

Risk-Focused Financial Analysis




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Presentation Overview




- Risk-Focused Financial Analysis Overview
- Typical Duties of Financial Analysts
- Priority Based Reviews
- Use of the NAIC Financial Analysis Handbook
- Financial Analysis Working Group (FAWG)

Risk-Focused Financial Analysis Overview

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- Regulators have enhanced their solvency monitoring activities to facilitate more timely regulatory action against troubled insurers
 - Financial analysis occurs every quarter on all multi-state insurers within each state
 - States 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

Risk-Focused Financial Analysis Overview

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- Depth of the analysis will depend on the complexity and the financial strength of the insurer and the existing or potential issues and problems found during review of the financial statements
 - At a minimum the following must be analyzed:
 - Annual and quarterly financial statements
 - Actuarial opinion
 - Management's discussion and analysis
 - Audited CPA report
 - Holding company filings
 - Financial ratios

Risk-Focused Financial Analysis Overview

- Group holding company analysis is a standard part of the financial analysis process as outlined in the *NAIC's Financial Analysis Handbook*
 - Includes reviewing the upstream and downstream holding company entities (both financial or non-financial entities)
 - Understanding the structure, affiliated relationships, financial condition, management, etc.
 - Utilizing public available information, such as SEC filings, international filings, and/or requested information

Risk-Focused Financial Analysis Overview



Lead State Concept

- The concept of a lead state is used to help states coordinate regulatory activities in their review of insurance groups
- The concept of a lead state is not intended to relinquish the authority of any state, nor is it intended to increase any state's statutory authority or to put any state at a disadvantage
- It is intended to facilitate efficiencies when one or more states coordinate the regulatory processes of all states involved

Typical Duties of Financial Analysts



- Analysis of insurer and group financial and non-financial information
- Desk audits to assess prospective risks and compliance
- Review of specific insurer material transactions (e.g. acquisition, reinsurance, investment, dividends, etc.)
- Determining regulatory courses of action regarding identified troubled insurance companies
- Evaluating and monitoring corrective plans
- Communicating results of regulatory actions
- Licensing and admissions

Typical Duties of Financial Analysts



- Understanding the insurance industry
- Understanding historical causes of insolvency
- Develop early warning systems, analytical tools and benchmarks
- Communicate with other regulators on an on-going basis
- Meet regularly with management
- Researching issues, industry topics, etc.
- Following-up on exam findings

Typical Duties of Financial Analysts



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

■ Examiner

- Identifies risk by reviewing business processes
- Utilizes control & detail tests to identify solvency concerns and findings

■ Analyst

- Identifies risk by reviewing reported financial results
- Utilizes analytical review, (ratio analysis, benchmarking, inquiry) to identify solvency concerns and compliance

Typical Duties of Financial Analysts



Example: Investments

- Off-site analysis can monitor balance and composition of portfolio, benchmark the company's investments against competitors and gather information from the insurer to explain significant changes
- On-site examination can evaluate the process in place at the insurer to monitor investment performance and reporting by testing the underlying transactions, reviewing reconciliations, obtaining confirmations, etc.

Priority-Based Review



- Financial analysis procedures are priority based to ensure that potential problem companies are reviewed first and promptly
- State prioritization schemes utilize appropriate factors as guidelines to assist in the consistent determination of priority designations
- Justification for priority and any change in priority is documented each quarter
- Change in priority ranking should be approved by the appropriate supervisor

Priority-Based Review



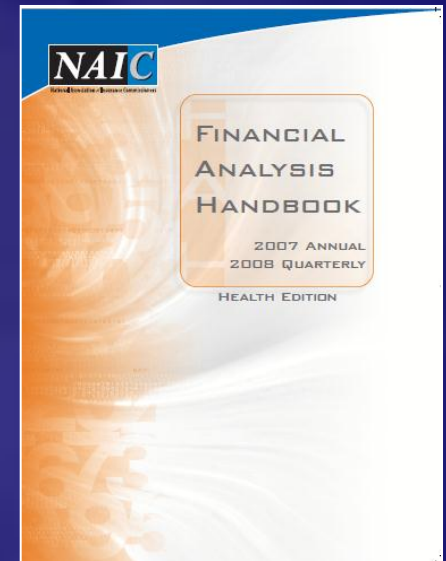
■ Timing of Analysis

Assuming a March 1st financial statement deadline, priority insurers should have their annual review performed by the end of April and the non-priority insurers completed by the end of June

The date by which the Department should finish its analysis of the annual statements depends in part upon the size and complexity of the domestic industry


Use of the NAIC *Financial Analysis Handbook*

- All states utilize the Handbook
- Purpose is to assist regulators in performing risk- focused financial analysis of insurance companies in a consistent and uniform manner
- Provides a uniform means for 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



Use of the NAIC

Financial Analysis Handbook

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- Developed by the Financial Analysis Handbook Working Group (FAHWG)
 - Property and Life - Pilot Programs - 1995 and 1996
 - Property and Life - Annual Release - February 1997
 - Life and Property - Quarterly Release - May 1998
 - Health – Developed by the Health Entities Working Group and Adopted in 2003
 - Updated every year

Use of the NAIC

Financial Analysis Handbook



- 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

Use of the NAIC *Financial Analysis Handbook*



Analyst Reference Guide

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

Use of the NAIC

Financial Analysis Handbook




Level 1 Procedures

- Consists of an overall analysis of the insurer and its operations
- At the conclusion of the Level 1, the analyst must determine whether the extent and areas, if any, for which Level 2 procedures may be necessary
 - Are there any prospective risks, unresolved risks or sophisticated activity as a result of the completion of the Level 1?

Use of the NAIC

Financial Analysis Handbook



Level 1 Procedures

- 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 Interrogatories, etc.
- Assessment of Latest Examination Report and Results

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Financial Analysis Handbook



Level 1 Procedures - Continued

- Assessment of Results from Prioritization and Analytical Tools
- Assessment of Supplemental Filings
- Recommendation for Further Analysis
- Summary and Conclusion
 - Conclude after completion of all Level 1, 2s and Supplemental procedures, if applicable
- Correspondence
 - Documentation of any follow-up

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Financial Analysis Handbook



Level 2 Procedures

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

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Financial Analysis Handbook



Supplemental Procedures

- Management Considerations
- Audited Financial Report
- Statement of Actuarial Opinion
- Management's Discussion and Analysis
- Holding Company Analysis
 - Form A – Statement of Acquisition of Control of or Merger with a Domestic Insurer
 - Form B – Holding Company System Annual Registration Statement
 - Form D – Prior Notice of a Transaction
 - Form E – Or other required information
 - Extraordinary dividend distributions
- Captives and/or Insurers Filing on a US GAAP Basis

Financial Reports

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10391 American Centennial Ins Co
10819 American Equity Specialty Ins Co
10903 American Excess Ins Exchange RRG
10386 American Family Ins Co
10864 American Freedom Ins Co
10256 American Home Shield Of OH Inc
10710 American Intl Ins Co Of NJ
11583 American Life Ins Co
10805 American Pacific Ins Co Inc
10536 American Ridge Ins Co
11129 American Skyline Ins Co Inc
10235 American Southern Ins Co
10387 American Standard Ins Co Of OH
10707 American Star Ins Co
10872 American Strategic Ins Corp
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- ☐ [A-Chapter 0 Level 1 Procedures Checklist](#)
- ☐ [B-Chapter 1 Investments \(see CMO link above\)](#)
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- ☐ [C Qtr 1-Chapter 8 Financial Examination](#)
- ☐ [C Qtr 1-Chapter 9 Overall Conclusion](#)
- ☐ [C Qtr 2-Chapter 0 Level 1 Quarterly Procedures Checklist](#)
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FAH - Level 1 Procedures Checklist

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Cocode: 10730

FEIN: 36-4335932

Year: 2003

Status: Active (Z)

Statement Type: P&C

Group Code: N/A

Group Name: N/A

Date: 03/20/2004

Domicile: Illinois

Nationally Significant - 2003: N

RBC Ratio - 2003: 199.6%

Section: Level 1 Procedures Checklist

Chapter: 0

Report: Complete Report

Question Number	Question RowDescription	Yes No	Item Results	Line No.	Item Amount
1.	Review the analysis performed on the insurer in the prior year.				
a.	Was the insurer designated a priority by the state or the Analyst Team as of the last review? If yes, indicate the state's priority designation _____; and, indicate the Analyst Team validated level _____.				
b.	Provide an explanation in the comment section for any concerns or problems noted as a result of the analysis performed in the prior year.				
2.	Review the Annual Statement Jurat Page (page 1).				
a.	Did the insurer fail to properly execute and notarize the Jurat Page?				
b.	Has there been a change in officers, directors or trustees since the previous Annual Statement was filed (indicated by a "#" after the name of the officer, director or trustee)? If yes, indicate the positions in which the changes have occurred.				
	President _____ Yes _____ No				
	Secretary _____ Yes _____ No				
	Treasurer _____ Yes _____ No				
	Vice Presidents (number: _____) _____ Yes _____ No				
	Directors or Trustees (number: _____) _____ Yes _____ No				

Financial Analysis Working Group



FAWG Mission

- ✘ Identify nationally significant insurers and groups that exhibit characteristics of trending towards or being financially troubled and determine if appropriate action and communication is being taken
- ✘ 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)
- ✘ Encourages, promotes and supports coordinated multi-state efforts in addressing solvency problems, and assists in sharing information between states

Financial Analysis Working Group



- For over a decade state insurance financial regulators have shared information and ideas by informal means through the NAIC Financial Analysis Working Group
- This Working Group creates a forum for state insurance regulators to identify, discuss and monitor potentially troubled insurers that are of national significance
- The Working Group meets on a routine basis with the intent of adding further strength to the states' financial monitoring system
- Although the insurers typically identified by the Working Group have already been identified by the respective states as being potentially troubled, the Working Group enhances the states' process by sharing ideas, experience and strategies on how to assist the state of domicile

Questions from Audience

