

DRAFT for Aug 8 call

ERM Assessment for Life Insurance Company of Alabama

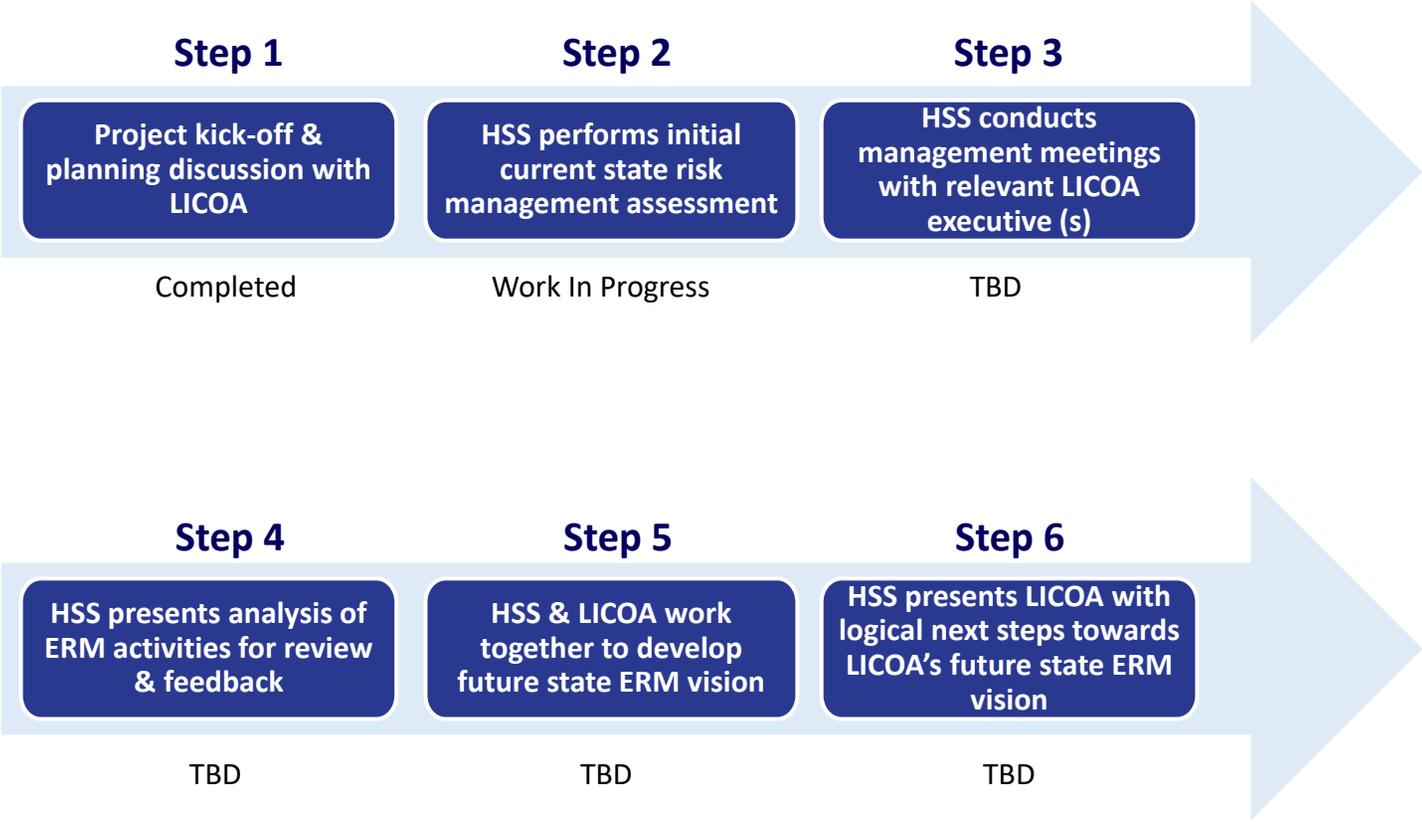
Summer 2016



Meeting Agenda

Day 1	Time
Introductions & HSS project update	15 Minutes
LICOA's business profile	30 Minutes
General topics for discussion	30 Minutes
LICOA's key business objectives	45 Minutes
<ul style="list-style-type: none">Including key risks to meeting objectives	
ERM processes in place at LICOA today	15 Minutes
ERM topics for discussion	45 minutes
<ul style="list-style-type: none">Review of reference material provided by HSS	
HSS initial ERM observations	1 Hour
Day 2	Time
Review updated HSS ERM observations	2 Hours
A.M. Best review of LICOA by HSS	90 Minutes
Next steps	30 Minutes

Project Plan Status Update & Timeline



LICOA's Business Profile

Vision: Supplemental health and life provider for middle-America to fill the gap using worksite marketing.

Key Strengths

- Experienced sales force in worksite market
- “Solid” risk-adjusted capitalization
- Cancer product now capped
- Increasing life exposure - diversification
- LICOA College
- Focused liability portfolio
- Licensed in 11 states

Offsets

- Concentration of business (by product line, assets, and state)
- No formal ERM documents (risk appetite, tolerance)
- Potential mismatch of assets/liabilities
- Recent asset portfolio missteps
- Limited growth in premiums
- Increasingly competitive marketplace
- Succession planning, outsourced expertise, unclear oversight
- Holistic level operational risk plan: disaster recovery, fraud, IT, cyber risk

General Discussion Topics

1. History and ownership of LICOA
2. Vision & mission
 - Middle-America, worksite supplemental products
3. Investment strategy in today's environment
4. Roles of executive management team and succession planning
5. Product offerings and plans for expansion & growth
6. Plans for disaster recovery, fraud, cyber assessment
7. LICOA's perspectives on capital management and risk
 - Consider risk metrics like RBC
8. LICOA's perspectives on earnings management
 - Drivers of recent financial results
9. LICOA's reinsurance program strategy
10. Purchase of corporate insurance (cyber assessment)
11. Main issues raised from discussions with A.M. Best

LICOA's Business Objectives

Discuss corporate & business unit objectives along with key risks to meeting these objectives, as well as metrics utilized to ensure success:

1. Increase life premium as percentage of total
2. What does LICOA do well? vs. outsourced tasks
3. Establish the framework of a responsive ERM program that can evolve as the company grows
4. Evolve on-line presence to meet customer needs while balancing privacy
5. Maintain underwriting discipline & underwriting expectations for continued development in claims as our LDFs are adjusted to reflect past performance
6. How does LICOA see the competitive marketplace for supplemental products over short, intermediate and long time horizons

ERM Related Processes - TBD

1. Board of Directors

- Compensation committee (are incentives aligned)
- Audit committee (how does risk team interact with three lines of defense)
- Corporate Governance committee (role of each committee and board as a whole)

2. Corporate & business unit objectives

- Measurable metrics, key risk indicators

3. Budgeting & business planning processes

4. Corporate policies & procedures (e.g., employee, investment, risk appetite)

5. Underwriting & Claims (e.g., claims reviews, underwriting protocol, monitored metrics like new policies in force, lapse rate, new claims rate, medical claims expense trend per treatment type, average claim paid per policy type/claim types, etc.)

ERM Related Processes - TBD

6. Monitoring of risk concentration & exposures
7. Business continuity & disaster recovery plans
8. IT security plan/Cyber assessment
9. Dashboard reports containing range of key metrics
10. A.M. Best's BCAR & NAIC RBC as models for risk-based capital adequacy
11. Emerging risks

ORSA is Organized into Three Key Sections

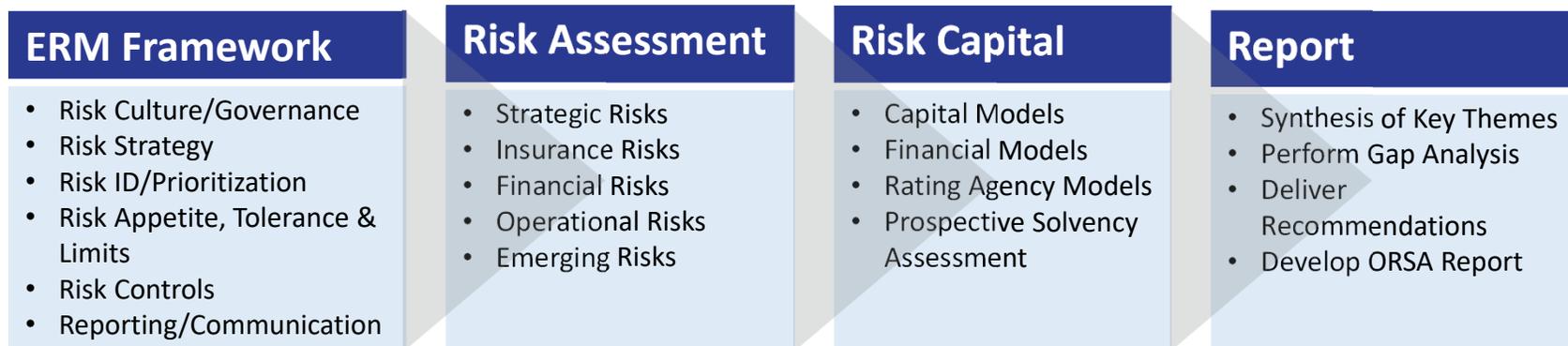
To be consistent with NAIC ORSA requirements, the following sections, “ERM Topics for Discussion” & “HSS Observations,” are organized into three key sections.

Section 1 - Description of insurer’s ERM framework including:	<ul style="list-style-type: none">• Risk culture & governance• Risk identification & prioritization• Risk appetite, tolerances & limits• Risk management & controls• Risk reporting & communication
Section 2 - Insurer’s quantitative & qualitative assessment of risk exposure to include:	<ul style="list-style-type: none">• Details of risks identified, measurement approaches used & assumptions• Quantification of risk for each major risk category• Outcomes of plausible adverse scenarios• The impact of stressed environments on available capital, considering multiple capital viewpoints if relevant (e.g., regulatory, rating agency)
Section 3 - Group risk capital & prospective solvency assessment:	<ul style="list-style-type: none">• Definition of solvency, accounting or valuation regime• Time horizon of risk exposure• Risks modeled• Quantification method• Measurement metric• Target level of capital• Aggregation and diversification

Note: ORSA Report to be filed annually with relevant State Insurance Department

HSS Approach to ERM

The HSS Enterprise Risk Management Approach



ERM Topics for Discussion: ERM Framework

1.	LICOA's ERM value proposition
2.	ERM goals and objectives for 2016 and beyond <ul style="list-style-type: none">• Future state vision
3.	ERM framework <ul style="list-style-type: none">• ERM practices already in place• ERM process elements to be introduced
4.	Risk appetite statement, tolerances & limits
5.	Risk & control assessment processes <ul style="list-style-type: none">• How to monitor mitigation plans• How to ensure elements are current (e.g., business continuity plans, identification of emerging issues)
6.	Risk governance <ul style="list-style-type: none">• How it fits into current structure• Role of board and audit/corporate governance committees

ERM Topics for Discussion: Risk Assessments

7.	Risk register for key business risks <ul style="list-style-type: none">• Linkage to corporate objectives
8.	ERM dashboard reports <ul style="list-style-type: none">• Current report types and distribution• Plans for development
9.	ERM related management actions plans
10.	Development of risk measurement tools <ul style="list-style-type: none">• Use of heat & value maps, etc.• Consistent pricing methodology
11.	Threats to LICOA's financial strength
12.	Risk aggregation

ERM Topics for Discussion: Risk Capital

13.	Current use of risk & capital models
14.	Key business risks identified by risk & capital model output
15.	Vendors used to develop risk & economic capital models <ul style="list-style-type: none">• Responsibility for running these models• Assets and liabilities
16.	Use of stress testing and scenario analysis
17.	Future plans to develop & use economic capital models <ul style="list-style-type: none">• Capital at risk• Earnings at risk• Capital allocation

ERM Review: Risk Management Framework

Risk Management Area	Stage	HSS Risk Assessment Components
Risk Culture & Governance		What is the organization’s risk management governance structure? Are roles, responsibilities & accountabilities clearly defined? Does the risk culture support accountability in decision making? Does management & the Board mutually understand the cos. risk profile?
Risk Identification & Prioritization		Who is responsible for ensuring risk identification & prioritization occurs? Are all key risks to meeting business objectives being identified? Are risks being assessed individually to determine relative importance? Is risk identification process functioning properly across the organization?
Risk Appetite, Tolerance & Limits		Have formal risk appetite statements been developed? If so, are risk appetite states being operationalized in the business? Are risk appetite statements actionable? Do they reflect the up-side of risk? Are risk appetites (top-down) aligned with risk limits (bottom-up)?
Risk Management & Controls		Are action plans developed to mitigate unacceptable risks? Are major issues & loss events being captured along with loss data? Are risk & control self-assessments being prepared? Are controls appropriately documented & tested?
Risk Reporting & Communication		Are internal risk reports complete & disseminated in a timely basis? Are key risk exposures being aggregated in dashboard reports? Are results from risk assessments being communicated to managers? Does existing technology adequately support risk management needs?

● = Advanced Level
 ● = Intermediate Level
 ● = Basic Level

ERM Review: Risk Assessment

Risk Management Area	Stage	HSS Risk Assessment Components
Strategic Risks		<p>Are all key risks to meeting business objectives being analyzed?</p> <p>How is the marketplace evolving?</p> <p>Is there a link between risk exposure & the decision-making framework?</p> <p>Does an effective dashboard risk reporting mechanism exist?</p> <p>Are key risk indicators or key performance indicators being utilized?</p>
Insurance Risks		<p>Is distribution risk being addressed appropriately?</p> <p>Is the size & structure of the reinsurance program purchased appropriate?</p> <p>What is the organizations risk appetite regarding reserve/pricing adequacy?</p> <p>Are pricing risk, risk selection, coverage & delegated authorities evaluated?</p>
Financial Risks (e.g., Credit, Market & Liquidity)		<p>Is liquidity and cash flow testing being done?</p> <p>Are assets & the investment strategy linked to the nature of liabilities?</p> <p>Are the impacts of interest rates & market price changes being recognized?</p> <p>Are accounting & tax risks being appropriately evaluated?</p>
Operational Risks		<p>Are product development & design risk being evaluated?</p> <p>Is scenario analysis being utilized to evaluate operational risk?</p> <p>Are the results of operational risk being included in the capital model?</p>
Emerging Risks		<p>Is there an emerging risk committee in place?</p> <p>Is there a formal way to identify & prioritize emerging risks?</p> <p>Are magnitude of emerging risks reported to management & the Board?</p> <p>Does the Company actively seek out external input on emerging risks?</p>

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ERM Review: Risk Capital Assessment

Risk Management Area	Stage	HSS Risk Assessment Components
Risk & Capital Model Overview		<p>Are internal risk & capital models being prepared? Which vendors are used? Who is responsible for running these models? What are model assumptions & what documentation exists? How frequently are models being run and what is quality of data utilized? Are processes and procedures formally documented? Is there an independent review of modeling processes? Are capital & financial models understood & used by management?</p>
Estimating Risk Capital		<p>Are key risks being captured in economic capital modeling? Are capital model risk charges factor based, deterministic or stochastic? What assumptions are made about risk correlation? Is credit given for diversification? If so how is this determined? Which risk capital metrics are being utilize? Probability of ruin, VaR, TVaR? At what percentile is the solvency security standing utilized defined? Is the capital assessment forward looking? If so, over what time horizon?</p>
Uses of Risk & Capital Models		<p>What are the business uses of risk & capital models? Does the reinsurance program design reflect risk modeling? Are outputs from capital models used for performance management? Are outputs from capital & financial models linked to business planning? Are Economic Scenario Generators used in capital modeling process? Is scenario analysis or stress testing incorporated into modeled results? Is capital being allocated to specific business units??</p>

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HSS Initial Observations: ERM Framework I

Risk Management Area	Level	Commentary - TBD
Risk Culture & Governance	●	<p><i>Discuss ERM value proposition & framework -strengths/opportunities</i></p> <ul style="list-style-type: none"> • Risk culture should support accountability and risk ownership • Develop and formally adopt risk appetite, tolerance and limits • Further articulate ERM policy and value proposition • A broader ERM framework should be developed – some pieces to the puzzle are already there – document and communicate • Challenge may be communicating and embedding risk culture & governance across a wide range of stakeholders • Expand board charter to include review of ERM issues
Risk Identification & Prioritization	●	<p><i>Discuss: Risk universe & use of a risk register</i></p> <ul style="list-style-type: none"> • Ensure corporate and business unit objectives are measurable • Create a formalized risk Identification process, maintain a risk register both in the context of the new ERM framework • Ensure key risks to meeting business objectives are being assessed and effectively addressed • Develop a calibrated risk assessment process for prioritizing and sizing risks (e.g., use of heat maps) • Ultimately, endeavor to ensure key business risks are incorporated into an estimated risk capital requirements

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HSS Initial Observations: ERM Framework II

Risk Management Area	Level	Commentary - TBD
Risk Appetite, Tolerance & Limits	●	<p><i>Discuss: Use of high-level risk appetite statements</i></p> <ul style="list-style-type: none"> • Develop risk appetite statements to ensure LICOA’s risk profile can be even more effectively monitored and managed • Ensure risk appetite statements are linked to risks associated with achieving key business objectives (i.e., the risks that really matter) • Ensure management team understands the concepts of risk appetite, tolerance and limits and alignment between them
Risk Management & Controls	●	<p><i>Discuss: Current risk & control assessment processes in place today</i></p> <ul style="list-style-type: none"> • Further develop risk and control processes • Use of mitigation action planning; especially when risk exposures exceed risk tolerance levels • Ensure annual audit plan covers risk-related areas and issues
Risk Reporting & Communication	●	<p><i>Discuss: Risk reporting processes and tools</i></p> <ul style="list-style-type: none"> • Ensure ERM processes are included in audit reviews • Further develop board and risk committee charters and reports • Fine tune content & distribution of current dashboard reports • Engage board in more effective ERM dialogue • Explore use of ERM software – MS Office may be sufficient • Longer-term, develop ERM processes that can easily be exported to create an NAIC ORSA report when needed

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HSS Initial Observations: Risk Assessment I

Risk Management Area	Level	Commentary - TBD
Strategic Risks	●	<p><i>Discuss: Strategic risks the can impact LICOA's long term health</i></p> <ul style="list-style-type: none"> • Review vision, mission, and creation of corporate objectives • Executing the plan is always challenging and there could be benefit to creating even more of a direct linkage – using more measurable metrics – to achieving future business objectives
Insurance Risks	●	<p><i>Discuss: Processes used to evaluate insurance risk</i></p> <ul style="list-style-type: none"> • A.M. Best’s BCAR and NAIC RBC models should be integrated into decision making • Review risk register for completeness

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HSS Initial Observations: Risk Assessment II

Risk Management Area	Level	Commentary - TBD
Financial Risks (Credit, Market & Liquidity)	●	<p><i>Discuss: Financial risks emanating from this volatile market</i></p> <ul style="list-style-type: none"> • <i>Ensure linkage to risk appetite, risk tolerance & risk limits</i> • <i>Monitor, forecast, and analyze interest rate, credit & stock market swings in light of current investments</i> • <i>Review ALM benchmarks</i> • <i>Test budget and earnings forecasts</i> • <i>Monitor alternative investment risks, if any</i> • <i>Monitor tax planning risks</i>
Operational Risks	●	<p><i>Discuss resources required to execute LICOA’s business strategy</i></p> <ul style="list-style-type: none"> • Use of scenario analysis to evaluate operational risks • Longer-term, developing operational risk assessments, can help validate risk appetite & estimate economic capital needs
Emerging Risks	●	<p><i>Discuss how emerging risks are currently being assessed</i></p> <ul style="list-style-type: none"> • As part of LICOA’s ERM future vision, suggest including the assessment of emerging risks (e.g., cyber & social media) • Ultimately, results from emerging risk assessments can be incorporated into economic capital model output

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HSS Initial Observations: Risk Capital I

Risk Management Area	Level	Commentary - TBD
Risk & Capital Model Overview	●	<p><i>Discuss: Current use of risk & capital models</i></p> <ul style="list-style-type: none"> • Current focus is on A.M. Best Capital Model (BCAR) & NAIC RBC • Suggest enhancing use of BCAR by performing stress-testing and scenario analysis and including output into the model • Suggest using A.M. Best BCAR Adjustment System to monitor current & prospective capital needs • As part of later phase of ERM development consider expanding capital models to be used in decision making
Estimating Risk Capital	●	<p><i>Discuss risk based capital</i></p> <ul style="list-style-type: none"> • Ultimately, output from the ECM will be used to help estimate & demonstrate how much capital is needed to run the business • Capital adequacy should be measured currently & prospectively, incorporating financial forecasts for the next several years • LICOA’s estimate of risk capital should take into account risk diversification and correlation or lack thereof • Risk capital estimates can be enhanced by including results from risk assessments for the following: <ul style="list-style-type: none"> – Strategic risk – Operational risk – Emerging risks

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HSS Initial Observations: Risk Capital II

Risk Management Area	Level	Commentary - TBD
Uses of Risk & Capital Models		<ul style="list-style-type: none">• Once satisfactorily parameterized and vetted an economic capital model can be used for capital allocation purposes to business units, product lines, geographies.• ECM also can be used to validate risk assessments, further develop risk appetite statements, evaluate earnings at risk and capital at risk and evaluate new business opportunities• ECM output can be used to further develop risk-based decision making processes and making even more informed decisions• Consistent decision making can utilize marginal analysis

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ERM Future State Vision

Addendum

HSS Operational Observations

A.M. Best Rating Review



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