



# AMERICAN ACADEMY *of* ACTUARIES

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October 4, 2010

Director Christina Urias  
Chair of the International Solvency (EX) Working Group  
National Association of Insurance Commissioners (NAIC)  
Via email: kdefrain@naic.org

Dear Director Urias:

The American Academy of Actuaries<sup>1</sup> ERM Subcommittee is pleased to provide comments on the NAIC's International Solvency (EX) Working Group's *Consultation Paper on the Own Risk and Solvency Assessment (ORSA) for the Solvency Modernization Initiative*.

The introduction of an Own Risk and Solvency Assessment (ORSA) requirement into the US solvency framework could provide regulators with significant insight into a company's risk management and risk governance practices. If used effectively, such information has the potential to:

- Assist regulators with identifying those companies with weaker risk management systems, thus encouraging more frequent and effective interaction between the regulator and those regulated entities.
- Allow more effective and efficient use of regulatory and corporate resources.
- Be an effective tool for reviewing and assessing systemic risk issues.

In order to achieve support for these desirable outcomes, we strongly encourage the NAIC to clearly describe how the information contained within the ORSA might in fact be used by regulators. For example:

- Would regulators have the authority to compel an insurer to take specific actions based upon the information contained within the ORSA?
- Could a regulator require the use of hedging of financial market guarantees by an insurer that has elected not to hedge part of its risk exposure even if its rationale for this position is made clear?

In addition, it would be useful for the NAIC to articulate the benefits to regulated entities that the introduction of an ORSA might offer. For example:

- Might the ORSA provide the insight needed to allow the regulators to vary their level of interaction with insurers based on the strength of their risk management practices (i.e.,

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<sup>1</sup> The American Academy of Actuaries (“Academy”) is a 17,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

interacting less with those insurers who are deemed to have strong risk management practices)?

- Would the information contained within the ORSA allow the regulators to enhance the efficiency of risk-focused examinations when they do occur?
- Will this information allow for the elimination of other duplicative reporting requirements?

While many questions related to this process remain, we offer the following responses to the specific questions contained within the Consultation Paper:

*1. A: Content: What content should be included in the ORSA/ERM tool about RISK MANAGEMENT?*

In addition to the items listed, the ORSA should contain a description of ERM governance, including the roles and responsibilities of management and the Board in the risk management function; how decisions are made; the role of the audit; legal and actuarial functions in the risk management system; and the role of business units in the management of risk.

The ORSA should contain a qualitative assessment of management's views of how well a company has performed with the management of risk, how the ERM function helped the company manage risks and where the ERM function failed. Companies should provide insight into their use of feedback loops.

An ORSA should also highlight changes to the insurer's risk profile over time.

We recognize that some ERM concepts such as “risk appetite” are still evolving and have only been expressed by many insurers in general terms. However, an assessment of how the overall level of an insurer's risk exposures compares to its risk appetite should also be included within an ORSA, as well as the reasons for significant changes to its risk appetite over time. Inclusion of a discussion on risk appetite will be valuable for the regulator in understanding the degree of sophistication of the insurer's risk management practices as well as advancing the regulator's understanding of risk management practices. These practices could include a review of the company's use of soft limits within its risk appetite limits that identify escalating actions, higher level authorities, mitigation actions and reassessment deadlines.

*1. B: Content: What content should be included in the ORSA/ERM tool about SOLVENCY ASSESSMENT?*

Prospective solvency assessments should be provided only in the context of specific stress scenarios: if a particular event happens, will the company have sufficient capital to support it. Asking company management to opine on FUTURE solvency without stating specific conditions would not be meaningful or practical.

2. *Frequency: How often should the insurers perform this process (e.g. quarterly, annually, prior to financial examinations, when there is a significant change in the risk profile of a company)? How often should the insurer report on this process to regulators?*

Companies perform risk management activities with different frequencies; some activities are performed daily while others are performed annually or on an as-needed basis. Our understanding is that the ORSA would be provided to regulators to explain an insurer's risk profile and risk management practices. Ideally, the information contained in the ORSA would be a subset of the information already being prepared by an insurer for its risk management efforts. The ORSA requirement will be more effective if the information requested is not a "one off" regulatory requirement, but instead, leverages the information already prepared by the company.

The frequency and extent of ORSA reporting should be dependent upon how the regulators intend to use the information provided. Where real risk management needs exist and if the regulators plan to act upon the information contained within the ORSA, some risk measures may need to be reported more frequently than the financial examination cycle, while other risk measures may need to be reported less frequently. After an initial review and discussion of the ORSA, additional follow up reporting for different risk exposures could conceivably range from daily to once every five years.

One option discussed by the ERM Subcommittee is a phased-in approach to this new requirement. While all insurers would be required to perform this assessment internally as part of their ERM activities, the frequency and extent of the regulatory reporting of ORSAs could be increased (e.g., annual reporting) for a selected group of insurers based upon certain criteria or triggers established by the regulators. Once the regulators are able to refine their intended use of this new information and develop the internal resources required to review ORSAs, the appropriate reporting frequency could then be determined. This will allow both insurers and regulators sufficient time to prepare for this new requirement.

3. *Confidentiality: How should confidentiality be maintained (e.g. through examination process or via a new law/regulation)? Which component(s) of the content identified in #1 is not proprietary and could be made public?*

All information contemplated for inclusion in the ORSA should be confidential, and would need to be maintained as such. The need for confidentiality within the ORSA process is critical and the steps taken to protect confidentiality should be greater than for other confidential regulatory documents. The information contained in an ORSA would likely include very sensitive and proprietary information that, if disclosed for any reason, could potentially damage the insurance company. Further, the information contained in the ORSA would likely include assessments of current risk exposures, as well as emerging risks. Information related to risks that may or may not materialize must be handled with care. Information related to *potential* risks could be damaging to an insurer in the event this information became available to a plaintiff's attorneys or other legal representatives.

4. *Group / Legal Entity / Pool: At what level should regulators require this tool (e.g. group, legal entity, intercompany pool)? Should the tool be required based upon “how the enterprise is managed? a. How should non-insurance entities be considered? b. Should international entities be included?*

An ORSA should be conducted on the basis of how risk is managed within a group. All insurance and non-insurance entities within a group should be included in the ORSA, both domestic and international, as all entities will affect the risk profile of the group in some manner. Any other requirement could create a level of compliance with less value to the insurer and the regulator.

An ORSA should cover all risk exposures of the group, regardless of reporting entity. As such, all risk exposures, whether or not reported on the balance sheet, should be covered in the ORSA.

5. *Proportionality: How should U.S. regulators implement proportionality (e.g. size, nature/scale/complexity, extent of international activity, certain lines of business, etc.)? What exclusions from the requirements or simplified reporting would you recommend, and for whom?*

Every insurer should be subject to an ORSA requirement. While the nature of an insurer's risks will likely differ by company size, all insurers need to understand their risks and have processes for managing those risks. The scope and complexity of an insurer's risk management practices will be reflected in the response to an ORSA requirement.

6. *Should the U.S. implement a questionnaire or a minimum level of standardized reporting? If so, should the reporting be an abbreviated reporting, with the full report available for review at the company upon request? Should a “sample report” or template be provided for educational purposes?*

ERM as a discipline is still in its infancy and will continue to evolve. Therefore, any standardized reporting created by the NAIC will likely be outdated before the information could be used. The ORSA should be principle-based in its entirety, not rule-based. Any form of standardized reporting will encourage conformity which would de-value the use of this assessment. Insurers would benefit, however, by the creation of a principle-based outline for the ORSA that identifies the most significant items that the regulators would find of interest.

7. *Should the tool be entirely driven by the company or should the regulators specify items such as specific stress tests or safety levels? a) If regulators specify stress or scenario tests, what should be the focus of the tests (e.g. major interest rate shift, major changes in lapse rates, misestimation of parameters, large adverse development in loss reserves (including adverse court decisions, etc.)? b) If regulators specify a safety level (e.g. 99.0% TVar) and time horizon for solvency assessment, what should those be?*

We support the use of and the reporting of stress testing in the ORSA requirement. We discourage standardized, fixed requirements for understanding risks. Stress testing does

provide useful information for company management and regulators. However, the specific stresses often change with the environment. Therefore, specifying stress tests that always need to be performed regardless of the current environment will create additional work with limited benefit.

We believe the initial requirements will be more effective if insurers provide stress testing results to regulators based on the stress testing already performed by the insurer. Insurers should perform this assessment on the same basis that risk is managed, and that is how it should be reported to the regulators

**As a later step, there may be situations where regulators would ask for the results of specific stress tests, though it should occur within the context of the centralized CRO type expertise mentioned in question 9.**

8. *Should the Board be responsible for the ORSA/ERM? If so, to what extent? Should there be a sign off or certification requirement (by an actuary, chief risk officer, risk professional)? Should there be a required report to the Board (e.g. on stress tests)?*

Yes, the Board should be responsible for the ORSA and ERM, and should describe and attest to their oversight role. In addition, the ORSA should be signed off on by a member of the senior management team with the appropriate level of experience. Specific reports to the Board should not be required as part of the ORSA; however, as part of the ORSA, companies should be required to disclose the nature and frequency of reporting to the Board.

9. *How great will the need be for additional resources? Do states need to hire more risk experts? Do they need these experts on staff, or should they hire consultants or share resources?*

State insurance departments will likely need to obtain additional resources to be able to evaluate the information contained in an ORSA, and may want to consider a centralized review function, such as the NAIC's Financial Analysis Working Group (FAWG.) The regulators would benefit from this centralization, not only from the perspective of shared resources but by enabling an industry-wide view of risk. To minimize the impact on resource needs, the NAIC should re-evaluate all of its risk reporting requirements and eliminate those that are redundant.

While the regulators may need to rely upon external consultants as part of the ORSA review process, the NAIC will first need to ensure that confidentiality restrictions could be extended to these external experts.

10. *What should we name this tool?*

"ORSA" does imply that an entity is observant of issues affecting its overall health and well being. If the US were to adopt a different name for this assessment requirement, it would ultimately be regarded as the "US ORSA." Therefore, we recommend that the ORSA name be utilized.

Thank you for this opportunity to comment. If you have any questions, please contact Tina Getachew, senior policy analyst, Risk Management and Financial Reporting Council, via email ([getachew@actuary.org](mailto:getachew@actuary.org)) or phone (202/223-8196).

Sincerely,



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Chairperson, ERM Subcommittee  
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