

ERM Assessment for Life Insurance Company of Alabama

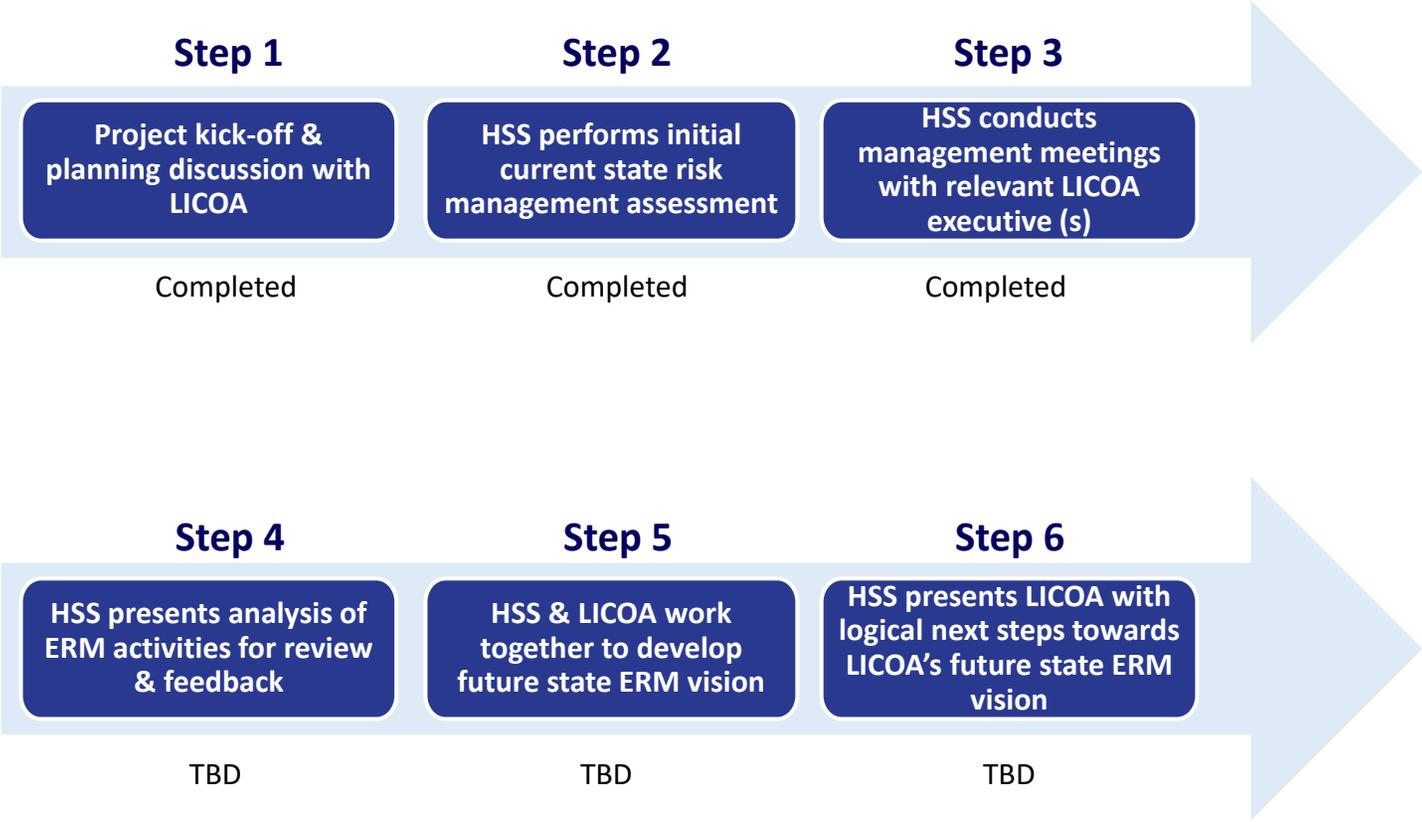
September 8, 2016



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

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
- Licensed in 11 states
- Focused liability portfolio

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
- Current A.M. Best rating of B++
- Agency rollover/recruiting

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. Identify what LICOA does well internally and what it should outsource
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
6. Evaluate the competitive marketplace for supplemental products

ERM Related Processes - Discussion

1. Board of Directors
 - Compensation committee
 - Audit committee
 - Corporate Governance (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. Silo risks such as underwriting, claims (including key risk indicators - 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 - Discussion

6. Business continuity & disaster recovery plans (need summary)
7. IT security plan/Cyber assessment (need summary)
8. Dashboard reports containing range of key metrics
9. A.M. Best's BCAR & NAIC RBC as models for risk-based capital adequacy

ORSA is Organized into Three Key Sections

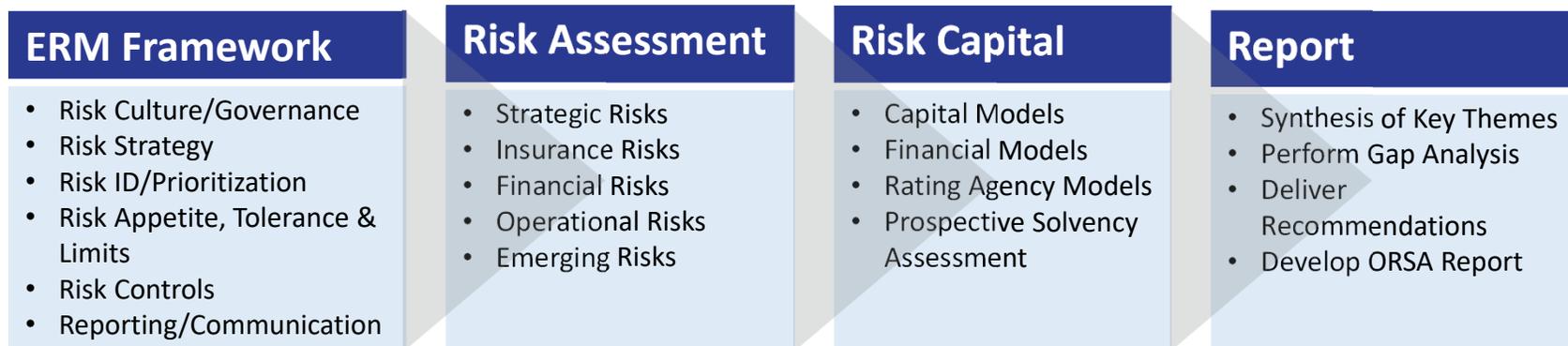
To be consistent with NAIC ORSA requirements, the following sections, “ERM Topics for Discussion” & “HSS Observations,” are organized into three key sections.

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

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ERM Review: Risk Capital Assessment

Risk Management Area	Stage	HSS Risk Assessment Components
Risk & Capital Model Overview		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?
Estimating Risk Capital		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?
Uses of Risk & Capital Models		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??

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HSS Initial Observations: ERM Framework I

Risk Management Area	Level	Commentary
Risk Culture & Governance	●	<p><i>Discuss ERM value proposition & framework -strengths/opportunities</i></p> <ul style="list-style-type: none"> • The company has no ERM value proposition and needs to develop one that balances risk and return and becomes integral in sustainability of a growing, independent enterprise. • The Board is not involved in ERM and needs to be integrated and educated in the ERM process. • There is no Risk Officer and one needs to be identified as the ERM process owner. • A broader ERM framework should be developed on a phased-in basis. • The Board should eventually include more independent directors, possibly with financial, legal or risk expertise.
Risk Identification & Prioritization	●	<p><i>Discuss: Risk universe & use of a risk register</i></p> <ul style="list-style-type: none"> • A risk Identification process needs to be developed that identifies risk owners. • The Company does not have a process for identifying specific business objectives. • The Company does not have a risk register and one needs to be created, with a minimum of 5 key risks prioritized initially and eventually expanded. • Eventually, the Company needs to create heat maps and dashboards consistent with the risk register.



HSS Initial Observations: ERM Framework II

Risk Management Area	Level	Commentary
Risk Appetite, Tolerance & Limits		<p><i>Discuss: Use of high-level risk appetite statements</i></p> <ul style="list-style-type: none"> • There is no risk appetite statement(s), which need to be created and approved by the Board, that link to achieving key business objectives, which support the Company’s strategy. • Ensure management team and staff understand 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"> • The Risk Officer should drive and manage the risk control process, which should include mitigation action planning and capital allocation. • The ERM process should be monitored by the Audit & Risk Committee quarterly and ultimately to the Board.
Risk Reporting & Communication		<p><i>Discuss: Risk reporting processes and tools</i></p> <ul style="list-style-type: none"> • The ERM framework should be reviewed and approved by the Board annually. • Risk Dashboards, as well as Key Risk Indicators, need to eventually be developed that align with the risk appetite statements. • ERM needs be integrated into both rating agency and regulatory (ORSA) reports that highlight best practices. • Better use of graphs to identify and highlight trends is needed.

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HSS Initial Observations: Risk Assessment I

Risk Management Area	Level	Commentary
Strategic Risks	●	<p><i>Discuss: Strategic risks that can impact LICOA’s long term health</i></p> <ul style="list-style-type: none"> • As the Company advances its strategy, it needs to be baked into the ERM process and reviewed no less than annually. • As the Company expands its product offerings, each needs to be assessed in terms of its ERM impact, including aggregate risk. • The Company faces increased competitive pressures at a time when it needs to grow. • The evolution of the health sector needs to be carefully monitored and assessed.
Insurance Risks	●	<p><i>Discuss: Processes used to evaluate insurance risk</i></p> <ul style="list-style-type: none"> • Integrate A.M. Best’s BCAR and/or NAIC RBC models into decision making. • The Company’s distribution network is aging and concentrated regionally, which will a challenge for new product development and expansion. • While reinsurance in not currently a critical factor, it could be with product expansion.

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HSS Initial Observations: Risk Assessment II

Risk Management Area	Level	Commentary
Financial Risks (Credit, Market & Liquidity)	●	<p><i>Discuss: Financial risks emanating from this volatile market</i></p> <ul style="list-style-type: none"> • The current effort with SAAI will add needed refinement of the investment policy statement and needs be considered a key component of the ERM framework. • As the Company refines its investment policy statement to assure a better ALM strategy, it needs solid liability benchmarking. • Stress testing driven by the Company’s unique risk profile needs to be enhanced. • The firm’s liquidity needs to be profiled, especially with an evolving product and asset mix.
Operational Risks	●	<p><i>Discuss resources required to execute LICOA’s business strategy</i></p> <ul style="list-style-type: none"> • Concentration is a key risk to the Company. • Succession planning is a key risk that needs to be developed. • Business continuity needs to be tested and documented (summary).
Emerging Risks	●	<p><i>Discuss how emerging risks are currently being assessed</i></p> <ul style="list-style-type: none"> • A key emerging risk is cyber risk and a clear cyber policy, as identifying exposures, needs to be developed. • Product delivery for millennials needs to be considered.

HSS Initial Observations: Risk Capital

“WORK IN PROGRESS”

Risk Management Area	Level	Commentary
Uses of Risk & Capital Models		<ul style="list-style-type: none">• Either the RBC or BCAR should be sufficient to evaluate capital needs for the foreseeable future.• Capital need should incorporated into the ERM process when making operational and performance evaluations.• The RBC or BCAR components should be evaluated individually and in aggregate.

 = Advanced Level  = Intermediate Level  = Basic Level

ERM Future State Vision

ERM Future State Vision

- **Phase 1: December 31, 2016**
 - Define ERM Value Proposition & Vision
 - Outline basic ERM Framework (how it fits together)
 - Integrate the new Investment Policy Statement, including liability benchmarks, into ERM
 - Determine basic Risk Appetite, approved by the Board, as well as Risk Tolerances and Limits
 - Identify five (5) Key Risks from a simplified Risk Register
 - Establish Governance:
 - Begin Board reporting on a regular basis
 - Form an Audit & Risk Committee of the Board
 - Designate a Risk Officer that reports to the Audit & Risk Committee
 - Eventually, form [3-5] person Working Risk Group to examine risk issues
 - Draft an A.M. Best ERM Presentation that becomes part of the Presentation Book
 - Prepare a revised A.M. Best Presentation Book for November

ERM Future State Vision

- **Phase 2: December 31, 2017**
 - Evaluate and Adjust Phase 1
 - Introduce to the entire staff, including training meetings
 - Establish bi-weekly meetings (to set the tone)
 - Ensure Key Risks are being managed
 - Expand the Risk Register with key risks developed
 - Develop an internal dashboard of key metrics
 - Refined and initiate dialogue internally on risk appetite, tolerances and limits
 - Update A.M. Best presentation
- **Phase 3: December 31, 2018**
 - Draft ORSA Report – internal or external focus
 - Refine Board Reporting and ERM organization
 - Evaluate capital modeling needs beyond BCAR or RBC

Addendum

HSS Observations

HSS Observations

- Considerations
 - Product and geographic mix needs to be diversified for growth
 - Distribution needs to be re-gentrified and matched to future state
 - Direct/Online distribution alternative should be considered
 - LICOA College might be resurrected and become a key contributor
 - Succession planning needs to be considered
 - Diversifying products beyond non-worksite seems opportune
 - Consider LICOA brokerage as a potential laboratory for product ideas
 - Consider evaluating acquisitions as a diversification strategy within capital limits

A.M. Best Rating Review



Contact Information

Tim Morris

49 Archdale Street, Suite 2F

Charleston, SC 29401

Phone: 843-723-8701

Cell: 843-437-8316

tmorris@HanoverStoneSolutions.com