Insights for Preparing an ORSA / ERM Report

February 2015
Where to Start? An ORSA / ERM Report Outline

The NAIC’s Risk Management and Own Risk Solvency Assessment (ORSA) Model Act became effective as of January 1, 2015. ORSA filing requirements are applicable to a single company with gross premiums written greater than $500 million or a group with gross premiums written greater than $1 billion. Companies domiciled in states that passed legislation adopting the NAIC’s model act should be actively conducting their ORSA in preparation for filing their required summary report sometime during 2015.

The general guiding principal from NAIC is that the ORSA report should document a company’s own assessment of its risk exposures and its processes to manage the risks specific to the company’s operations. The stated intent is to not have a prescriptive format for the ORSA documents, however, some guidance has been provided regarding key topics and areas of risk that analysts reviewing the document are being instructed to expect. The primary purpose of this document is to offer practical ideas and considerations that companies can use as a reference in developing their own report, making sure that key topics are addressed where relevant and key materials are identified to be included.

Based on reviewing a number of actual draft ORSA summary documents and referencing general guidelines provided by the NAIC, the following provides perspectives of typical main sections and relevant subsection topics in an ORSA report. Depending on the scope and complexity of a company’s specific operations, length and content of the main report will vary. High quality draft reports we reviewed generally ranged from 25 to 35 pages excluding appendixes or exhibits.

Lastly, while this outline is targeted to companies preparing for ORSA filing requirements, it is also very useful for clients not required to file ORSA that are looking to enhance their ERM documentation for Board and/or rating agency communications.

Executive Overview (2 – 5 pages)

Topics typically included:

A. Company Overview
   ▪ Holding company structure and access to capital
   ▪ A brief description of intra-company reinsurance pooling agreement if one exists
   ▪ Business Overview such as line of business mix, geographic coverage and distribution channel
     - Highlight any unique niche marketplace strategy and its impact on the overall organization’s risk exposures
     - Highlight any recent significant changes to the organization which could potentially or already is having an impact to the group’s risk environment.

B. ORSA Report Overview; highlight what will be covered in key sub-sections of the report
   ▪ Risk governance and ERM framework
   ▪ Link of ERM to Strategy
     - Illustrate logical connections of ERM role in supporting company strategy
   ▪ Risk Measurement and capital stress testing approach
- Group capital assessment approach
  - Accounting methodology
  - Risk metrics utilized
  - Time horizon

Section I: Risk Management Framework

Provide an overview of the company’s approach to ERM in terms of:

A. Risk culture and governance
   - Document the link of the ERM functions to the Board of Directors, Management Team, and Operations.
   - Describe the chief executive’s role and responsibilities where applicable in risk management process. The leader position normally is the Chief Risk Officer or other designated chief executive.
   - Charter for the ERM committee can be referenced to illustrate:
     - Purpose of the committee
     - Organization - list of ERM committee members by their functional titles can demonstrate that the committee is comprised with individuals from various functional areas of the company
     - And general responsibilities
       1. Document connections between ERM and organization’s strategic risk management process

B. Risk tolerance and appetite framework; Providing specific definitions of company’s risk tolerance and appetite
   - Tolerance: The amount the company is willing to put at risk of loss in the normal course of business
     - Can be at enterprise and Key Risk level
     - Example of risk tolerance can include:
       1. Risk definition
       2. Measure
       3. Definitions of action levels: e.g. Accept/Review/Unacceptable
   - Appetite: The process used by a company to evaluate risk, reward tradeoff and select which risks to accept
     - “A statement that documents the overall principles that a company follows with respect to risk taking, given its business strategy, financial soundness objectives and capital resources. Often stated in qualitative terms, a risk appetite defines how an organization weighs strategic decisions and communicates its strategy to key stakeholders with respect to risk taking.” (per NAIC guidance manual)
     - Any process in place for periodic update, review and approval for the risk tolerance
C. Risk identification and prioritization
   - Briefly describe the company’s approach to the considerations for risk assessments between quantitative and qualitative approaches
     - Risk assessment approach
     - Link to day-to-day operations of risk management and executive management team
     - Tools/mechanisms used
     - Frequency of reporting risk management processes to the ultimate controlling authority – normally B.O.D.
     - How risks are being prioritized and further monitored
   - Key risk identified (Top 5 or 10)

D. Risk management and controls; provide brief descriptions of various risk management functions and processes including:
   - Certain board or management level working groups and or teams that has risk management responsibilities
     - Chairperson
     - Composition
     - Function
     - Topics being discussed during regular committee meetings
   - Internal audit & control processes in place
   - Reinsurance protection
   - External audit & validation services utilized

E. Risk reporting and communication
   - Document the framework and process utilized for risk monitoring and communication
     - Are reports periodically received by board, senior management, business units, and operational heads?
     - Are there risk management meetings, regular reports and events held by various functions and business units within the organization
     - What is the frequency of the reporting/monitoring?
Section II: Assessment of Risk Exposures

In Section II of the summary report, companies generally provide their quantitative and qualitative assessment of critical risk categories in both normal and stressed scenarios. From observations, companies normally start this section with high level summaries on risk management methodology and capital stress testing overview.

Typical discussions in the overview section include:

A. Methodology for:
   - Overall strategies of risk assessment and controls
   - Specific definition of measures of risk severity and frequency

B. Capital stress testing:
   - Provide general goals and bases for stress and scenario testing
   - Explain use of stress scenario results in capital adequacy assessment
   - Describe outcome of each scenarios testing

Following the overviews, remaining Section II normally included detailed assessment of key risks identified in Section I. The outlines below illustrated typical discussion topics companies considered in assessing these risks:

- Company’s own understanding of each key risk or risk category
- Identification of risk owners
- Monitoring procedures for containing risk level within the organization’s risk tolerance level and in accordance with stated risk appetite
- Benchmarks for measuring key risks and triggers for actions in terms of company risk tolerance level
- Detailed descriptions of risk mitigation processes including specific examples of risk management procedures and/or policies
- Stress scenario testing and potential capital impacts

Including the “9 branded risks” suggested by the NAIC guidelines, following are some typical key risks being assessed in Section II:

<table>
<thead>
<tr>
<th>Examples of risks addressed in Section II of ORSA</th>
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<tbody>
<tr>
<td>Business interruption</td>
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<tr>
<td>Business model / brand risk</td>
</tr>
<tr>
<td>Claims</td>
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<tr>
<td>Cyber security</td>
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<tr>
<td>Insurable risks</td>
</tr>
<tr>
<td>Fraud &amp; embezzlement</td>
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<tr>
<td>Legal / compliance / regulator</td>
</tr>
</tbody>
</table>
Section III: Group Assessment of Risk Capital and Prospective Solvency

In this section, the focus should be on various quantitative aspects of measuring group-level capital adequacy relative to the various risks to which the enterprise is exposed. The quantitative approach should document the accounting framework (GAAP, STAT, IFRS, other), the modeling framework (internal economic capital model, rating agency capital adequacy model, regulatory capital adequacy model, other), and the risk metric being utilized. The objective is to measure the capital needs of the enterprise given the scale and complexity of the risks within the group.

Group level capital adequacy can be quantified by using internal economic capital model, other key financial ratio indicators such as premium-to-surplus ratio, or external capital models such as the A.M. Best's Capital Adequacy Ratio and NAIC’s Risk Based Capital. Rationales for establishing certain capital adequacy targets can be explained in this section. For prospective solvency assessment, the expectation is that a group needs to have a robust capital forecasting ability that can support financial planning and risk management functions. This includes the ability to project their expected financial position (income statement and balance sheet) over a 3-5 year time horizon in both normal and stressed environments. These projections should be able to demonstrate the group has the financial resources to execute on their plan and stay within their risk tolerances, while operating in accordance to their stated risk appetite.

Examples of typical stressed scenarios for a P&C insurance group that can be modeled include:

- Multiple small storm losses causing losses to come in above plan
- Significant single catastrophe loss events – measuring property CAT extreme risk
- Non-Cat Loss results worse than plan
- Adverse reserve development
- Investment losses in equity positions
- A significant increase in inflation and interest rates
- New business or renewal retention disruptions

How Aon Benfield can help

Our team actively assists clients as they prepare of ORSA reporting requirements, including conducting ORSA workshops and informational sessions. Specific areas of assistance include:

- Review and provide detailed feedback on draft ORSA reports
- Assist clients formalize risk tolerance statements that align with stakeholder expectations; benchmarking of risk tolerance statements
- Use of Scenario Analysis & Planning (SnAP) tool for financial planning and deterministic stress testing, including pre-defined ORSA stress scenarios
- Assist in communications of ERM initiatives and objectives to internal and external stakeholders, including ORSA and rating agency requirements
- Use of ReMetrica® economic capital model software with parameterization benchmarking from Aon Benfield’s global Insurance Risk Study
Contact Information

Please contact your Aon Benfield broker, or Aon Benfield Analytics professional below to discuss the facts surrounding this important topic and path to evaluate potential impact on your company’s A.M. Best rating.

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Appendix

Below is a list of U.S. states and territories that have passed insurance legislation adopting NAIC’s ORSA Model Act as of February 10, 2015.

- California
- Connecticut
- Delaware
- Iowa
- Illinois
- Wyoming
- Indiana
- Kentucky
- Maine
- Minnesota
- Nebraska
- New Hampshire
- New Jersey
- New York
- Ohio
- Pennsylvania
- Rhode Island
- Tennessee
- Virginia
- Vermont
- Wisconsin
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