



**U.S. Insurance Regulation and Supervision – International Fellows Spring 2012**



**Overview of U.S. Insurance Regulation and Supervision**

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NAIC



**Insurance Supervision**

- State Regulation of Insurance
- McCarran-Ferguson Act (1945) – “business of insurance” regulated by the states
- Department of Insurance
- Commissioner / Superintendent / Director
  - Mostly Appointed by Governor
  - Elected – 12 states
  - Appointed by Legislature - 1



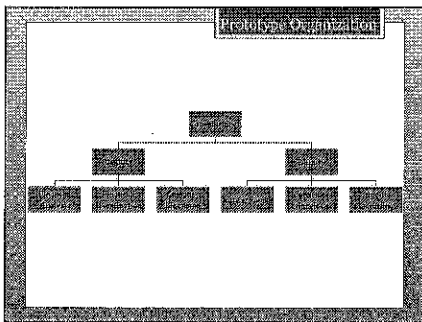
**Introduction**

- Insurance Department Overview
- Basic Functions Of Insurance Regulation
- Role Of The NAIC
- Summary Information On U.S. Industry
- Interaction Between Regulators And Legislators

**Insurance Supervision**

- Department of Insurance
  - Commissioner, Deputy Commissioners
  - Licensing – Agent/Broker
  - Products Regulation
    - Forms
    - Rates
  - Insurer Financial Regulation:
    - Licensing & Admissions
    - Financial Analysis & Examination
  - Market Conduct/Consumer Affairs
  - Legal
  - Consumer Education
  - Others



**Insurance Regulation**

**Insurance Regulators Protect Policyholders through:**

- Solvency Surveillance (financial regulation)
- Ensure Appropriate & Equitable Rates (Profitable)
- Complex & Technical Nature Of Insurance Contracts (Consumer Services, products, transaction approval)
- Protect Consumers Against Fraud & Unethical Market Behavior (Market Conduct, Agents, Criminal Investigation)
- Foster Efficient Insurance Markets (Market Development)
- Restrict Ability Of Insurers To Withdraw From Certain Markets (Market Development)



**To Enforce Insurance Laws**

- Ensure Laws Are Followed & Implemented Correctly



**Insurance Supervision**

- Insurance Department Data
  - Total budgets 2010: \$1.79 B
  - Total budgets 2009: \$1.60 B
  - 11,590 full time employees
- Funding Sources
  - Applications, Filing Fees & Assessments
  - Fines & Penalties
  - General Funds
  - Premium Taxes

**Measurement of Insurance Supervision**

- To Keep the Public Informed**
  - Consumer Protection
  - Insure U Campaign
- To Preserve Open, Competitive Markets**
  - Prevent Under-priced Products To Gain Market Share
  - Ensure That Premium Levels Are Adequate
- To Maintain Insurer Solvency**
  - Continuously Monitor Insurers' Financial Condition
  - Ensure That Insurers Are Financially Able To Pay Claims



**Ongoing Core Initiatives**

### Solvency and Accreditation

- NAIC's Financial Regulation & Accounting Division Provides Financial Regulation and Solvency Surveillance Support to States - Monitoring Approx. 1,300 Largest Insurers
- 1989 Policy Statement - Financial Regulation Standards
- 1990 - Formal Certification Program - Accreditation
  - Annual Evolution and Re-certification at 5 Year Intervals
- Standards Are Flexible In Order to Adapt to Changing Market Needs
- As of June 2009 - all 50 States Certified/Accredited



**Ongoing Core Initiatives**

### NAIC Research and Statistics

- Actuarial Expertise (Life, Health and P&C)
- Rate and Form Expertise
- Economic Studies
- Regulatory Policy Analysis
- Statistical Reports
- Market Analysis
- Assist in monitoring states' progress toward NAIC goals




**Ongoing Core Initiatives**

### NAIC Publications

- Currently, the NAIC Publishes Over 150 Insurance Related Products for use by Regulators, Insurers and Consumers
- Top Sellers
  - Medicare Supplement Guides and Long-term Care Guides
  - Annual Statement Instructions and Annual Statement Blanks
  - Accounting Practices and Procedures
  - Valuation of Securities CD
  - Model Laws
  - Listing of Companies
  - Retention Guide

### NAIC Education


- 81 Education Programs - Regulators and Public



**U.S. Insurers Market**

- Total insurers in the U.S. - 7,869
  - Property/casualty - 2,737
  - Life/health/accident - 1,105
  - Others: HMO, Blue Cross/Shield, Fraternal
- Gross insurance premium (USD) - \$1.787 Tr.
  - Property/casualty - \$456B
  - Life/health/accident - \$1.2 Tr

• Source: 2009 Insurance Dept. Resources Report




**U.S. Insurance Market**

### • Largest states - annual premium volume

State	2010	2009
California:	\$211B	\$221B
New York:	\$130B	\$152B
Florida:	\$105B	\$106B
Texas:	\$103B	\$98B
Pennsylvania:	\$83B	\$81B
Illinois:	\$59B	\$59B


• Source: 2010 Insurance Dept. Resources Report, NAIC P&C Policy & Health Accident, and Life/Health/ACCID. Markets by State



**U.S. Insurance Market**

- "Producers" = agents, brokers
- Total licensed agents, brokers
  - 6,032,018 Licensed Individuals
    - 2,124,924 Resident
    - 3,907,094 Non-resident
  - 483,763 Licensed Business Entities


• Source: 2009 Insurance Dept. Resources Report



**Global Insurance Market**

Jurisdiction	Premium Volume*	Market Share
1 United States	\$1,549,034	34.61%
2 Japan	\$505,628	11.31%
3 United Kingdom	\$309,241	6.91%
4 France	\$288,070	6.39%
5 Germany	\$235,265	5.33%
6 CALIFORNIA	\$230,594	5.18%
7 Italy	\$180,280	4.09%
8 P&C China	\$183,647	4.14%
9 NEW YORK	\$174,802	3.91%
10 Netherlands	\$105,144	2.37%
11 FLORIDA	\$101,268	2.28%
12 TEXAS	\$96,396	2.16%
13 Canada	\$85,540	1.91%
14 South Korea	\$1,583	0.04%
15 Spain	\$2,776	0.06%
16 PENNSYLVANIA	\$80,983	1.80%
17 India	\$6,085	0.14%
18 Taiwan	\$5,547	0.12%
19 Australia	\$0,317	0.01%
20 ILLINOIS	\$59,559	1.33%
21 OHIO	\$6,946	0.15%

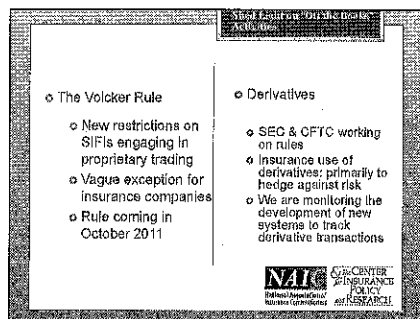
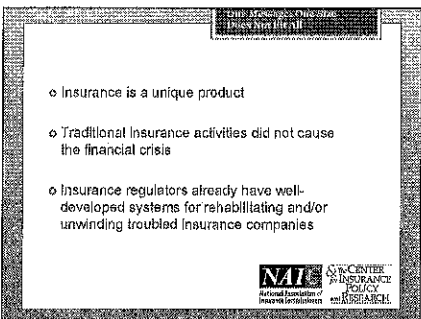
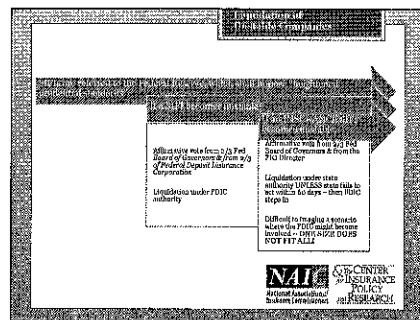
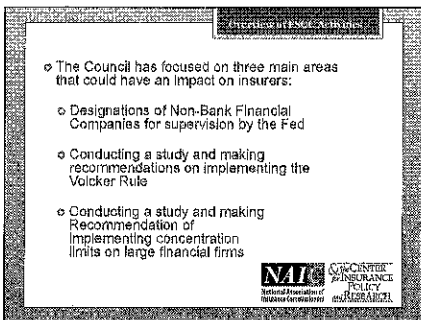
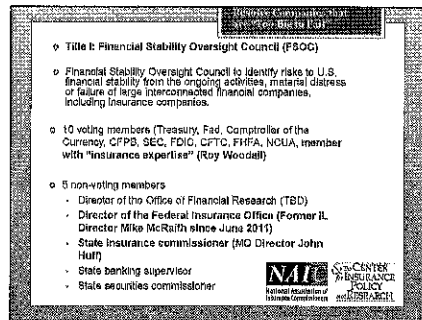
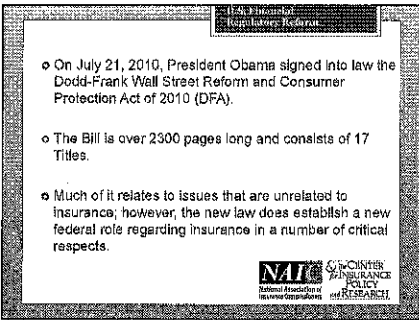
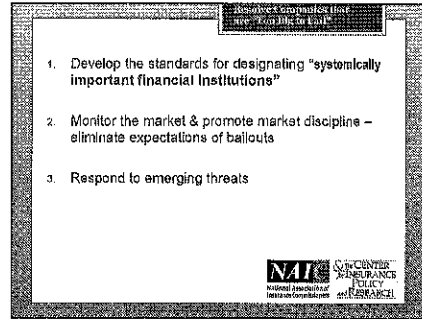
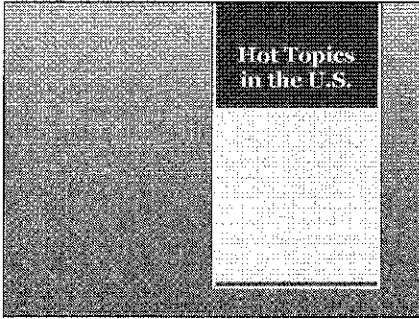
\* US \$ million 2008 Q4W



**Global Insurance Market**

- State Legislature
  - House
  - Senate
  - NCSL (National Conference of State Legislators)
  - NCOIL (National Conference of Insurance Legislators)
- State Department of Insurance
  - Legislative Proposals, Consultation - Model Laws
  - Authority to "Regulate" / Implement Laws





**Federal Insurance Office  
(FIO) (U.S. Initiative)**

- Establishes a Federal Insurance Office (FIO), housed in the Treasury Department
- Help the federal government gain a better understanding of the insurance market and negotiate international agreements
- Does not give Treasury general supervisory or regulatory authority over the business of insurance.
- No jurisdiction over solvency or capital

**NAIC** National Association of Insurance Commissioners  
**AI-CENTER** INSURANCE POLICY RESEARCH

**Federal Insurance Office  
(FIO) (U.S. Initiative)**

- Preemption shall not include:
  - any State insurance measure that governs any insurer's rates, premiums, underwriting, or sales practices;
  - any State coverage requirements for insurance;
  - application of the antitrust laws of any State to the business of insurance;
  - or any State insurance measure governing the capital or solvency of an insurer, except to the extent that such State insurance measure results in less favorable treatment of a non-United State insurer than a United States insurer;

**NAIC** National Association of Insurance Commissioners  
**AI-CENTER** INSURANCE POLICY RESEARCH

**Federal Insurance Office  
(FIO) (U.S. Initiative)**



- The Treasury department and the USTR have authority to enter into "covered agreements" - international agreements that preempt state law if they are:
  - 1) entered into between the U.S. and a foreign government, authority, or regulatory entity, and
  - 2) relate to the recognition of prudential measures to the business of insurance or reinsurance *that achieves a level of protection of insurance or reinsurmes consumers that is substantially equivalent to the protection achieved under state law.*

**NAIC** National Association of Insurance Commissioners  
**AI-CENTER** INSURANCE POLICY RESEARCH

**Questions?**

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**NAIC International Fellows Program**  
April 2012



**Overview of U.S. Solvency Framework**

Todd Salls  
Director, Financial Regulatory Services Department

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**Introductions**

- **Presenter**
  - NAIC Staff
  - Expectations-Learn from each other-Comparison by each participant on each section
- **Participants**
  - Name, country, position, experience in the industry and as a regulator
  - Expectations for this session, learn from each other?

**Purpose**

- The purpose of this presentation is to discuss the NAIC's US Solvency Framework, which was developed as a tool (document) to help international regulators and federal regulators understand the US Insurance system.

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**United States Insurance Financial Solvency Framework**

**Topics**

1. US Insurance Regulatory Mission
2. Preconditions for Effective Regulation
3. US Insurance Financial Solvency Regulation Foundations
4. US Insurance Financial Solvency Core Principles
5. NAIC Accreditation Program






**United States Insurance Financial Solvency Framework**

**US Insurance Regulatory Mission:** To protect the interests of the policyholder and those who rely on the insurance coverage provided to the policyholder first and foremost, while also facilitating an effective and efficient market place for insurance products.

**Participant Comments on Mission:** What is your perception of the regulatory environment compared to this mission in your country?

**Discussion Question:** How do regulators balance both of these expectations?

**United States Insurance Financial Solvency Framework**

**US Insurance Financial Solvency Regulation Foundations:**



- Risk focused
- On-going consensus based on collaboration
- Regulatory peer review/pressure




**United States Insurance Financial Solvency Framework**

**Preconditions for Effective Regulation:**

- Legal authority and financial resources to exercise its function (hires, trains, and maintains sufficient staff)
- Independent from commercial and political interference
- Is ultimately accountable to the public

**United States Insurance Financial Solvency Framework**

**US Insurance Financial Solvency Core Principles**


1. Regulatory Reporting, Disclosure and Transparency
2. Off-site Monitoring and Analysis
3. On-Site Risk-focused Examinations
4. Reserves, Capital Adequacy and Solvency
5. Regulatory Control of Significant, Broad-based Risk-related Transactions/Activities
6. Preventive and Corrective Measures, Including Enforcement
7. Exiting the Market and Receivers



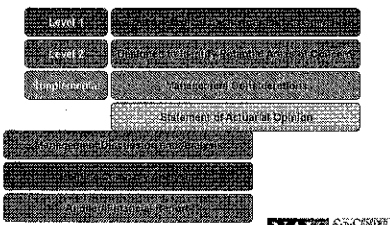


### United States Insurance Financial Solvency Framework

**1. Regulatory Reporting, Disclosure and Transparency**

- Heavy emphasis on reporting and disclosure
- Used in the continual assessment of risk
- Standardized reporting allows comparability
- Drive offsite and onsite monitoring
- More information requested when needed
- Used with internal company information




### Solvency Monitoring Processes (Analysis Handbook)

### United States Insurance Financial Solvency Framework

**2. Off-site Monitoring and Analysis**


- Assess on an on-going basis the financial condition of the insurer (quarterly)
  - Identify/assess current and prospective risks
  - Automated financial analysis tools
  - Use any information to help understand the company/actions (SEC filings, market conduct reports, rate and policy form filings, consumer complaints, rating agency reports, media).
  - Used to determine targeted exams
  - Continual loop between analysis and exam



### Solvency Monitoring Processes

**Level 2 Procedures-Consider Risks In Specific Areas**


- Investments
- Reserves
- Profitability and Leverage
- Capital Adequacy
- Cash Flow and Liquidity
- Reinsurance
- Affiliated Transactions
- MGAs/TPAs/Separate Accounts



### United States Insurance Financial Solvency Framework

**3. On-Site Risk-focused Examinations**


- Used in addition to annual audit by CPA firm
- Although exam includes an "audit" of the reported figures, as well as state law compliance, is now more "risk focused"
- Considers review of corporate governance and ERM process (risk identification and mitigation) of the insurer
- Prospective risk analysis combined with regulators previous documented opinions regarding risk into insurer profile
- Insurer profile documents strengths and weaknesses of the company and feeds into supervisory plan
- Limited scope exams (e.g. reserves) conducted as often as deemed necessary



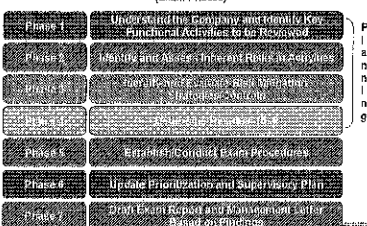

### United States Insurance Financial Solvency Framework

**4. Reserves, Capital Adequacy and Solvency**

- Regulators have traditionally used conservative accounting requirements to add protection into system (e.g. non admitted assets in general, expensing of acquisition costs, reinsurance collateral).
- Introduced Risk-Based Capital (RBC) in 1990s, which requires capital based upon the specific risks of the insurer (asset, underwriting, reserving) as opposed to fixed dollar amounts (which still exist).



### Solvency Monitoring Processes (Exam Phases)

### United States Insurance Financial Solvency Framework

**4. Reserves, Capital Adequacy and Solvency**

- Found to be highly effective in **HELPING** to identify weakly capitalized companies.
- RBC also gives the state specific authority.
  - » Obtain updated business plan on how it will address problems with RBC
  - » Allowed to take control of the company or take other actions
  - » Required to take control of the company





### United States Insurance Financial Solvency Framework

#### 5. Regulatory Control of Significant, Broad-based Risk-related Transactions/Activities

- Certain significant broad based transactions require separate treatment
  - Licensing Requirements - Discuss
  - Change in Control - Can have a tremendous impact on the direction and future of any company
  - Extraordinary Dividends - Authority to retained earned surplus for the benefit of policyholders
  - Transactions with Affiliates - subject to abuse
  - Reinsurance - Potentially material and subject to abuse



### United States Insurance Financial Solvency Framework

#### 7. Exiting the Market and Receivership

##### Receivership law examples include:

- Mergers, acquisitions, reinsurance
- Arrangements, non-renewal of part or all of the insurer's book of business, and the
- Allowing the insurer to be placed in run-off mode under its own management
- Priority of claims and guaranty funds



### United States Insurance Financial Solvency Framework

#### 6. Preventive and Corrective Measures, Including Enforcement

##### Corrective examples include:

- Requiring the insurer to file interim financial reports;
- Reducing, suspending or restricting the volume of business being accepted or renewed by the insurer;
- Limiting or withdrawing the insurer from certain investments or investment practices;



### United States Insurance Financial Solvency Framework

#### Accreditation

- Adequate solvency laws and regulations
- Effective and efficient financial analysis
- Cooperation and information sharing with other state, federal and foreign regulatory officials
- Timely and effective action on troubled companies
- Appropriate organizational and personnel practices
- Effective processes for company licensing and change in controls (2012)
- Effective holding company analysis (2012)



### Questions/Comments





**BASIC ELEMENTS OF SOLVENCY SUPERVISION: NAIC ACCREDITATION PROGRAM**

Steve Madison  
Accreditation Programs Specialist

**STATE REGULATION WEAKNESSES NOTED IN THE DINGELL REPORT**

- Information provided by companies not verified
- Inadequate staffing & regulatory resources
- No mandatory requirement regarding frequency of examinations
- Lack of interstate coordination and cooperation

**WHY IS ACCREDITATION NEEDED?**

- Multiple insurance company insolvencies during mid to late 1980s
- U.S. Rep. John Dingell report entitled, "Failed Promise: Insurance Company Insolvencies"
- Weaknesses noted in state regulation of insurance companies
- Federal regulation may be more efficient

**SUPERVISION & ADMINISTRATION OF THE ACCREDITATION PROGRAM**

**Financial Regulation Standards & Accreditation (F) Committee**

- National Meetings three times/year
- Votes on all significant matters

**NAIC Staff Support**

- Prepares all materials
- Performs technical research

**WHAT IS THE ACCREDITATION PROGRAM?**

- Formed in 1988
- Voluntary program for state insurance departments
- Focus is on multi-state life/health and property/casualty insurers and risk retention groups
- First 2 states accredited in 1990 - FL and NY
- All 50 states, the District of Columbia and Puerto Rico currently accredited

**PART A: LAWS & REGULATIONS**

- States must adopt certain laws and regulations to have sufficient authority for financial solvency regulation of multi-state domestic industry
- State must have all laws and regulations in effect to be accredited (i.e., pass or fail)
- Performed by NAIC Legal Division starting in 2004

**WHAT ARE THE ACCREDITATION STANDARDS?**

○ Financial Regulation Standards

- Part A: Laws & Regulations - Traditional Insurers
- Part A: Laws & Regulations - Risk Retention Groups
- Part B: Regulatory Practices & Procedures
- Part C: Organizational & Personnel Practices
- Part D: Organization Licensing & Change of Control of Domestic Insurers

**PART A: LAWS & REGULATIONS STANDARDS (TRADITIONAL INSURERS)**

1) Examination Authority	10) Reinsurance Ceded
2) Capital and Surplus Requirement	11) CPA Audits
3) NAIC Accounting Practices and Procedures	12) Actuarial Opinion
4) Corrective Action	13) Reinsurance
5) Valuation of Investments	14) Guaranty Funds
6) Holding Company Systems	15) Filings with NAIC
7) Risk Limitation	16) Producer Controlled Insurers
8) Investment Regulations	17) Managing General Agents Act
9) Liabilities and Reserves	18) Reinsurance Intermediaries Act
	19) Regulatory Authority

**PART A: LAWS & REGULATIONS STANDARDS  
(RISK RETENTION GROUPS)**

1) Examination Authority	10) Reinsurance Ceded
2) Capital and Surplus Requirement	11) CPA Audits
3) NAIC Accounting Practices and Procedures	12) Actuarial Opinion
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5) Valuation of Investments	14) Filings with NAIC
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9) Liabilities and Reserves	

**FINANCIAL ANALYSIS STANDARDS**

- Sufficient Qualified Staff and Resources
- Communication of Relevant Information to/from Financial Analysis Staff
- Appropriate Supervisory Review
- Priority-Based Analysis
- Appropriate Depth of Review
- Documented Analysis Procedures
- Reporting of Material Adverse Findings
- Action on Material Adverse Findings

**PART B: REGULATORY PRACTICES & PROCEDURES**

- Financial Analysis (8 standards)
- Financial Examinations (10 standards)
- Information Sharing and Procedures for Troubled Companies (2 standards)

**FINANCIAL EXAMINATION STANDARDS**

- Sufficient Qualified Staff and Resources
- Communication of Relevant Information to/from Examination Staff
- Use of Specialists
- Appropriate Supervisory Review
- Use of Appropriate Guidelines and Procedures
- Performance and Documentation of Risk-Focused Examinations
- Scheduling of Examinations
- Examination Reports
- Reporting of Material Adverse Findings
- Action on Material Adverse Findings

**INFORMATION SHARING & PROCEDURES FOR TROUBLED COMPANIES STANDARDS**

**Information Sharing**

- Should have the ability to share information with regulatory officials of any state, federal agency or foreign country and the NAIC
- Should have the ability to gather information from other member organizations and the relevant states

**Procedures for Troubled Companies**

- Should have the ability to identify companies in the troubled company list or in the process of being added to the troubled company list and to develop the necessary procedures to address the troubled company list

**PART D: ORGANIZATION, LICENSING & CHANGE OF CONTROL OF DOMESTIC INSURERS**

- Standards are not scored by the accreditation team members
- Each component is evaluated and any deficiencies will be noted in management comment letters
- Standards:
  - Sufficient Staff & Resources
  - Sufficient Staff & Resources
  - Scope of Procedures for Primary Applications
  - Scope of Procedures for Form A Filings
  - Use of the Form A Database
  - Documentation of Work Performed

**PART C: ORGANIZATIONAL & PERSONNEL PRACTICES**

- Standards are not scored by the accreditation team members
- Each component is evaluated and any deficiencies will be noted in management comment letters
- Standards:
  - Professional Development
  - Minimum Educational & Experience Requirements
  - Retention of Personnel

**TYPES OF ACCREDITATION REVIEWS**

- Pre-Accreditation Reviews
- Full Accreditation Reviews
- Sub-Part Re-Reviews
- Interim Annual Reviews (IAR)

### PRE-ACCREDITATION REVIEWS

- When?**
  - Approximately one year prior to full review
  - Duration is approximately 1.5 days
- Who?**
  - NAIC Accreditation Staff only
- What?**
  - Voluntary but strongly recommended
  - High-level review
- Why?**
  - Identify areas of improvement (report issued is strictly between NAIC staff and the state insurance department)

### SUB-PART RE-REVIEWS

- When?**
  - When may be required in certain circumstances following a full review
- Who?**
  - Supervised by the NAIC Accreditation Program Manager
  - Utilize same accreditation team members from full review
- What?**
  - Review limited only to areas which require follow-up
- Why?**
  - Same reports issued as with full accreditation review for areas under review
  - FRSAC members vote based on review team's recommendations

### FULL ACCREDITATION REVIEWS

- When?**
  - Once every 5 years
  - Duration is approximately 4.5 days
- Who?**
  - Performed by a team of consultants
  - Supervised by the NAIC Accreditation Program Manager
- What?**
  - Full review of all the accreditation standards (Parts A, B, and C)
- Why?**
  - Reports distributed to the Financial Regulation Standards & Accreditation Committee (FRSAC)
  - FRSAC votes on whether state should be accredited based on review team's recommendation

### INTERIM ANNUAL REVIEWS

- When?**
  - IRF forms submitted annually
- Who?**
  - NAIC Accreditation Program Specialist performs detailed review
- What?**
  - Review of Parts B and C
  - Review of changes to Part A by NAIC's Legal Division
- Why?**
  - To maintain accredited status between a state's full reviews
  - Results are communicated to FRSAC each quarter
  - Action may be taken if problems are identified

### HOW HAS ACCREDITATION HELPED THE REGULATORY PROCESS?

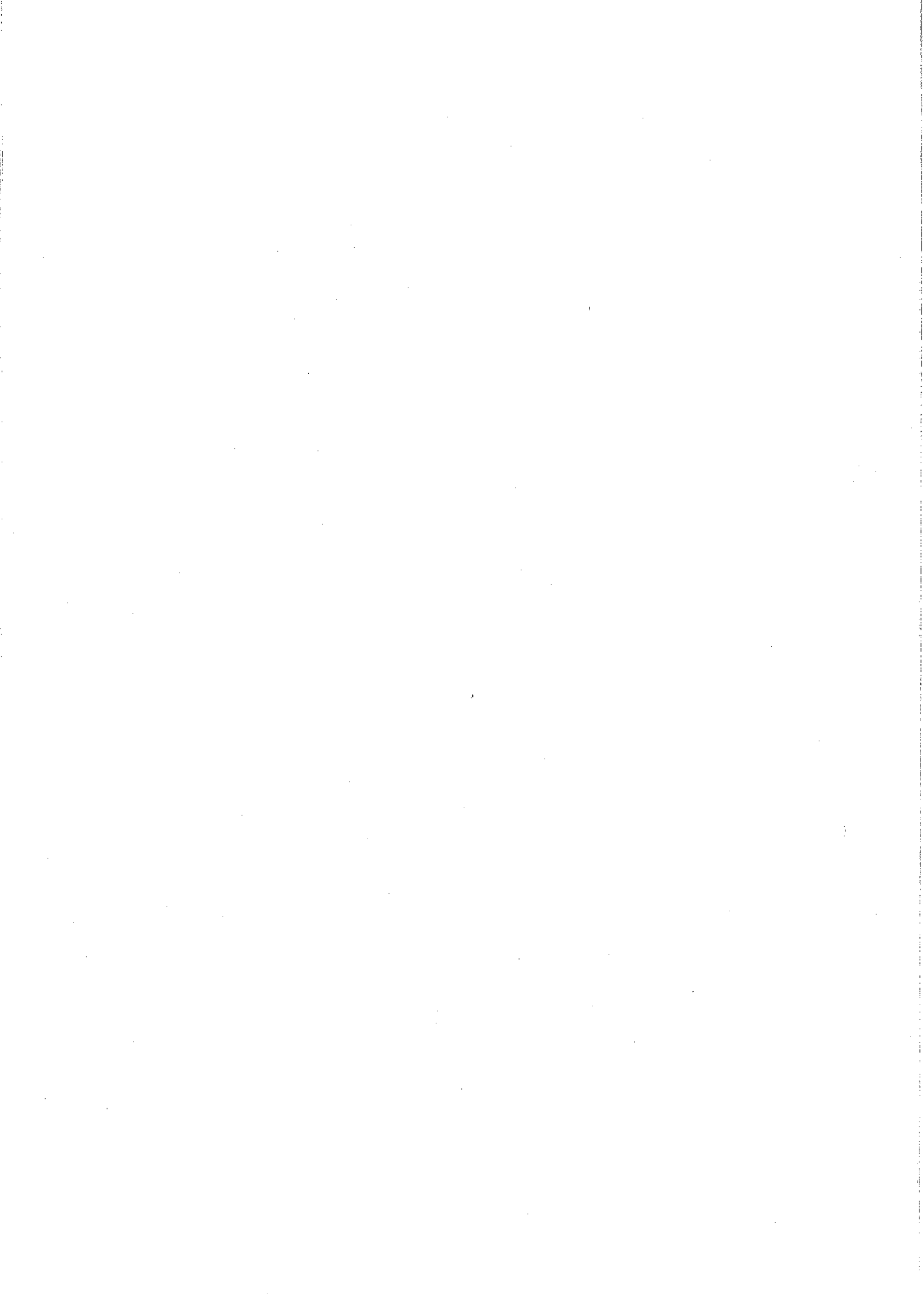
- Information provided by companies was not verified**
  - Annual CPA audit & actuarial opinion required
- Inefficient staffing & regulatory resources**
  - Accreditation helped justify increased budgets/staffing
- No mandatory requirement regarding frequency of examinations**
  - Domestic companies must be examined no less frequently than once every five years
- Lack of interstate coordination and cooperation**
  - Documented policy is required

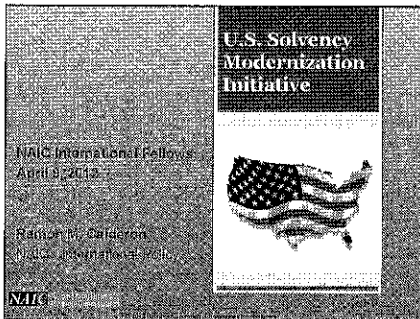
IT'S QUESTION TIME!!

**Contact Information**

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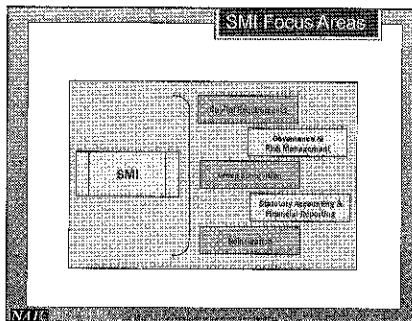
[http://www.naic.org/committees\\_f.htm](http://www.naic.org/committees_f.htm)





**What is the SMI?**

- Critically review the U.S. Regulatory Solvency Framework
- Principles and "whys" of our system
- International developments
- IAIS insurance core principles, IMF FSAP
- Financial crisis



**Governance and Risk Management**

- State governance statutes and case law
- Analysis of Corporate Governance Regulatory Authority
- Own Risk and Solvency Assessment "ORSA"
  - (1) The company's or group's risk management process and risk mitigation
  - (2) Stress Tests
  - (3) Prospective Solvency Assessment (5-5 years)
  - (4) Group Capital
- ERM Interim Meeting

**Capital Requirements**

- RBC "Story" -- weakly capitalized companies
- RBC Improvements
  - Add missing risk charges
  - Re-think the correlation (e.g. square root formula)
- Partial Internal models for RBC
  - The cost/benefit of full internal models to replace RBC entirely, especially when it comes to regulatory prior approval, does not currently pass U.S. regulatory scrutiny.
- Group capital; ORSA

**Statutory Accounting & Financial Reporting**

- Valuation (Life Insurance Principles-Based Reserving)
  - 2011 Impact Study
  - Standard Valuation Model Law
  - Valuation Manual
- Future of Statutory Accounting
  - International accounting standards development
  - SPC's expected decisions
  - IAIS valuation standards
  - At present this discussion is on hold, pending further developments.

**Reinsurance**

- Reinsurance Regulatory Modernization Framework
- Conceptual framework -- consider collateralization regarding unauthorized reinsurers & the design of the U.S. reinsurance regulatory framework
- State reinsurance collateral reforms
- Revisions to Reinsurance Model Laws

**Group Solvency**

- Lesson learned from the financial crisis:
  - Holding company Enterprise risk
  - "Windows and Walls"
- Holding Company Model Act and Regulation Dec. 2010
- IAIS ComFrame for the supervision of internationally active groups
- Current activity:
  - Accreditation changes for the new models
  - Holding company best practices & reporting requirements
  - Supervisory Colleges






**SMI Roadmap**

- We continue to expect all major policy decisions to be adopted by December 2012.
- The RBC changes are going to take many years, but we need to get the "story" right.
- ERM Symposium was held July 21.
- We've already made major changes
  - Adoption of Standard Valuation Law
  - Adoption of Group Holding Company Model Act and Regulation
- 2012 - Expect significant SMI activity.

NAIC

**SMI Information**

NAIC Website [www.naic.org](http://www.naic.org)

- Solvency Modernization Initiative button  

- Consultation papers
- Links to Task Forces & Working Groups
- Updates

NAIC



## Financial Reporting, Statutory Accounting

International Interns  
Robin Marcotte  
Accounting and Reporting Manager

### Robin Marcotte

- NAIC Accounting and Reporting Manager
- NAIC Senior Accounting Policy Advisor
- NAIC P&C Accountant
- NAIC – codification training
- Missouri Department of Insurance (89-00)
- Missouri State University
- CPA, CFE, Associate in Reinsurance
- Member of AICPA, MSCPA, and SOFE
- 816 783-6124 or [rmarcotte@naic.org](mailto:rmarcotte@naic.org)



NAIC

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At the end of this session participants should:

- ✓ Understand the importance of financial reporting to solvency regulation
- ✓ Identify the key differences between GAAP Statutory Accounting Principles
- ✓ Understand the importance of the annual statement format

NAIC

### Financial Reporting-

- **Cornerstone of Solvency Regulation**
  - Major duty of an insurance department is protection of policyholders
  - Meet obligations when they are due
  - Adequate margins of safety

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2

### AP&P Manual

- Purpose of Codification
  - To produce a comprehensive guide to Statutory Accounting Principles
  - Became effective on January 1, 2001
  - Updated every year
- Remember!
  - Is not intended to preempt state legislative and regulatory authority.
  - It may be the basis of accounting if state statutes are silent.

NAIC

### Statement of Concepts

- Conservatism
  - Estimates include a margin
- Consistency
  - Regulators need comparable financial information
- Recognition
  - Assets- must be available.
  - Liabilities when incurred
  - Revenues only when earnings complete

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### Preamble – STAT vs. GAAP

GAAP	SAP
■ Going Concern	■ Solvency
■ Matching	■ Meet Policyholder Obligations
■ Income Statement / Earnings Focus	■ Balance Sheet Focus
■ Deferred Expenses	■ Non-Admitted Assets

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### Comprehensive Accounting Rules-

- **Consistent Reporting**
  - Regulators need meaningful comparable financial information
  - Must have consistent reporting to have comparability
  - In order to have consistent reporting you must update the rules.

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### Conservative Accounting Rules-

- Promotes Interests of Consumers
  - Insurance accounting requires the use of judgment and estimates
  - Estimates will vary from the actual amounts for numerous reasons.
  - To provide a margin of protection must have conservatism when developing estimates and in SAP.
  - Protect the policyholders against adverse deviation
  - SAP needs to be conservative over the economic cycles

NAIC

### Recognition

- Up to date financial information is essential must have consistent rules on when to recognize income and expenses.
- Liabilities as they are incurred
- Revenue as the earnings process is complete
- Expenses fully recognized when incurred.

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### Statutory Review of US GAAP Based Accounting Rules

- Generally review GAAP and determine if there is a regulatory need for a difference from GAAP.
  - Adopt/
  - Adopt with Modification or
  - reject
  - Minimizes System Differences for Insurers

NAIC

### 3 Characteristics of an Asset:

- It embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows;
- a particular entity can obtain the benefit and control others' access to it;
- the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

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### If it does not meet the definition of an asset?

- Charged to operations in the period the transactions occur.
- Some items meeting the definition of an asset are specifically identified in the AP&P Manual as charged to operations in the period the transaction occurs.
  - Example: policy acquisition costs

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### What are Nonadmitted Assets?

- Statutory Concept
- Not found in GAAP
- Ability to pay policyholder claims



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### Is it an Admitted Asset?

A nonadmitted asset is defined as one which is accorded limited or no value in statutory reporting and is one which is:

- specifically identified within the AP&P Manual as a nonadmitted asset; or
- not specifically identified as an admitted asset within the Codification.

NAIC

### What to do with a Nonadmitted Asset?

- Report as nonadmitted
- Charged against surplus (unless otherwise addressed in the Manual)
- Most (but not all) nonadmitted assets are depreciated or amortized against net income in accordance with a written capitalization policy.

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### Balance sheet

	Asset	Non admitted	Net admitted
Premium	4,500,000	(500,000)	=4,000,000

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### 3 Characteristics of a Liability:

- it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand;
- the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice;
- the transaction or other event obligating the entity has already happened.

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### When to record a loss contingency?

- An estimated loss from a loss contingency or the impairment of an asset shall be recorded if **both of the following conditions are met:**
  1. Probable
  2. The amount of the loss can be reasonably estimated.

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### Liability accrued?

- Management's best estimate shall always be used.
- If not a range, something has to be 'best' estimate.

*(This forces the company to make an estimate of the loss and provide rationale for their determination.)*

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### Key Statutory Accounting Differences

- Many Investments are carried at amortized cost (Bonds)
- Acquisition Costs are expensed as incurred
- Prepaid expenses are expensed as incurred
- More conservative reserving

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### Key Statutory Accounting Differences

- Assets with little value to pay claims are nonadmitted or limited
  - Nonadmitted – Not included in regulatory surplus
    - Furniture and equipment
    - Receivables over 90 days overdue
  - Limited amounts
    - Computer software and equipment
    - Goodwill
    - Deferred Tax Assets

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### NAIC Annual Statement Blank-

- **Prescribed Format for Financials**
  - See the handout on blanks pages
  - Promotes consistent reporting among types of Companies
  - Promotes consistent analysis

NAIC

### Financial Condition Exams

- Verify that financial statements are properly completed in accordance with SAP and/or prescribed or permitted practices.
- Required every 3-5 years
- Exam is focused on risk-assessment, but often includes procedures from four key processes of insurance operations:
  - Premium (Revenue)
  - Claims, Loss and LAE
  - Investments
  - Reinsurance

NAIC

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## NAIC Risk Based Capital

- Utilizes Data From NAIC Blank
  - Different formulas for different company types.
    - Life
    - Health
    - Property and Casualty
  - Calculates an hypothetical minimum Capital and surplus for the company
  - Overview handout

NAIC

## RBC Ratios

- Another tool to monitor financial condition.
- Items and amounts reported within the annual statement are utilized to determine risks considered in the calculations.
- Risks reflected:
  - Asset Risk – Affiliate
  - Asset Risk – Other
  - Insurance Risk
  - Interest Rate Risk

NAIC

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## IRIS Ratios

- Early warning system for financially troubled Insurers
- Calculated in accordance with the results from an insurer's financial filings with the NAIC.
- Normal to have ratio results outside of established ranges, but as the number of ratios outside ranges increases, so does the concern for future solvency.

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## Consistent Data-Enhances Financial Analysis and Action

- Automated scoring and analysis helps sort the companies for additional scrutiny.
- Prioritize reviews

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## Action Protects Consumer

- Improve the ability to meet policyholder claims
- Protects public



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## Questions ??



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INTERNATIONAL FELLOWS  
PRESENTATION

Risk-Focused Analysis



Bob Schump  
Surplus Lines & Reinsurance Division Manager  
NAIC Insurance Analysis & Information Services Department

Presentation Overview

- Understanding the Financial Analysis Process
- Mechanics of Solvency Regulation
- Financial Analysis Solvency Tools
  - NAIC Financial Analysis Handbook
- Financial Analysis Working Group
- Holding Company Considerations

Financial Regulation

- To help ensure insurance companies do not incur excessive insolvency risk in order to protect policyholders against the risk that insurers will not be able to meet their financial obligations

Mechanics of Solvency Regulation

- How do Insurance Departments regulate for solvency?

Financial Regulatory Framework

- Statutory Financial Requirements
- Licensing
  - Financial Reporting
  - Financial Analysis
  - Financial Examinations
- Intervention and Receivership
- Guaranty Associations

Solvency Monitoring

Regulatory requirements are of little value if there is no mechanism to monitor insurers' compliance with those requirements. Thus, solvency monitoring encompasses a broad range of regulatory activities including:

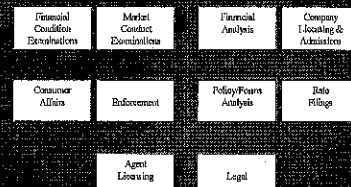
- Financial Reporting
- Examinations

Roles of Examiner and Analyst

On-site and OESite solvency monitoring involve roles and skill sets that are different, but complement each other:

- |   |   |
|---|---|
| <ul style="list-style-type: none"> <li>■ Examiner                     <ul style="list-style-type: none"> <li>- Identifies risk by reviewing business processes</li> <li>- Utilizes control &amp; detail tests to identify solvency concerns and findings</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>■ Analyst                     <ul style="list-style-type: none"> <li>- Identifies prospective risks by reviewing reported financial results</li> <li>- Utilizes analytical review, ratio analysis, benchmarking, liquidity to identify solvency concerns and compliance</li> </ul> </li> </ul> |
|---|---|

Components of Insurance



## Solvency Monitoring - Financial Analysis

- Since 1989, Regulators have enhanced their solvency monitoring activities to facilitate more timely regulatory action against troubled insurers/groups. For example, financial analysis occurs every quarter on all multi-state insurers within each state.
- States use a risk-focused approach to ensure that insurers/groups receive an appropriate level or depth of review commensurate with their financial strength, position and complexity.
- States prioritize the review of their domiciliary companies to ensure potentially troubled companies are reviewed promptly.
- Many states perform analysts on foreign and alien insurers.

## Roles of Analyst

State Insurance Analysts typically perform the following functions:

- Collection and analysis of insuror and group financial information
- Desk audits to assess risk and compliance
- Review of non-financial information regarding insurance companies that is routinely collected by other department units
- Classification of insurance company transactions
- Coordination with other department functions
- Determining regulatory courses of action regarding identified troubled insurance companies
- Evaluating and monitoring corrective plans
- Communicating results of regulatory actions
- Licensing and admissions

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## Roles of Analyst

Continued

- Understanding the insurance industry
- Monitor early warning systems, analytical tools and benchmarks
- Communicate with other regulators on an on-going basis
- Meet with management
- Researching issues, industry topics, etc. (Accounting)
- Studying special reports from research firms, NRSROs, etc.
- Following-up on exam findings

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## Mechanics of Solvency Regulation

What guides the Insurance Department through their process of analysis?

- Financial Regulation Standards and Accreditation Program - Part B, Regulatory Practice and Procedures - Financial Analysis

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## Mechanics of Solvency Regulation

- Understanding Specific Causes For Insolvencies
  - Deficient reserves
  - Inadequate pricing
  - Rapid growth
  - Overstated assets
  - Fraud
  - Change in business
  - Reinsurer failure
  - Catastrophic losses

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## Mechanics of Solvency Regulation

- What do regulators look for?
  - Dramatic growth or decline in one or more lines of business
  - Significant changes in book of business
  - Rapid expansion into new states and significant volume in new states
  - Significant concentrations of risk (including geographic)
  - Changes in ownership/ Sr. management
  - Increase in consumer complaints
  - Audited financial statement opinions
  - Significant change in reinsurance agreements

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## Mechanics of Solvency Regulation

- Early Warning Signs Can Be Seen In:
  - Capitalization
  - Profitability
  - Leverage
  - Asset Quality
  - Liquidity
  - Performance

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## Financial Analysis Solvency Tools

- *Internet-State Interface Technology Enhancement (I-SITE)*
  - Provides a comprehensive system for regulators to access numerous NAIC tools and databases
- The tools are developed to serve all types of regulator needs
  - Financial, Market, Legal, Actuarial, Rates and Forms, Licensing

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## Financial Analysis Solvency Tools

### Prestigious Database

- Financial Data Repository (FDR) is the world's largest U.S. domestic financial insurance database
- Contains 10 years of annual and quarterly financial data
- Over 4,300 individual insurers are available, as well as approx. 225 separate account and 300 embedded filings
- Provides key source data for several financial solvency tools

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## Financial Analysis Solvency Tools (FAST)

- Collection of analytical tools designed to provide an integrated approach to screening and analyzing the financial condition of insurers

### Financial Analysis Solvency Tools (FAST)

#### Analytical

- Financial Profile Reports, Financial Analysis Handbook, Summary Reports, Jumpstart Reports, Investment Snapshot Form A, Etc.

#### Prioritization Tools

- IRIS Ratios, ATS, Scoring System, Handbook Automated Yes, RBC, RBC Tread

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## Financial Profile Reports

- The Insurer Profile is a summary of key financial information for a company over the last five years.
- Includes a Financial Summary page
- There are also detailed sections for: Assets, Liabilities, Capital & Surplus, Loss & LAE, Reserve Analysis, Income Statement, Cash Flow and Exhibit of Business and Profitability
- Provides trend, common size and ratio analysis

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The screenshot displays a complex financial data table with multiple columns and rows. The columns represent different financial metrics, and the rows represent individual insurers. The data is organized into sections, likely corresponding to the 'Analytical' and 'Prioritization Tools' mentioned in the text. The table includes various ratios and percentages, providing a comprehensive overview of the financial health of the listed insurers.

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## Insurance Regulatory Information System (IRIS)

- Integrated approach to screening and analyzing the financial condition of insurance insurers
- Statistical Phase
  - IRIS Ratio Results (Public)
- Analytical Phase (confidential)
  - Analyst Team System (ATS)
  - Only tool that incorporates regulator experience

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## IRIS Ratios

- 13 ratios for Property/Casualty
  - Overall
  - Profitability
  - Liquidity
  - Reserve
- 12 ratios for Life and Health
- 11 ratios for Fraternal
- Asterisks highlight ratios outside usual range

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## IRIS Ratios (P&C)

- Gross P&C Written/Surplus
- Net P&C Written/Surplus
- Chg. in Net Writings
- Surplus And Surplus
- Two-Year Overall Operating Ratio
- Investment Yield
- Chase Chg. in Surplus
- Net Chg. in Surplus
- Liabilities to Liquid Assets
- Gross Assets/Balances/Surplus
- One-Year Reserve Development/Surplus
- Two-Year Reserve Development/Surplus
- Estimated Current Reserve Deficiency/Surplus

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## IRIS Ratios (L&H)

- Net Change in C&S
- Gross Change in C&S
- Net to Total Income
- Adequacy of Investment Income
- Non-Admitted to Admitted Assets
- Total Real Estate & Mortgages to Cash & Invested Assets
- Total Affiliated Investments to C&S
- Surplus Ratio
- Change in Premiums
- Change in Product Mix
- Change in Assort Risk
- Change in Reserving Ratio

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## Analyst Team System (ATS)

- Available for P&C, Life, Health and Fraternal
- Automated review system that uses various statistical analysis to assign review levels
  - Level A - High level of concern
  - Level B - Requires attention
  - No level required
- Confirmed by team of State financial analysts and examiners
- ATS Reports
  - Analyst Team Comments and Summary of Criteria

## NAIC Financial Analysis Handbook (FAH)

- The purpose of the Handbook is to assist regulators in performing financial analysis of insurance companies in a consistent and uniform manner
  - Provides qualitative and quantitative
  - Provides for automated responses
- Developed by the Financial Analysis Handbook Working Group (FAHWG)
- Updated every year

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## FAH - Contents

- Introductory Chapters
- Financial Analysis Framework
- Analyst Reference Guide
  - Level 1, 2 and Supplemental
- Annual Procedures
  - Level 1 and 2
- Supplemental Procedures
- Quarterly Level 1 & 2 Procedures
- Guidance for Notes to Financial Statements

## Framework Chapter Overview of Financial Analysis Process

Procedure Description	Complete for All Insurers	Complete if Insurer requests
Level 1 Annual Procedures, Annual Financial Statements, and Financial Analysis Reference Guide	✓	✓
Level 2 Annual Procedures	✓	✓
Supplemental Procedures	✓	✓
Management Condition/Unaudited Financial Report	✓	✓
Management of Financial Operations & Account Operations/Quarterly Management's Discussion and Analysis (MD&A)	✓	✓
Rating Agency Reports	✓	✓
Form 10-K, 10-Q, 10-E and Interim/Quarterly/Annual/Supplemental Reports and Financial Statements (10-K, 10-Q, 10-E)	✓	✓
Quarterly Statements, Quarterly Financial Statements, Rating Agency, Quarterly Financial Statements	✓	✓

\*Based on the requirements of a 2007 financial liability, the state Insurance Department determines when and in what order the Level 2 procedures are used and in what order the Level 1 procedures are used and in what order the Supplemental procedures are used. The order of the procedures is subject to change.

\*\*The completion of the supplemental procedures is not a prerequisite to the completion of the Level 1 procedures.

\*\*\*The completion of the supplemental procedures is not a prerequisite to the completion of the Level 1 procedures.

\*\*\*\*The completion of the supplemental procedures is not a prerequisite to the completion of the Level 1 procedures.

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## FAH - Analyst Reference Guide

- Background information, if needed
- Overview of the topic
- Detailed discussion of the purpose included in the procedures
- Bibliography of additional reference sources

## FAH - Analyst Reference Guide

- Example Investments
  - Background - Discusses key component of pricing, asset and liability matching, diversification of a portfolio
  - Procedures - Discusses the purpose of each procedure
    - » Many of Level 2 procedures are benchmark oriented
    - » Use of benchmarks
  - Additional Sources - SVO Proposals & Procedures Manual, Accounting Practices & Procedures Manual, NAIC Annual Statement Instructions

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## FAH - Annual Procedures - Level 1

- Consists of a comprehensive analysis of the insurer and its operations
- In-depth analysis focused on key areas of regulatory concern
- At the conclusion of the Level 1, the analyst must determine the system and areas, if any, for which Level 2 or Supplemental procedures may be necessary
  - Are there any new, unresolved or supplemental risks as a result of the completion of the Level 1?

## FAH - Annual Procedures - Level 1

- Background Analysis
  - Last priority designation, inter-department communication, regulatory actions, NRSRO rating
- Management Assessment
  - Shift in management or philosophy
- Balance Sheet Assessment
- Operations Assessment
- Investment Practices
- Review of Disclosures
  - Omission of Notes, General Interrogations, etc.
- Assessment of Latest Examination Report and Results

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## FAH - Annual Procedures - Level 1

- Assessment of Results from Prioritization and Analytical Tools
  - Review Annual Scoring, IRIS ratios, A.T.S. Profile and Market Conduct Information
- Assessment of Supplemental Filings
  - Actuarial Opinion and Summary, MD&A, Audited Financial Reports, 10-K
- Recommendation for Further Analysis
- Summary and Conclusion
  - Conclude after completion of all Level 1, 2s, and Supplemental procedures
- Correspondence
  - Documentation of any follow-up

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## FAH - Annual Procedures - Level Two

- In-depth analysis focused on key areas of risk
- Procedures are more quantitative and benefit-risk oriented
  - Investments
  - Unpaid Losses and LAE
  - Income Statement and Surplus
  - Risk-Based Capital
  - Cash Flow & Liquidity
  - Reinsurance
  - Affiliated Transactions
  - MGAs & TPAs

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## FAH - Supplemental Procedures

- Management Considerations
- Audited Financial Report
- Statement of Actuarial Opinion
- Management's Discussion and Analysis
- Captives and/or Insurers Filing on a US GAAP Basis
- Holding Company Analysis
  - Including Form A, Form B, Form D, Form E, Extra Ordinary Dividend Distribution

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## FAH - Quarterly Procedures

- Level 1
- Level 2s
- Focuses on Significant Changes from Quarter to Quarter and Quarter to Prior Year End
- Ratio calculations are automated

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## Holding Company Analysis

- U.S. statutory holding company laws apply *directly* to individual insurers and *indirectly* to holding companies
- Standardized in the NAIC Insurance Holding Company System Act and Regulation (#440 and #450)
- Provisions within the law are designed to regulate transactions *between* insurers and other affiliated entities
  - Subsidiaries of insurers
  - Mergers and acquisitions
  - Standards for transactions
  - Holding company information

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## Holding Company Analysis

- U.S. transactions that require notification:
  - Acquisition of control
  - Transactions and investments
  - Reinsurance agreements
  - Management agreements, cost sharing agreements, tax allocation agreements
  - Certain guarantees made by insurer
  - Inter-company investments
  - Extraordinary dividends

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## Holding Company Analysis

### Obtaining Data on Holding Companies & Sources of Data Currently Available to Regulators

- Statutory Financial Statements, Combined Statements
- SEC Filings, IRS Filings, Other Federal regulator filings
- Annual Shareholders Reports and Board Minutes
- Form B Registration Statement
- New Financial Analysis Handbook Chapter on Management Assessment and revised Form A Checklist

### If Applicable:

- Form A - Statement of Acquisition of Control or of Merger with a Domestic Insurer
- Form D - Prior Notice of Transaction
- Form E - Pre-Acquisition Notification Form Regarding the Potential Competitive Impact

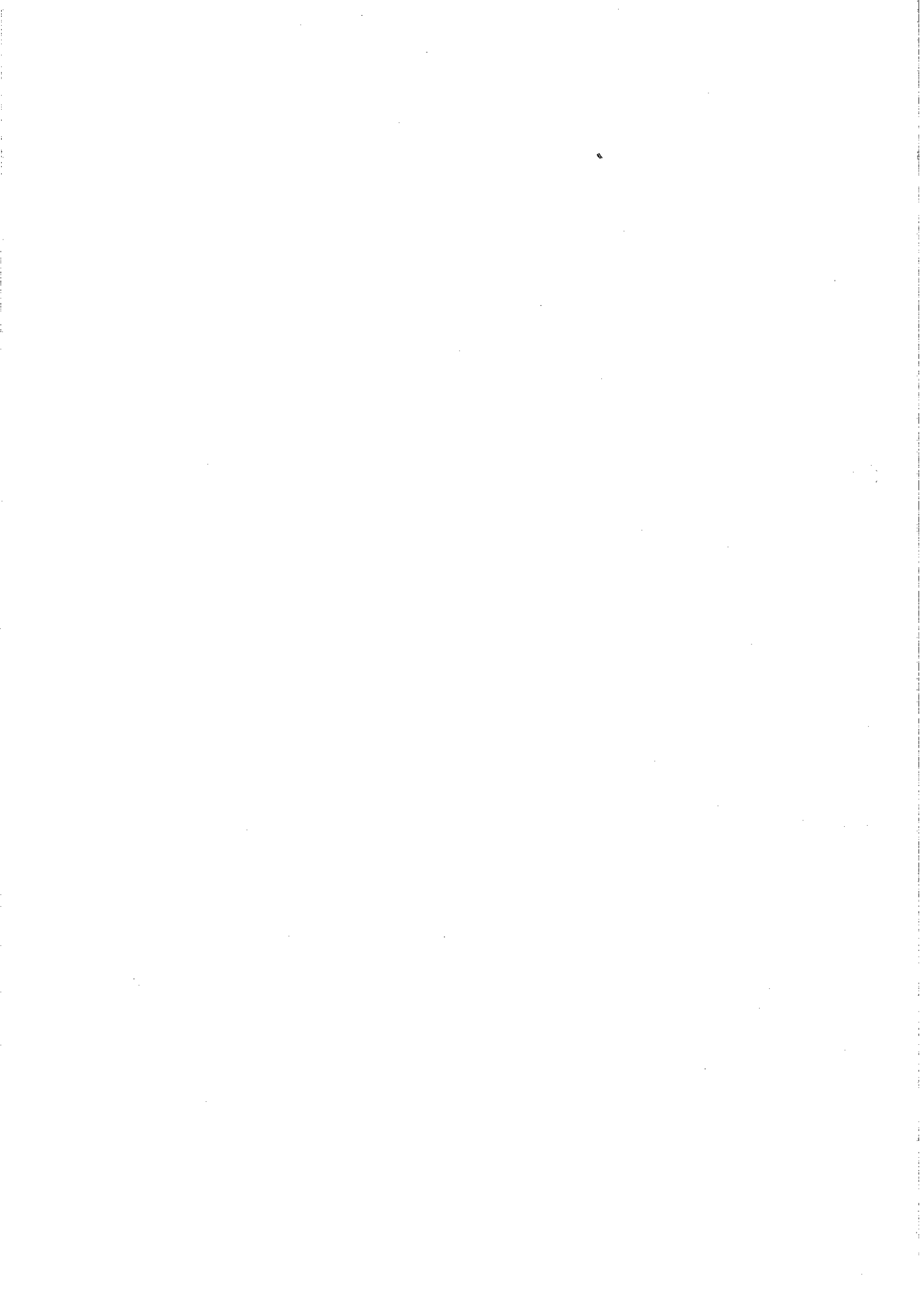
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## Questions from Audience



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**Regulation - Enterprise Risk Report (Form F)** - Include the following areas:

- Identification of material concerns of the insurance holding company system raised by supervisory college, if any, in last year;
- Identification of insurance holding company system capital resources and material distribution patterns;
- Identification of any negative movement, or discussions with rating agencies which may have caused, or may cause, potential negative movement in the credit ratings and individual insurer financial strength ratings assessment of the insurance holding company system (including both the rating score and outlook);
- Information on corporate or parental guarantees throughout the holding company and the expected source of liquidity should such guarantees be called upon; and
- Identification of any material activity or development of the insurance holding company system that, in the opinion of senior management, could adversely affect the insurance holding company system.

**Regulation - Enterprise Risk Report (Form F)** - Include the following areas:

- Any material developments regarding strategy, internal audit findings, compliance or risk management affecting the insurance holding company system;
- Acquisition or disposal of insurance entities and reallocation of existing financial or insurance entities within the insurance holding company system;
- Any changes of shareholders of the insurance holding company system exceeding ten percent (10%) or more of voting securities;
- Developments in various investigations, regulatory activities or litigation that may have a significant bearing or impact on the insurance holding company system;
- Business plan of the insurance holding company system and summarized strategies for next 12 months;

**Revisions to the NAIC Holding Company System Regulatory Models** included the following:

- Enhancements to require disclosure of any enterprise risk within the insurance holding company system
- Clarification on the ability to access books and records and compelling production of information
- Notification of divestiture of any controlling interest
- Established expectation of funding with regard to regulator participation in supervisory colleges
- Enhancements in corporate governance, such as Board of Director and Senior Management responsibilities
- New requirements related to agreements for cost sharing services and management

- Raised the bar on Accreditation Guidelines for holding company analysis procedures (e.g. Depth of review and documentation expectations)
- Adopted enhanced NAIC Holding Company System Model Act and Regulations
- Adopted revised holding company analysis checklist and best practices guidance
- Adopted new holding company system schedule that will be data captured
- Adopted NAIC *Own Risk and Solvency Assessment (ORSA) Guidance Manual*

- Section 1 - Description of the Risk Management Framework
- Section 2 - Insurer's Assessment of Risk Exposures
- Section 3 - Group Internal Capital and Prospective Solvency Assessment

**Benefits of FAWG:**

- Provides a strong check and balance on supervisory processes
- Encourages supervisory cooperation and communication
- Brings diversity of experience and perspective, including jurisdictions not directly involved with an insurer or event
- Builds stronger supervisory relationships and trust
- Results in convergence of supervisory review and reporting best practices and requirements
- Leads to early identification of issues
- Provides for timely and effective supervisory processes

**Financial Analysis Working Group (FAWG)**

- Analyze significant groups that exhibit characteristics of trending toward or being financially troubled
- Interact with domiciliary regulators and lead states to assist and advise as to what may be the most appropriate regulatory strategies, methods, and action(s)
- Monitor macro-prudential indicators and trends, and support multi-jurisdiction efforts in addressing related potential solvency problems

**Examination**

- For multiple US insurance legal entities within the same group, states may engage in group examinations to maximize resources and create efficiencies

Workpapers are typically shared real-time via a server and common software

**Overall**

- U.S. has strong experience with cross border supervision and cooperation

**Financial Analysis**

- Coordinated holding company analysis is a routine part of the financial analysis process as outlined in the NAIC's *Financial Analysis Handbook* and required by Accreditation

Includes review of the upstream and downstream holding company entities (both financial or non-financial), such as structure, affiliated relationships, financial condition, management, etc.

The applicable "Lead state" will coordinate with other domestic supervisors within a group

- States share "Insurer Profile Reports" and analysis workpapers



