The Future of Financial Regulation

John Rehagen, Acting Division Director
Debbie Doggett, Chief Financial Analyst
Tom Cunningham, Examiner-In-Charge
Overview

Introduction
Basics of Exam & Analysis:
  • Missouri’s System & Team
  • Analysis & Examination Processes

Recent and Future changes:
  • Focus on Critical Risk Factors
  • ERM & Form F
  • ORSA
  • Corporate Governance
  • International Considerations
  • Other Future Changes

The Future of Financial Regulation
Basics of Exam & Analysis

• Missouri examines about 100 commercial life, P&C, health companies & 125 other special insurance entities

• Examiners perform on-site exams every 3-5 years and risk focused exams

• Financial Analysts quarterly and ongoing analysis of all companies
Exam and Analysis Team

- Chief financial examiner
- Chief financial analyst
- Audit managers, EICs, field examiners
- Examiner/analysts
- Info. system examiners & reinsurance examiners
- Life, P&C actuaries & other support
Missouri’s Joint Approach

- Combines work of analysis and examination teams
- Continuous cycle of supervision tailored to risk identified and does not end between on-site exams (continuous process)
- On-site examiner verifies and enhances understanding of the company
- Analyst utilizes exam information to enhance their review
- Ensures proper supervisory plan, enhances resolution of exam findings & recommendations
Financial Analysis Process

• Continuous review process that begins & ends with analysis
• Continual monitoring before, during, after exam
• Reviews financial reports and related documents:
  ► Quarterly & annual financial reports, actuarial report & audited financials, management discussion & analysis, holding company financial statements
• Review all required filings
• Review of news reports and regulatory ratings
• Early identification of risks, negative trends
• Analysis reports and & supervisory plan & exam follow up
• Reviews changes in company operations between exams

The Future of Financial Regulation
Recent Shift in Solvency Monitoring

More emphasis on qualitative considerations:

• Corporate governance
• Suitability of persons (fit and proper)
• Risk Management and Internal Controls
• Qualitative risks (Strategic; legal; emerging; reputational, etc.)
• Prospective solvency risks
• Holding company system risks including contagion risk
Recent Shift in Solvency Monitoring

- More contact and interaction with examiners
- More utilization of analysts in risk-focused examinations
- More contact with other regulators/supervisors
- More contact with companies/groups
- New training for analysts in order to have qualifications/skillsets for changing environment of oversight expectations
Recent Revisions to Objectives

**REVISIONS**
- Assess and monitor current and prospective solvency
- Emphasize review of business processes and controls
- Identify and evaluate critical risks

**FORMER OBJECTIVES**
- Assess risk management and corporate governance
- Update priority status
- Compile information for regulatory action
- Detect potential financial trouble
- Identify noncompliance with statutes/regulations
- Identify financial misstatements
Critical Risk

• Shift the focus of examinations to areas which represent critical solvency risks
• Reduce unnecessary financial statement verification
• Free up exam resources to identify & address high inherent risks
• Allows for greater reliance on existing work (CPA, IA, etc.)
• Enhanced flexibility based on the assessment of risks
• More frequent contact with company & ability to go on-site more frequently
Critical Risk

Development of Critical Risk Categories:

• Shift the focus of examinations to areas which represent critical solvency risks and reduce unnecessary financial statement verification
• Free up exam resources to identify and address high inherent risks
• Developed 10 categories designed to assist the exam team in focusing on the most critical financial solvency risks facing an insurer
• Categories developed were considered the most common for the large majority of companies
• Replaced requirement to address all line items > TE
10 Critical Risk Categories

- Valuation/Impairment of complex or Subjectively Valued Invested Assets
- Liquidity Considerations
- Appropriateness of Investment Portfolio and Strategy
- Appropriateness/ Adequacy of Reinsurance Program
- Reinsurance Reporting and Collectability
- Underwriting and Pricing Strategy/Quality
- Reserve Data
- Reserve Adequacy
- Related Party/ Holding Company Considerations
- Capital Management

The Future of Financial Regulation
Model Holding Company Act

- New Form F- Enterprise Risk Report
  - Address group supervision considerations
  - Filed with lead state
- Source for risk identification at holding company level
- Significant confidentiality provisions
- Corporate governance & internal control procedures
- Participation in supervisory colleges
Future Impact of HCA & Form F

- Better understanding of insurer’s holding company system
- Identify significant events that may affect financial condition
- Risk identification and identification of contagion risks
- Lead States will perform group analysis of US entities
- Group-wide supervisor takes the lead internationally with respect to conducting and coordinating supervisory colleges
Future Impact of HCA & Form F

• States place significant reliance on Lead State
• Develop relationships and trust between involved supervisors
• Current Status
  ► All insurers subject to HCA
  ► Revised Insurer Holding Company Model Act is available for states to adopt as law
  • Legislation proposed for upcoming session
  ► 38 states have passed legislation to-date
  ► Accreditation requirement effective January 1, 2016

The Future of Financial Regulation
Risk Management and ORSA Model Act

- ORSA Guidance Manual - Adopted by NAIC in March 2012
- Guidance Manual provides the following:
  - Summary Report, at a minimum, should discuss:
    - Section 1 – Description of Insurer’s Risk Management Framework
    - Section 2 – Insurer’s Assessment of Risk Exposure
    - Section 3 – Group Risk Capital and Prospective Solvency Assessment
Risk Management and ORSA Model Act, Cont’d

- ORSA Summary Report may be provided in any combination as long as all insurance legal entities within the group are represented.

- Regulators will use the ORSA Summary Report to gain a high-level understanding of the group’s process for assessing risk.
Future Impact of ORSA

• Provide guidance to analyst and examiners
• Insurers must maintain risk management function
• Lead state prepares summary
• Non-lead rely on lead

Current Status
• ORSA Model Law available for adoption
  ➤ 18 states have passed to date
• Currently being considered for Accreditation
Corporate Governance

Corporate Governance Model Act and Regulation:

• At the recent Louisville Annual meeting a new Corporate Governance Annual Disclosure Model Act and Regulation were adopted by the NAIC.

• States can start legislating now for possible effective date of 2016.

• It is anticipated that this model act and regulation will be considered as an NAIC accreditation requirement.

• The provisions of this model act and regulation are similar to the requirements of ICP 7 on corporate governance of the IAIS.
New Tools to be Available

• Exhibit M – Understanding the Corporate Governance Structure
  ► Recently included in the Financial Examiner’s Handbook
  ► Should be customized to the insurer being examined and utilized by the examination team to document an understanding and assessment of the corporate governance structure
  ► Enhancements made to include consideration of certain governance principles highlighted in the International Association of Insurance Supervisors Insurance Core Principles
New Tools to be Available

Included in new Model Law & Regulation (requires legislation)

• Corporate Governance Annual Reporting
  ► Discussion of significant changes from prior year
  ► General description of the organization’s corporate governance framework

• Governance Framework
  ► Description of Board of Directors and committee policies and practices
  ► Description of management policies and practices
  ► Management and oversight of critical risk areas
  ► Internal Audit Reports (insurers writing greater than $500M)
International Considerations

Future IAIS work streams could impact state based systems:

- IAIS Common Framework for the Supervision of Internationally Active Ins. Groups
- IAIS and FSB assessment and designation G-SII
- G-SIIs are one class of global systemically important financial institutions that are defined by the FSB and endorsed by G20 as:

  “institutions of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system”
International Considerations

• Group capital considerations
• Development of Basic Capital Requirements (BCR) and Higher Loss Absorbency (HLA) requirements for G-SIIIs
• Development of Insurance Capital Standard (ICS) for large internationally active insurance groups
• Routine enhancement of ICPs, standards and guidance
Other Future Changes

• Principle-Based Reserving
  ► New risk and related test procedures to consider the insurer’s preparedness for implementation of PBR

• Coordination with other Regulators
  ► Oversight of designated SIFI’s by Federal Reserve
  ► International regulators and supervisory colleges
Questions?

The Future of Financial Regulation
Get Social

#MoReg2014
@MoConsumerHQ
Disclaimer

The information provided in this presentation does not provide legal advice or interpretation and does not bind the Department in its enforcement of Missouri’s insurance laws.