td>1. Demonstrates commitment to integrity &amp; ethical values</td>
</tr>
<tr>
<td></td>
<td>2. Exercises Oversight Responsibility</td>
</tr>
<tr>
<td></td>
<td>3. Establishes Structure, Authority, and Responsibility</td>
</tr>
<tr>
<td></td>
<td>4. Demonstrates Commitment to Competence</td>
</tr>
<tr>
<td></td>
<td>5. Enforces Accountability</td>
</tr>
<tr>
<td><strong>Risk Assessment</strong></td>
<td>6. Specifies Suitable Objectives</td>
</tr>
<tr>
<td></td>
<td>7. Identifies and Analyzes Risks</td>
</tr>
<tr>
<td></td>
<td>8. Assesses Fraud Risk</td>
</tr>
<tr>
<td></td>
<td>9. Identifies and Analyzes Significant Change</td>
</tr>
<tr>
<td><strong>Control Activities</strong></td>
<td>10. Selects and Develops Control Activities</td>
</tr>
<tr>
<td></td>
<td>11. Selects and Develops General Controls over Technology</td>
</tr>
<tr>
<td></td>
<td>12. Deploys through Policies and Procedures</td>
</tr>
<tr>
<td><strong>Information &amp; Communication</strong></td>
<td>13. Uses Relevant Information</td>
</tr>
<tr>
<td></td>
<td>14. Communicates Internally</td>
</tr>
<tr>
<td></td>
<td>15. Communicates Externally</td>
</tr>
<tr>
<td><strong>Monitoring Activities</strong></td>
<td>16. Ongoing Monitoring and Internal Audit</td>
</tr>
<tr>
<td></td>
<td>17. Evaluates and Communicates Deficiencies</td>
</tr>
</tbody>
</table>
## COSO 2013 impact on ORSA

<table>
<thead>
<tr>
<th>ORSA Summary Report Guidance</th>
<th>COSO 2013 Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Control Objective</strong></td>
</tr>
<tr>
<td>Risk Culture and Governance</td>
<td>Control Environment</td>
</tr>
<tr>
<td>Risk Identification &amp; Prioritization</td>
<td>2. Exercises Oversight Responsibility</td>
</tr>
<tr>
<td>Risk Appetite, Tolerance &amp; Limits</td>
<td>3. Establishes Structure, Authority, and Responsibility</td>
</tr>
<tr>
<td>Risk Management &amp; Controls</td>
<td>4. Demonstrates Commitment to Competence</td>
</tr>
<tr>
<td>Risk Reporting and Communication</td>
<td>5. Enforces Accountability</td>
</tr>
<tr>
<td>Risk Assessment</td>
<td>6. Specifies Suitable Objectives</td>
</tr>
<tr>
<td></td>
<td>7. Identifies and Analyzes Risks</td>
</tr>
<tr>
<td></td>
<td>8. Assesses Fraud Risk</td>
</tr>
<tr>
<td></td>
<td>9. Identifies and Analyzes Significant Change</td>
</tr>
<tr>
<td></td>
<td>Control Activities</td>
</tr>
<tr>
<td></td>
<td>11. Selects and Develops General Controls over Technology</td>
</tr>
<tr>
<td></td>
<td>12. Deploys through Policies and Procedures</td>
</tr>
<tr>
<td></td>
<td>Information &amp; Communication</td>
</tr>
<tr>
<td></td>
<td>14. Communicates Internally</td>
</tr>
<tr>
<td></td>
<td>15. Communicates Externally</td>
</tr>
<tr>
<td></td>
<td>Monitoring Activities</td>
</tr>
<tr>
<td></td>
<td>17. Evaluates and Communicates Deficiencies</td>
</tr>
</tbody>
</table>
BUILDING THE ENGINE FOR THE ERM PROCESS
Determine that management is continuing to:

> Build consensus around the ERM process
> Gather relevant information and existing data
> Conduct interviews, surveys and facilitation work sessions
> Identify key risks and develop a risk profile
> Initiate risk mitigation, optimization activities, and ownership to emerging risks
Confirm that management has

> Compiled a list of risks that impact the business sorted by category

> Performed risk assessment facilitated workshops and surveys to identify, analyze, and prioritize key risks and strategies
Building the engine for the ERM process

Risk identification, analysis, and prioritization

> Results of the risk identification process are compiled

> Risk are evaluated and assessed (high, medium, low) from two perspectives, impact and likelihood

> Options used:

  - Accept = monitor
  - Avoid = eliminate (get out of situation)
  - Reduce = institute controls
  - Share = partner with someone (e.g. re-insurance)

> Risk assessment is linked to strategic objectives

> Results are compiled and risk maps developed to summarize and prioritize key risks (top 10 to 15 risks)
Validate risk assessment and responses

> Review management’s feedback on risk assessment; identify and evaluate possible responses to risks (Accept, Avoid, Reduce and Share)

> Evaluate options in relation to entity’s risk appetite, cost vs. benefit of potential risk responses, and degree to which a response will reduce impact and/or likelihood

> Select and execute response based on evaluation of the portfolio of risks and responses

> Facilitate meetings or work sessions with key members of management to address developed responses
Risk monitoring and reporting

> Ensure accountability for risks

> Summarize a risk assessment report

> Create risk dashboards for high-level board reporting
  – Leverage technology tools

> Develop a continuous monitoring program
  – Ensure updates are reflected (i.e., changes in systems or processes)
  – Risks are being properly addressed
  – Controls are working to mitigate risks
Risk management framework

**Strategy**
- Strategic Goals & Objectives
- Risk Universe
- Risk Appetite / Tolerance
- Risk Limits

**Organization**
- Culture & Governance
- Accountability
- Roles & Responsibilities

**Process**
- Identification
- Quantification
- Prioritization
- Mitigation & Execution

**Tools**

**Monitoring and Reporting**
- Risk Committees & Reports
- Key Risk & Performance Indicators
- Board Meetings & Reports
- Dashboard Reports (e.g. Balanced Scorecard)
RISK ASSESSMENT PROCESS
Risk assessment process

1. Review strategic objectives
2. Identify key risk areas and risks to meeting objectives
3. Conduct risk assessment to quantify and prioritize key business risks
4. Develop initial risk appetite statements
5. Align risk appetite statements with risk limits and key performance indicators
6. Review initial risk appetite statements and validate
7. Monitor and identify need for risk mitigation - ensure execution
8. Update risk dashboards for reporting
Operationalizing risk assessments

- Business Strategy
  - Business Plan Objectives
  - Key Risks to Objectives
  - Emerging Risks

- Risk Assessments
  - Includes review of:
    - Strategic
    - Operational
    - Emerging Risks

- Key Risk Mitigation

- Risk Control Effectiveness
  - Internal & External Audit
  - Management Self Assessments
  - Self Audit Testing

- Management Action Plans

Risk assessment process
The ORSA requires an insurer to consider the following in its attitude towards managing risk capital:

> Sound processes for assessing capital adequacy in relation to their risk profile and those processes should be integrated into the insurer’s business decision making

> Processes may assess risk capital through a myriad of metrics and future forecasting periods, reflecting varying time horizons, valuation approaches and capital management strategies (e.g. economic, rating agency, regulatory)

> This section is intended to assist commissioners understand an insurer’s capital adequacy in relation to its aggregate risk profiles
Economic capital is typically assessed via use of financial modeling and includes analysis of key risks areas that may impact an organization:

- Underwriting and reserving risks
- Investment and credit risks
- Market and liquidity risks
- Strategic, emerging, and operational risks

Output from capital models (deterministic or stochastic) can be utilized to assess risk reward trade-offs and create a linkage between risk appetite and risk-based decision making processes.
REVIEW PROCESS
The biggest challenge facing companies submitting their first ORSA summary report?

Trying to understand what the regulator will be looking for.
Currently, many regulators are concerned that their staffs do not have the skills to understand a company’s ERM programs.

The summary report should be drafted in a way that the key elements are laid out *as plainly as possible.*
Questions?

Connect with us:

Dan Buttke
Baker Tilly Virchow Krause, LLP
daniel.buttke@bakertilly.com
+1 920 739 3348

Eric Moser
Illinois Department of Insurance
Eric.Moser@illinois.gov
+1 217 557 3759
Pursuant to the rules of professional conduct set forth in Circular 230, as promulgated by the United States Department of the Treasury, nothing contained in this communication was intended or written to be used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Service, and it cannot be used by any taxpayer for such purpose. No one, without our express prior written permission, may use or refer to any tax advice in this communication in promoting, marketing, or recommending a partnership or other entity, investment plan, or arrangement to any other party.

Baker Tilly refers to Baker Tilly Virchow Krause, LLP, an independently owned and managed member of Baker Tilly International. The information provided here is of a general nature and is not intended to address specific circumstances of any individual or entity. In specific circumstances, the services of a professional should be sought. © 2014 Baker Tilly Virchow Krause, LLP