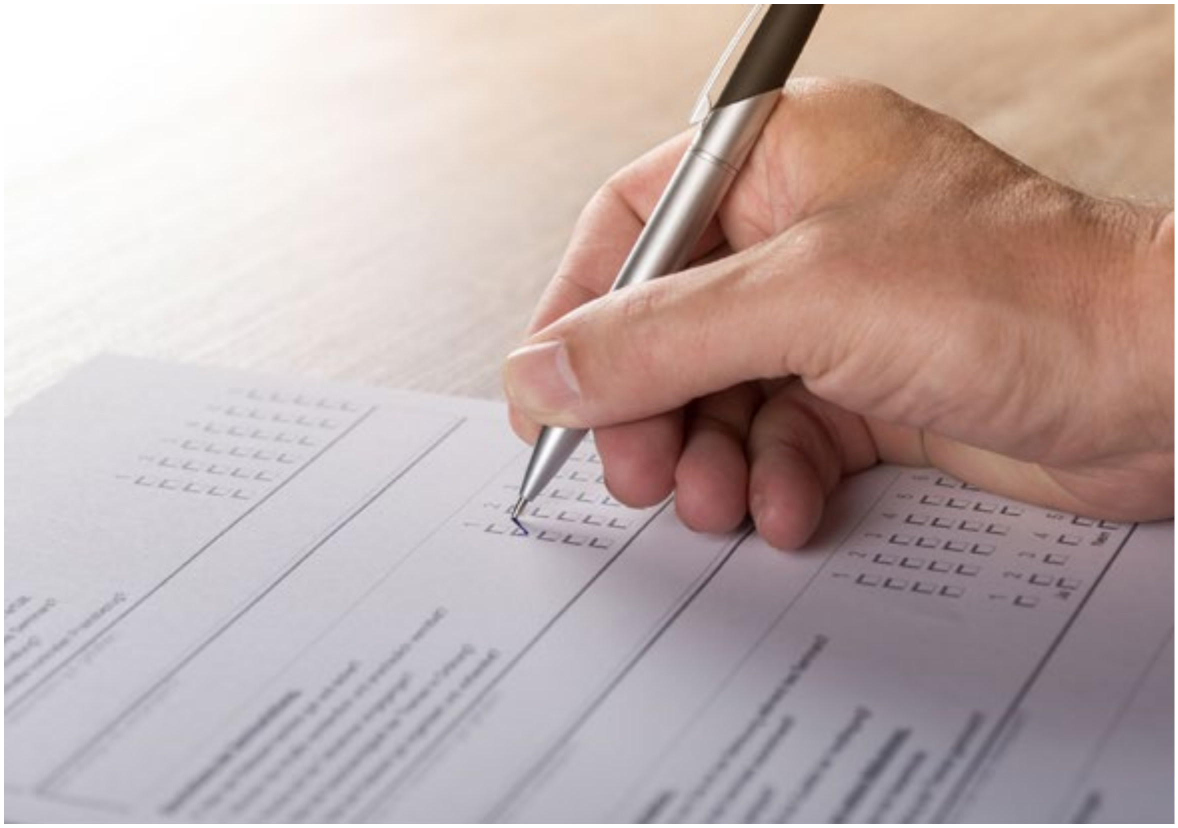
Captive Insurer and ORSA

Written by Karrie Hyatt

During the last few years, the term ORSA has become a watchword. ORSAs (Own Risk and Solvency Assessment) are becoming an important component to an insurer's Enterprise Risk Management (ERM) framework. Captives are not yet required to conduct ORSAs, but the time may not be far off when they will be. Yet many industry professionals recommend captives add ORSAs into their roster of risk assessment and solvency tools.

"All insurance companies, including captives, need to be able to identify, measure and manage their major risks in order to stay in business," said Kate Boucher, Director of Captive Management with Premier Insurance Management Services, Inc. "An ORSA evaluation can also help an insurance company, captive or otherwise, with planning for future growth."



What is ORSA?

At its most simplistic, ORSA is an internally conducted survey of current and future risk borne by an insurance company. However, it is not a one-off assessment, but an on-going evaluation that is intended to evolve as a company grows and changes. It can be a key component to a company's ERM structure and can help a company anticipate potential capital needs.

According to Sandra Bigglestone, Director of Captive Insurance with the Vermont Department of Financial Regulation, "ORSA is about determining future solvency needs based on risk measurements and reporting the results."

ORSA was initially developed as part of Solvency II, the directive initiated by the European Union that addresses the levels of capital European insurers must have. In 2012, the NAIC's Financial Condition (E) Committee passed the *Risk Management and Own Risk and Solvency Assessment Model Act*. This act, which became effective January 1, 2015, requires medium-to-large insurers to "regularly perform an ORSA and file a confidential ORSA summary report" with their regulator upon request. In addition, starting January 1, 2018, ORSA will be required of state insurance departments for NAIC accreditation.

Launching an ORSA

No two companies will conduct the same ORSA—there is no set way to pursue it. The four steps involved in an ORSA are: identifying major risks; establishing a process for measuring those risks; managing and alleviating major risks; and documenting the assessment process and results. These basic guidelines will allow companies developing an ORSA to adapt the process to their individual needs and to adapt the assessment based on changes to their business. "ORSA is not something to be done once and put on a shelf—it is an ongoing process," said Tim Cremin, Consulting Actuary with Milliman, Inc.

According to Boucher, "The ORSA model requires an insurance company to go a bit further than a basic risk self-evaluation and requires that the insurer tie the risk assessment to its risk capital and solvency. An insurer would be expected to stress test its capital based on the risks identified and make sure there is adequate capital to withstand adverse scenarios. In addition, the insurer should be able to demonstrate it has sufficient capital to implement its business plan, even in an adverse scenario."

At this time, captives with $500 million plus in premium are subject to the NAIC's Act. However, many captive regulators and others in the industry endorse the idea that other captives and risk retention groups would benefit from voluntarily conducting ORSAs.

"ERM experts have advised that although ORSA may not be required for risk retention groups and captives," said Bigglestone. "It could be an effective capital assessment tool for monitoring ongoing capital needs and enhance corporate strategies for mitigating solvency risks."

What's In It For a Captive?

While the majority of captives are not currently required to conduct an ORSA by their regulator, voluntarily adopting the practice can help expand their ERM program as well as being ready for regulatory inquiries.

"ORSA is applicable for insurers who write $500 million or more in premiums annually with the goal of providing a group-level perspective on risk and capital," said Bigglestone. "Captive regulators and companies will find value in knowing how a company will respond in the event the captive's surplus falls below company targets and/or regulatory minimums."

Cremin believes that, "ORSA can benefit a captive by providing an ongoing process for identifying, measuring, and mitigating the captive's risks so that the probability of an insolvency is reduced to a tolerable level."

ORSA should be considered a component of a captive's ERM framework and can be an important way for a company to internally assess its risk. According to Bigglestone, "If a captive follows a formal ERM process, perhaps integrated with the captive owners' risk management program, then ORSA

might serve to foster a more effective level of ERM."

Cremin has a similar thoughts about the assessment, "Once the ORSA process is established, future iterations can be used to expand and/or fine-tune the analysis as needed. Additional risks can be identified and incorporated into the plan."

Yet developing and regularly conducting an ORSA is not a solution for every captive. According to Bigglestone, "Implementation of a formal ORSA process is a complex undertaking. Unless the company is already employing formal ERM practices, the price tag would be quite high if the ORSA model and reporting were required for captives."

"Presumably a captive insurer is already doing its own risk assessment and risk management," said Boucher. "A captive may require some assistance with the next step in developing a model to test the key assumptions in the risk assessment and prepare financial projections. Assistance may be available from the parent company or from advisors to the captive, such as the actuary, investment advisor or other insurance consultants. The price tag will depend on where the resources will come from and what work the captive has already done.

Should Captives Adopt ORSA?

As ORSA becomes more widely used and regulators begin to look to the assessment as a reliable tool for evaluating capital, captives will probably want to consider developing an ORSA program. Bigglestone said, "Companies should already be looking at their own unique risk profile, and identifying major risks, and perhaps some actually have a process for measuring, managing and mitigating the major risks. If captives identify the need for a capital assessment tool, a cost-benefit analysis should help determine whether an ORSA-type approach would be worth the trip down that road."

Bigglestone continued, "ORSA is not a one-time exercise, but an ongoing process whereby a company documents the process and results to track changes over time. Since there's a cost to implement such formal processes, it won't make sense for every company to adopt an ORSA, so that decision should be left to the individual companies."

Boucher suggests that, "With ORSA there is not a one-size fits all evaluation, so every insurance company, including every captive, should be doing some sort of ORSA to ensure its surplus position is in sync with its business plan. The depth of analysis and testing should be tailored to the captive depending on the type and amount of risk it is insuring and what its plans are for future growth."

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"I think having an ORSA process in place is another way for a captive to show that it is appropriately capitalized and is being managed in a responsible manner consistent with the approach used by the most highly regarded commercial insurers," said Cremin. *"Insurance regulators are taking a more risk-focused approach to financial examinations, and the ORSA process directly addresses the concerns of this type of examination."*

Cremin added, "Beyond the benefit of regulatory compliance, the ORSA process provides a useful tool that enables the captive's Board and management to identify, measure, and mitigate the risks that arise from the captive's operations."

While ORSA is not required for all captives at this time, it may be some time in the near future. Until then, it can be an important tool to enhance risk management practices. Industry opinion is mixed about whether or not captives should be required to conduct ORSA examinations by their domicile regulator, but most agree that ORSA is an important tool for risk assessment.

"I think that it should be encouraged as a best practice," said Boucher. "Just as every ORSA is different, every captive is different, so a captive should determine based on discussions with its board, regulators and rating agencies just how extensive an ORSA is needed."

"The concept of ORSA is relevant and should raise awareness that captives can and should look at their own risks to measure future solvency needs," said Bigglestone. "At this point in time, I don't believe that a formal mandate requiring captives to implement ORSA would improve the reputation of the captive insurance industry." ■

Karrie Hyatt is a freelance writer who has been involved in the captive industry for more than ten years. More information about her work can be found at: www.karriehyatt.com.