ORSA: A Prospective View of Solvency

By Carol S. Stern, FLMI, AIRC, ACS, and C.J. Rathbun, CCEP, FLMI, HIA, AIRC, BFA, First Consulting & Administration, Inc.

The Own Risk Solvency & Assessment (ORSA) NAIC Model Law 505 has been called a "game changer" by some regulators because of the expectation that it will bring about a cultural change for both regulators and insurance companies. This new view of solvency shifts to not only considering the current state of capital management but also the company's future plans for that management. Companies must understand and communicate their company "story" from this shifted perspective. ORSA requires an Enterprise Risk Management (ERM) framework that monitors, assesses, and reports **all areas of risk** within the insurer, including the **quantification of non-financial risks** such as reputation and brand risk. An assessment on the group level will also be required if an insurer is part of a group of insurers or an affiliate of a holding company.

ORSA was adopted unanimously by the NAIC commissioners — a rare occurrence. Therefore, the adoption of ORSA should move quickly through the legislative process in many states during 2014 for a January 1, 2015 effective date. To date, eight states have adopted the model (IA, NY, CA[6], NH, ME, RI, VT, PA) and seven states have proposed the model (CT, TX, IL, MD, OH, VA, WY). Because this new Model Law was made part of the NAIC accreditation requirements for state insurance departments, all jurisdictions will likely adopt it without variations. All of these efforts highlight the importance that the NAIC is placing on the ORSA Model and put added pressure on states who want to maintain their accreditation status.

ORSA & the ERM Framework

Regulators highlight that not all ERM programs are alike, but that the framework should be "appropriate to the nature, scale and complexity of the insurer's risks, in a manner that is adequate to support risk and capital decisions" according to the NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual as of March 2013.[7] The manual and the regulators do not prescribe **how** a company should implement their ERM program, putting emphasis instead on the improvement of that program from year to year.

As defined in the Manual, ERM is "a risk management framework to assist the insurer with

- Identifying *(potential risks tied to company objectives/ strategic plan)*
- Assessing *(the likelihood and effect of its occurrence)*
- Monitoring *(procedures that mitigate the risks)*
- Managing *(the occurrence and impact)* and
- Reporting *(to the Board and regulators, as required)* on its **material and relevant risks."**

ORSA Responsibility and Governance

The new ORSA **governance structure** may be a big change for insurers, requiring that they now clearly define and articulate roles, responsibilities, and accountabilities. The Board of Directors is responsible for the ultimate decisions for risk management policy and for making key risk policy management decisions. This does not mean that the day-to-day risk decisions should be made by the Board. Instead, the company must have a risk governance team or risk committee with responsibility for daily oversight with respect to risk management, as well as for development of applicable policies and procedures to help the company avoid or mitigate those risks. Under ORSA, the Chief Risk Officer (CRO) will utilize this team to make risk-based decisions and will report to the Board in a regular, transparent manner about their actions and decisions.

The risk governance team is comprised of senior officers with ultimate responsibility for decision making as heads of various company departments. The risk functions could be assigned to an existing senior management team or a newly-designated team. For a small company, the President or CEO should create a team with at least one other officer and not take sole responsibility for the risk governance. If the company does not have a CRO, the risk governance team should immediately appoint either a CRO or, at a minimum, an ERM Program Director.

Assessment of Risk Exposure and Risk Reporting

Managing risk is an ongoing ERM activity, operating at all levels within the organization. Regular reports from each business unit to the risk governance team should contain key risk indicators and risk metrics, which will give the risk governance team all the elements of transparency required for ongoing communication of risk-management. The CRO is responsible for selecting the risk metrics for reports to the Board of Directors, so they will have everything they need to make responsible decisions for the risk management program.

Summary

The ultimate purpose of the ORSA Model and its reporting requirement is to give the company's management and regulators a more accurate way to evaluate material risks that might cause an insurer to fail. Regulators have stated that they will be using company ORSA reports to decide which companies should be targeted for risk-focused examinations. This is good news for the industry, since it should lead to fewer examinations overall for companies with strong ERM programs and well-documented ORSA reports.

At the **2014 Regulatory Compliance Exchange**, Carol Stern and C.J. Rathbun will go into greater detail on this topic in concurrent session 4, **The Own Risk Solvency & Assessment (ORSA).** They will describe the law's requirements, examine how to implement an enterprise risk management (ERM) framework, and discuss why compliance officers will need to be imbedded in the company's risk committee or ERM governance team.

Carol Stern, FLMI, AIRC, ACS, is a Senior Consultant at First Consulting and Administration, Inc. Carol is the newest addition to First Consulting's Operational Compliance and Enterprise Risk Management (ERM) consulting practice. With 30 years of experience in the industry, she brings a CCO perspective to the practice for insurance, annuity, retirement and wholesale broker-dealers. For the past 16 years she held a variety of positions at ING U.S., including Chief Compliance Officer, Head of Corporate Compliance & Ethics, and Chief Money Laundering Officer. Carol was formerly the Director of Legislative and Regulatory Services at the ACLI, where she implemented the online version of the law and compliance services. Please contact her at Carol.Stern@FirstConsulting.com.

C.J. Rathbun, CCEP, FLMI, HIA, AIRC, BFA, is a Senior Consultant at First Consulting & Administration, Inc. C.J. carries responsibilities in the Operational Compliance and Enterprise Risk Management consulting practice, and also manages relationships and workflow for First Consulting's advertising review agency clients. Between 1997 and 2008, C.J. established a proven track record as a Qualified Assessor for the Insurance Marketplace Standards Association (IMSA). C. J. spent two years in the Market Regulation department of the NAIC. She is a member of the Society of Corporate Compliance and Ethics, Contact her at CJ.Rathbun@FirstConsulting.com.

6 Circular Letter No. 14 (2011) requires all domestic companies to implement an ERM program and file an annual risk report. It refers to ORSA but does not adopt the Model Law.

7 NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual http://www.naic.org/documents/committees_e_orsa_wg_related_docs_guidance_manual_2013.