



The Future of Financial Regulation

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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

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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

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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

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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

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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



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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

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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

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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

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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

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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

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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

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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

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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

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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

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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

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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

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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

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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.

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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

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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)

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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-SIIs
- 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”

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International Considerations

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

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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

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