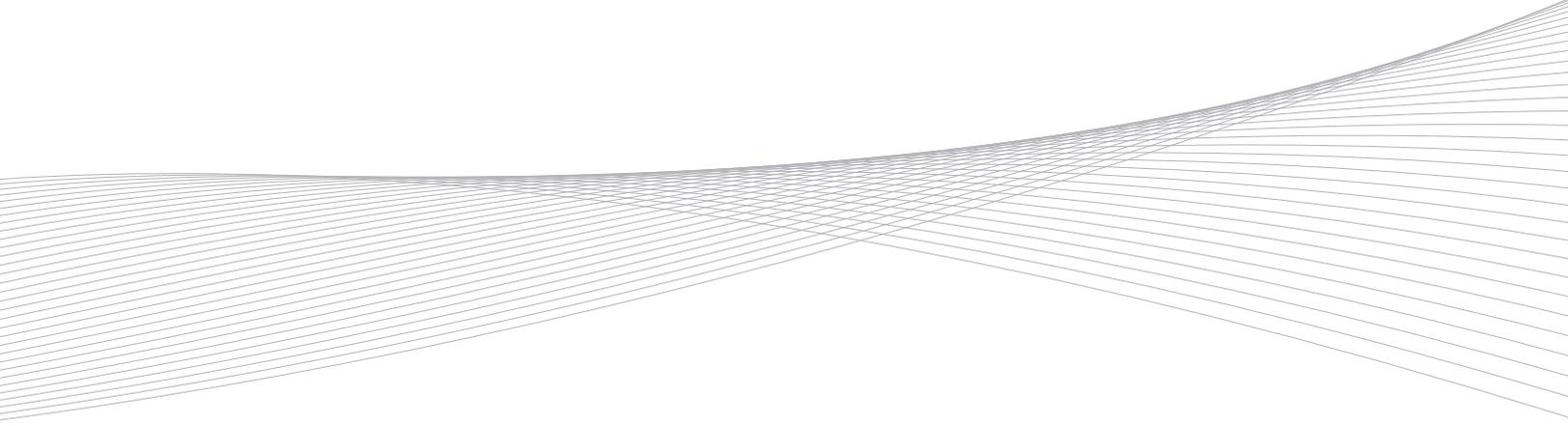




## ORSA: Getting Ready for the 2015 Summary Report

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## INTRODUCTION

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In 2015, the first Own Risk and Solvency Assessment (ORSA) Summary Report will be officially filed in the United States by U.S.-domiciled state-regulated companies. The first ORSA filing will be a climactic point of the Solvency Modernization Initiative (SMI) – the endeavor by the National Association of Insurance Commissioners to create a regulatory framework able to weather economic storms similar to those that battered the U.S. financial services industry and contributed to the global financial crisis.

ORSA was developed as a process of solvency regulation that allows regulators to look through the front window and see how insurers identify, assess, monitor and manage risk, as opposed to looking wistfully in the rearview mirror at events that have already occurred. ORSA is, by its nature, forward-looking; its intent is to link risk regulation to the future strategy of an organization, rather than only applying scrutiny during an exam or other inquiry.

## UNDERSTANDING ORSA

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The ORSA challenges organizations to think about their solvency and risk management processes as part of their overall risk strategy. While the ORSA filing is essentially an annual report, ORSA itself should be viewed internally as an organic, ongoing process that is part of the company's overall enterprise risk management (ERM) efforts. Rather than thinking of the ORSA report once a year, it makes sense for companies to integrate the report's production into their overall ERM efforts on an ongoing and continuous basis.

Because the ORSA is viewed by regulators as a process, the annual document should detail this process to provide regulators relative comfort around the ORSA activities undertaken by the organization. Material risks to the firm, based on its size, scale and capital levels, and the strategic plans to assist senior management with regard to these risks should be featured prominently and articulated clearly in the report, as they serve as the foundations for establishing a promising ORSA process. The ORSA report should also include a broad range of stress tests, scenarios and reverse stress tests to support the assessment of key risks and their potential impacts. In light of the recent heightened focus on capital requirements, the stress testing of strategic capital structures should be considered an integral part of the overall ORSA process and report. Inclusion of these measures within the ORSA report has already proven key in Europe and the same will likely hold true for the U.S., as European and U.S. regulations continue to trend toward similar areas of focus.

## CRAFTING AN ORSA PROCESS AND REPORT

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To meet the ORSA requirements, organizations need to consider a much closer alignment of the risk management activities of the enterprise. Risk management activities and their various components (i.e., risk profile, organization strategy, and solvency needs) will be part of the report, and their alignment will enable a coordinated analysis and true reflection of the material risks to the organization in the report. Producing an ORSA report will thus require a close collaboration among the finance, actuarial, capital management and risk departments of an insurance organization. An integrated approach is key, given the large amount of information and data required from a broad spectrum of sources. It is critical to get a clear view and early agreement on what data will be included in the report (quantitative and qualitative) in order to help identify the processes and tools that will deliver it.

Once an organization has considered its ORSA process and participants, it is in a position to create a report that reflects its risks realistically and dynamically. An ORSA report is made up of both static elements (i.e., information that changes infrequently, such as company history, governance structures, etc.) and variable elements (strategic pieces, solvency requirements and specific risks). While the static elements should not be overlooked, the focus of the ORSA must be on the variable elements to ensure the organization is focusing on a risk profile that changes over time with the organization's evolution.

The ORSA report should cover the future risk profile of the organization and thus it is predominately forward-looking. However, the ORSA report should also include an overview of any key issues and decisions that have developed within the organization over the preceding 12 months, in order to support any difference between the current report and that of the prior year.

Finally, the ORSA report needs to strike a balance between its views on capital, risk and strategy, as well as balance a forward-looking approach with current-state information. Balancing these areas is the key to a successful ORSA report.

## **ESTABLISHING BUSINESS RISK MANAGEMENT**

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In reviewing the risk management frameworks of leading insurance organizations during the buildup to and preparation for ORSA, the following common themes and challenges have emerged:

- Senior management and the board may not have been sufficiently engaged in the role of overseeing risk management;
- Senior management may not be adequately informed of the significant nature of risks facing the organization;
- Risk management policies and procedures may not have been defined sufficiently or consistently across the organization;
- The authority of the CRO is not as developed or at the same level as other C-suite officers; and
- CROs within the business units predominantly report to the business unit instead of to the corporate risk function.

In order to prepare satisfactorily for their ORSA filings, organizations should seek to create a synergy between the risk oversight and business functions in the following ways:

- The board- and management-level risk committees should provide oversight and guidance to the risk management function.
- Management-level committees should establish risk policies to address the major key risk areas.
- The CRO should have board access.
- Overall responsibility for risk management should reside with the CEO, supported by a CRO (optimally reporting directly to the CEO) and a comprehensive risk committee.
- The CRO should have the necessary authority to exercise certain veto powers over transactions, subject to an appropriate escalation process.
- The CRO should be independent of the business units and key business functions.
- Risk management organization functions such as ERM, Compliance, and Internal Audit should operate in an integrated fashion across all business units and risk categories.

## SOURCING RISKS

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The challenges experienced by insurers who do not recognize the early signs of increasing risk and fail to take action to mitigate its impact are now unfortunately apparent. Most traditional risk management processes generally do not include the forward-looking emphasis required to identify and assess emerging or hidden risks. In general, risk measurement capabilities in traditional models are not sufficiently developed, whereby risk and returns are always viewed jointly to measure performance and support decision-making. There are challenges with developing sufficient rigor with which to identify and understand previously overlooked exposures, particularly as they relate to links between market risk and underwriting products.

To combat these challenges and prepare for Solvency II and the proposed NAIC ORSA standards, insurers must replace their traditional risk management models with forward-looking ones. They must conduct a continuous emerging risk management process on a formal basis. They must also develop and implement a consistent approach to risk identification and measurement, data management and modeling (i.e., stress testing, back testing and scenario analysis). They should include liquidity risk management as a core risk management function, along with underwriting, market, credit and operational risk, to address its growing contribution to companies' risk profiles, as specified by the NAIC. Risk management should lead the development of product risk assessment policies and procedures, particularly for complex products, that should be incorporated into the product approval process. Finally, insurers should have a scalable, enterprisewide risk management technology platform to allow for future flexibility as insurance regulations continue to evolve.

## PRIORITIZE BUSINESS RISK

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In hindsight, the financial crisis revealed the inability of select banking and insurance institutions to understand adequately the risk exposures that generated losses and to take appropriate measures. In many organizations, risk management information has yet to be fully integrated into the business in the context of risk-adjusted returns to measure performance and support decision-making. Although there are exceptions, the insurance industry at large has yet to integrate risk and capital metrics with return and profitability metrics when analyzing business results and financial strength. At many companies, there is a lack of consensus among management about the appropriate balance of risk and return. Also typically lacking are regularly occurring formal venues where robust discussions about risk between risk personnel and the business units can take place.

How returns and risk are to be balanced should be specifically articulated by senior management, with input and approval from the board. Business units and key corporate business functions, such as investment management and reinsurance, should receive clear information and guidance from senior management regarding risk tolerance, risk limits, and how they relate to the firm's risk appetite. Compensation for all personnel should be linked to risk-adjusted performance metrics. Risk management should provide input into the calculation of risk-adjusted performance metrics. Policies and procedures should be in place to ensure the ERM group and the risk committee work together to develop an analysis comparing risk-adjusted results against planned results, and share their findings with senior management and the board.

## INTERNAL AND EXTERNAL RISK REPORTING

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Many organizations also face challenges with internal and external reporting of risk-related information. At many companies, multiple risk frameworks such as ERM, Compliance, and the Internal Audit function are siloed instead of inextricably linked. When risk information within a company is produced in silos, it becomes increasingly difficult to aggregate this crucial data for reporting purposes. Historically, the level of risk-related information required by shareholders, regulators and rating agencies was generally low. However, all three have increased their risk disclosure requirements in recent years and will continue to do so.

## IN CONCLUSION

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Insurers should consider the following when building out their ERM system and ORSA reporting process:

- Risk information related to strategy and key decisions should be communicated to stakeholders on a regular basis.
- The way key risk decisions are made within the organization and the forums where decisions are made must be examined, to ensure that the concept of “effective challenge” exists.
- Key risk functions associated with ERM, Compliance and Internal Audit must be closely aligned. The concept of the “three lines of defense” should be applied and should be operating effectively.
- There must be clear communication to risk owners regarding risk policies and expectations for compliance.
- CRO-sponsored workshops related to risk management should be offered and available to personnel.
- External stakeholders such as shareholders, policyholders, regulators, rating agencies and key counterparties should receive risk-related information, to maintain transparent disclosure of key risk issues and risk management strategy.

## HOW PROTIVITI CAN HELP

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Establishing a risk management framework and culture is an evolutionary process. Its development is more successful when it is done in stages and people understand the objectives – building blocks that move the organization closer to an end-state vision. Protiviti’s proven approach to insurance regulation compliance and depth of risk management expertise provide the risk management infrastructure needed not only to implement a robust ERM framework, but also to perform the self-assessment of material risks and evaluate the interrelationships of those risks, as required by ORSA.

We perform the following services:

**Risk management capability assessment and ORSA roadmap** – Our experts can perform an assessment of current risk management practices of specific areas against an ERM/ORSA capability maturity model to identify gaps, create recommendations to remediate gaps, and develop a roadmap for ERM/ORSA implementation and enhancement.

**Model validation** – We can assess a company’s model, the output of which is used to support key decisions, to ensure the model is logical and conceptually sound. In addition, we can benchmark the company model against other model constructs and methods, and compare model predictions to real events and outcomes.

**Stress testing framework and methodology** – Protiviti can provide the governance, framework and methodology to conduct a systematic stress testing process for key risk exposures, to assist insurers in managing their risks and maintaining adequate resources to deal with those risks under atypical conditions.

**Integrated compliance and risk management** – We can design a process for selecting and implementing tools and technologies to automate and increase the organization’s efficiency around risk management and compliance activities.

**Software vendor selection and tool implementation** – Protiviti can assist with selecting and implementing tools and technologies to automate and increase your organization’s efficiency around risk management and compliance activities in a way that will help you maximize investment and gain synergies.

**Internal audit** – Our experts can review your internal audit process to identify key process controls, highlight gaps and inefficiencies in controls and recommend improvements. We also can provide subject-matter expertise to the Internal Audit function to monitor and audit the organization’s progress toward ORSA implementation.

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## ABOUT PROTIVITI

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Protiviti ([www.protiviti.com](http://www.protiviti.com)) is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit, and has served more than 35 percent of FORTUNE 1000® and FORTUNE Global 500® companies. Protiviti and its independently owned Member Firms serve clients through a network of more than 70 locations in over 20 countries. The firm also works with smaller, growing companies, including those looking to go public, as well as with government agencies.

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