The ORSA opportunity:

Compliance and business value

12 March 2014
Today’s agenda

► Background and regulatory update
► ORSA overview
► Industry perspectives
► Achieving long-term business value
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► ORSA overview
► Industry perspectives
► Achieving long-term business value
Background and regulatory update

Own Risk and Solvency Assessment (ORSA) per the US NAIC*

► Definition
  ► “an internal assessment… conducted by [the] insurer of the material and relevant risks associated with an insurer’s current business plan and the sufficiency of capital resources to support those risks”

► Primary goals
  ► To foster an effective level of enterprise risk management at all insurers through which each insurer identifies, assesses, monitors and reports on 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

► Other jurisdictions with an ORSA process include
  ► Bermuda, the European Union and Canada

* National Association of Insurance Commissioners
Background and regulatory update

► ORSA Summary Report – highlights
  ► Section 1: Description of Insurer’s Risk Management Framework
  ► Section 2: Insurer’s Assessment of Risk Exposure
  ► Section 3: Group Risk Capital and Prospective Solvency Assessment

► ORSA Summary Report – expectations
  ► Annual reports due starting in 2015
    ► Exemption criteria for smaller insurers/groups
    ► No specified report date, NAIC states it will be dependent on when ORSA is performed
  ► Can utilize ORSA reports prepared for other jurisdictions
  ► Should facilitate a more in-depth review by the regulator through analysis and examination processes
  ► Horizon for key risks and capital adequacy should align with business plan (e.g., 1-3 years)
State adoption

To date, the Risk Management and ORSA Model Act has been fully or substantially adopted by:

- Iowa
- Maine
- New Hampshire
- Rhode Island
- Vermont
- California
- Pennsylvania

The Risk Management and ORSA Model Act was considered by legislatures in other states in 2013-14 (CT, NY, OH, TX, VA, WY)

The NAIC has advocated for full and uniform adoption of the model act by states during the 2013-14 legislative sessions
Today’s agenda

► Background and regulatory update

► ORSA overview

► Industry perspectives

► Achieving long-term business value
## ORSA overview

### ORSA requirements

<table>
<thead>
<tr>
<th>Section 1: Description of risk management framework</th>
<th>Description</th>
<th>Considerations</th>
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<tbody>
<tr>
<td>• Risk culture and governance</td>
<td></td>
<td>Identify assessment tools used to monitor and respond to changes in risk profile</td>
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<tr>
<td>• Risk identification and prioritization</td>
<td></td>
<td>Explain how new risk information is incorporated</td>
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<td>• Risk appetite, tolerance and limits</td>
<td></td>
<td>Risk quantification method is not prescribed; should be consistent with way in which business is managed</td>
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<tr>
<td>• Risk management and controls</td>
<td></td>
<td>Impact of stresses on capital; consider risk capital requirements, available capital, regulatory, economic, rating agency or other views of capital</td>
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<tr>
<td>• Risk reporting and communication</td>
<td></td>
<td>Demonstrate process for model validation, including factors considered and model calibration</td>
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<tr>
<th>Section 2: Assessment of risk exposures</th>
<th>Description</th>
<th>Considerations</th>
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<tr>
<td>• Documentation of quantitative measurements of risk exposure in both normal and stressed environments</td>
<td>Risk quantification method is not prescribed; should be consistent with way in which business is managed</td>
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<tr>
<td>• Quantification of risk exposure under a range of outcomes using risk measurement techniques that are appropriate to the nature, scale and complexity of the risks</td>
<td>Impact of stresses on capital; consider risk capital requirements, available capital, regulatory, economic, rating agency or other views of capital</td>
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</tr>
<tr>
<td>• Detailed descriptions and explanations of the risks identified and quantitative methods used</td>
<td>Demonstrate process for model validation, including factors considered and model calibration</td>
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<th>Section 3: Group risk capital and prospective solvency assessment</th>
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<td>• Documentation of the combining of qualitative and quantitative elements of risk management policy</td>
<td>Capital adequacy assessment process integrated into management and decision making culture</td>
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<tr>
<td>• Determination of the level of financial resources needed to manage current business for the next 2-5 years</td>
<td>Projection of future financial position should include economic and regulatory capital given current risk profile, management policy, quality and level of capital, considering normal and stressed scenarios</td>
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<tr>
<td>• Completion of an annual group risk capital assessment, complete with a description of the approach used to conduct the analysis</td>
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<tr>
<td>• Discussion of how risk and capital interrelate over various time horizons and the interplay between group risk and other capital frameworks (e.g. rating agency and regulatory)</td>
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► Background and regulatory update
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► Achieving long-term business value
Industry perspectives
ORSA readiness

- Companies are at different levels of readiness
  - In general – healthcare industry capabilities are behind life and property/casualty
  - Companies with favorable ERM ratings from S&P likely have many capabilities in place
- Several companies across life/health and property/casualty industries participated in one or both pilots
  - First pilot allowed incomplete submissions – many submitted partial ORSA reports
  - Second pilot required more comprehensive ORSA report and participants indicated comfort with their capabilities

Some companies use ORSA as the driver for ERM enhancements that drive business value
Industry perspectives

► Key ORSA implementation questions for the insurance industry
  ► For an insurance group with multiple insurance legal entities or with different types of business (e.g., both Life and P/C), should they prepare a single or multiple ORSA reports?
  ► What will the final report look like, what information should be included and what is an appropriate report length?
  ► How will all the information for the report, which will likely come from multiple business units, be pulled together effectively and efficiently?
  ► If capital is viewed through multiple lenses/bases (e.g., RBC, economic capital, rating agencies capital), should all of these be included in the report?
  ► What other stakeholders (e.g., rating agencies, external auditors) will want to receive a copy of the report?
Industry perspectives

- Section 1 - much of the industry has put an ERM framework on paper for the organization, but evidence of use and effectiveness remains inconsistent

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<th>Industry perspective</th>
<th>Common capability gaps</th>
<th>Implementation challenges</th>
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<tr>
<td>Most companies feel comfortable that current capabilities meet most of the requirements of Section 1 of the ORSA Guidance Manual</td>
<td>Risk appetite</td>
<td>Companies continue the struggle to directly link risk appetite and limits/tolerances across key risk types</td>
</tr>
<tr>
<td>Certain companies that have very immature ERM programs need to formalize their framework in place to cover all components</td>
<td>Strong risk culture</td>
<td>Definition of the risk appetite to incorporate quantitative measures requires the adoption of a consistent quantitative measure of risk</td>
</tr>
<tr>
<td>Governance structures in the insurance industry are very different than other financial services companies</td>
<td>Evidence of risk management’s role in key decisions</td>
<td>Consistent implementation of ERM framework across the group – specifically different countries and industries (e.g. P&amp;C vs. Life)</td>
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<td>Independent CRO reporting to CEO/Board</td>
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<td>Separate risk committee of the Board</td>
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## Industry perspectives

- **Section 2** - calls for the quantitative and qualitative assessment of risk exposures in normal and stressed conditions

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| - Current risk assessment is dependent on risk taxonomy  
  - In general, life companies are less focused on operational risk  
  - In general, P&C and Health companies are less focused on investment/market risk  
  - Companies that have moved towards an economic capital framework have a more mature quantitative approach in place | - Comprehensive risk inventory with quantitative and qualitative assessments  
  - Consistent metric across risk types | - Determining how to perform the assessment under “stressed” conditions when the metric may already be under a “stress” (e.g., economic capital may be defined as a 1 in 200 year stress)  
  - Building a more robust approach for both qualitative and quantitative assessment of broader range of operational risks  
  - Difficult due to lack of exposure data  
  - Even more quantitative approaches require significant approximations |
## Industry perspectives

- **Section 3 - includes two complex components**
  - group risk capital calculation
  - prospective solvency assessment

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<td>Generally viewed as most complex component of ORSA Guidance Manual</td>
<td>Complex groups typically don’t have a group risk capital calculation</td>
<td>Accounting differences acrossgeographies and product lines increase difficulty in relying onexisting frameworks</td>
</tr>
<tr>
<td>Was not typically part of a good ERM framework</td>
<td>Capabilities to project future income statement and balance sheet under stressed conditions incorporating new business</td>
<td>Comprehensive views of future balance sheets under required accounting regime (Stat, GAAP, Economic)</td>
</tr>
<tr>
<td>Flexibility provided by the Guidance Manual leaves many question unanswered</td>
<td>Capabilities to project future capital requirements – in particular under internally developed measurement framework</td>
<td>Approaches for calculating future required capital components for calculation intensive balances (e.g., future projections of stressed market value of liabilities)</td>
</tr>
<tr>
<td>Apprehension exists with regards to the ultimate use of this section by regulators</td>
<td>Used to require additional capital?</td>
<td>Incorporation of multiple capital frameworks to model future distributions of excess capital</td>
</tr>
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<td></td>
<td>Used to compare companies?</td>
<td>Reliable aggregation of financial statements across legal entities</td>
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</table>
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► Background and regulatory update

► ORSA overview

► Industry perspectives

► Achieving long-term business value
Achieving long-term business value

- Link to ERM
  - The flexibility around the ORSA report and Guidance Manual minimize the “compliance” nature of the requirement
  - ORSA compliance shouldn’t be a standalone item – but rather a way to push ERM capabilities forward
  - The ORSA Guidance Manual is looking to formalize and document a robust ERM framework; the value to an organization comes from the value of ERM
  - The ORSA requirement should push an organization to use and show evidence of their ERM program working when undertaking complex decisions
Achieving long-term business value

► Value from a strong ERM program
  ► Improves focus on risk and further establishes the “tone at the top”
  ► Provides an independent challenge and review of key information, assumptions and business practices, allowing the ability to escalate issues
  ► Helps to improve decision making through increased rigor and standard / structured processes, as well as the ability to understand financial impact based on stress events
  ► Enhances collaboration with business units and leadership to identify emerging risks, understand current plans to address and focus on the future
  ► Improved executive level discussions about risk and strategic decision making
  ► Enhances the external stakeholder (rating agencies, policyholders, peer organizations) perspective of the organization resulting in improved opportunities for growth
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Questions from the audience