

# Overview of U.S. Solvency Framework

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- Background
- U.S. Solvency Framework
  - Financial Requirements & Authority
  - Solvency Monitoring
  - Intervention and Receivership
  - Guaranty Funds
- Financial Regulation Standards and Accreditation
- The Future

- When did insurance regulation begin?
  - Regulatory framework for insurance has its roots in the early 1800s
  - State based rather than single regulator for the entire country

## Role of U.S. State Insurance Departments

- Every state and U.S. territory has chief government official charged for supervising insurance companies and markets
  - Most appointed by governor, but 11 states and one territory elect commissioners
  - Exert significant authority, but operate within the framework of state law and court oversight
- Key functions
  - Financial Regulation
  - Market Regulation

### Financial (Solvency) regulation

- To limit insurance companies from incurring excessive insolvency risk, in order to protect policyholders against the risk that insurers will not be able to meet their financial obligations

- Financial Requirements & Authority  
*(Laws/Regulations)*
- Solvency Monitoring
  - Financial Reporting
  - Risk-Focused Financial Analysis
  - Risk-Focused Financial Examinations
- Intervention and Receivership
- Guaranty Funds

- State insurance regulators protect policyholder's interests by requiring insurers to meet certain financial standards and to act prudently in managing their affairs
- To accomplish this task, regulators are given authority:
  - Over insurers' ability to incorporate and/or conduct business
  - Over insurers' financial reporting requirements
  - To monitor
  - To take other actions to protect policyholders' interests
- NAIC has identified 18 laws and regulations that are key in ensuring a state has sufficient authority to regulate the solvency of its traditional domestic insurers

# Financial Requirements & Authority



Capital and Surplus Requirements

Reserve Requirements

NAIC Accounting Practices and Procedures

Holding Company Systems

Risk Restrictions

Investment Restrictions and Valuation



# Financial Requirements & Authority



Examination Authority

Corrective Action & Receivership

Filings with NAIC

Reinsurance Restrictions

CPA Audits and Actuarial Opinions

Requirements for Producers, Managing General Agents

Regulatory requirements are of little value if there is no mechanism to monitor insurers' compliance with those requirements

Financial Reporting

Financial Analysis

Financial Examination

- State statute, regulation or practice mandate that insurers are required to maintain records and file annual and quarterly financial statements with regulators in accordance with statutory accounting principles (SAP)
- SAP seeks to determine an insurer's ability to satisfy its obligations at all times

# Solvency Monitoring - Financial Reporting



Annual and quarterly financial statements

Actuarial Opinion

Management Discussion & Analysis

Independent CPA Report  
(Statutory Basis)

Holding Company Registration Statement

Risk Based Capital Report

- Financial reporting requirements have expanded within the last 15 years to provide more detailed and accurate information, including:
  - Reinsurance,
  - Investment,
  - Expense, and
  - Loss reserve schedules

# Solvency Monitoring – Risk-Focused Financial Analysis



- Regulators have enhanced their solvency monitoring activities to facilitate more timely regulatory action against potentially troubled insurers
- Risk-focused financial analysis occurs every quarter on all multi-state insurers within each state
- State insurance departments prioritize the review of their domiciliary companies to ensure potentially troubled companies are reviewed promptly
- Most states also perform some analysis on non-domestic insurers operating within their state

## Other activities by analysts:

- Holding company system analysis
- Desk audits to assess prospective risks and compliance
- Review of non-financial information regarding insurance companies
- Determining regulatory courses of action regarding identified troubled insurance companies
- Evaluating and monitoring corrective plans
- Communicating results of regulatory actions
- Licensing and admissions

- All states utilize the *NAIC Financial Analysis Handbook*
- The Handbook assists regulators in performing risk-focused financial analysis of insurance companies in a consistent and uniform manner
- Provides qualitative and quantitative analysis techniques
- Prompts the analyst to conduct more in-depth analysis based upon risk factors
- Includes automated calculations for quantitative questions to increase efficiency



# Solvency Monitoring – Risk-Focused Financial Examination



- Regulators have authority to examine companies whenever they deem necessary, if the entity is licensed within its state
- Typically full-scope exams are conducted every 3 to 5 years and is based on the *NAIC Financial Condition Examiners Handbook*
- Regulators are increasing use of “target exams”, which are limited in scope
- NAIC encourages Group exams of U.S. domestics in the same holding company system to consolidate efforts and avoid duplicative and redundant examinations

# Intervention and Receivership



Preventative  
Actions

Receivership/  
Delinquency  
Proceedings

## Prevention:

- Hearing/Conferences
- Corrective plans
- Restrictions on activities
- Notice of impairment
- Cease and desist orders
- Supervision

## Receivership/Delinquency

### Proceedings:

- Seizure of Assets
- Conservation
- Rehabilitation
- Liquidation

# Intervention and Receivership

- ❑ Because of McCarren-Ferguson Act, troubled insurance companies do not go into “bankruptcy”
- ❑ Insurers are placed into receivership by the courts of the state where the company is domiciled
- ❑ Insurance Commissioner is appointed Receiver with the domiciliary state court taking jurisdiction over all matters involving the estate
- ❑ Receivers works to recover assets, oversee accounting, adjudicate and pay claims, administer the estate of the insurance company, and in some cases rehabilitate the insurer
- ❑ Receiver’s overarching goal is to maximize the value of the estate for valid claimants (e.g. policyholders, third parties, creditors, stockholders, etc.) in accordance with payment priorities specified by state law

- Fundamentally, the purpose of insolvency guaranty law is to pay an authorized insolvent insurer's covered claims, within statutory limits, to policyowners, beneficiaries, and third-party claimants
  - State guaranty laws have maximum benefits limits established by state law that can vary from state to state
  - Laws of each state spell out what types of policies are protected
- Guaranty fund will not pay any claim the insurance company would not have paid
- Most licensed insurance companies are required to be members of the state guaranty association
- Guaranty funds are typically financed by assessments on member insurers' premiums written in covered lines of business in a state subject to an annual cap

- States must have an effective system of solvency regulation in order to protect consumers. In order to have an effective system regulators need:
  - Adequate administrative authority and procedures to regulate an insurer's corporate and financial affairs
  - Necessary resources to carry out that authority
  - Effective and efficient financial analysis and examination processes in each accredited state

- Continuous refinement of state regulation to ensure efficiency and effectiveness of the Solvency Framework
  - Governance and self assessment
  - Enhanced solvency requirements and supervision
  - International communication and collaboration
- Solvency oversight is very strong, however, continued modernization efforts will provide for better communication and more consistency among supervisors

# Questions

