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Enterprise Risk Management And Own Risk And Solvency Assessment - New York Regulation 203

Last week, Superintendent Benjamin M. Lawsky of the New York Division of Financial Services posted on the Division's website proposed regulations governing enterprise risk management ("ERM") and own risk solvency assessment ("ORSA"). Public comment is open through March 8.

ORSA As A Function Of ERM

The proposal defined "enterprise risk" consistent with the New York Insurance Holding Company Act (Insurance Law §§1501A7, 1604B2 or 1702(f)) with respect to an insurer which is part of a holding company system. With respect to an insurer that is not a member of a holding company system, "enterprise risk" is defined to mean:

Any activity, circumstance, event or series of events involving the insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer, including anything that would cause the insurer's risk-based capital to fall into company action level as set forth in Insurance Law §§1322 or 1324, or would cause further transaction of business to be hazardous to the insurer's policyholders or creditors or the public.

Section 82.2 of the regulatory proposal and Insurance Law §§1503B, 1604B and 1717B¹

¹ These sections of the New York law regulating insurance holding company systems were amended on July 31, 2013 to require insurance holding companies, domestic property-casualty insurers and parent companies of domestic life insurers to adopt formal enterprise risk management

require that domestic insurers adopt a formal ERM function that identifies, assesses, monitors and manages enterprise risk. An insurer not a member of a holding company system must also adopt a formal ERM function which, at a minimum:

- is directed by an appropriately experienced individual with requisite authority and access to the board of directors and senior management;
- includes a written risk policy adopted by the respective boards of insurers within the holding company system that delineates risk/reward framework, risk tolerance and risk limits;
- identifies a measurement of risk under a sufficiently wide range of outcomes using techniques that are appropriate to the nature, scale and complexity of the risks the insurer's holding company, Article 16² or Article 17³ system bears and that are adequate for capital management and solvency purposes;
- has a process of risk identification and measurement supported by documentation

("ERM") functions and to file ERM Reports annually with the Superintendent by April 30. These amendments became effective 90 days after July 31, or on October 29, 2013, and were intended to track amendments to the NAIC Model Insurance Holding Company System Regulatory Act and Regulation implemented in 2010 as part of the NAIC's "Solvency Modernization Initiative." The NAIC is currently considering which elements of the NAIC Model Holding Company Act Amendment states will be required to adopt in order to maintain their NAIC accreditation.

² "Article 16 system" means an authorized domestic insurer registered or required to register under New York Insurance Law Article 16 and all of the insurer's subsidiaries.

³ "Article 17 system" means a parent corporation registered or required to register under Insurance Law Article 17 and all of the parent corporation's subsidiaries.

■ **Like the NAIC's Model ORSA Act, the entity is required to file electronically an ERM Report with the Superintendent of the Division of Financial Services by April 30th of each year which identifies material risks within the holding company system.**

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providing appropriately detailed descriptions and explanations of the risks identified, measurement approaches used, key assumptions made and outcomes of any plausible adverse scenarios that were run;

- utilizes prospective solvency assessments, including scenario analysis and stress testing;
- incorporates risk tolerance levels and limits in the policies and procedures, business strategy, and day-to-day strategic decision-making processes;
- considers a risk and capital management process to monitor the level of financial resources relative to economic capital and regulatory capital requirements;
- incorporates investment policy, asset-liability management policy, effective controls on internal models, long-term contingency analysis and feedback loops to update and improve the ERM function continuously;
- addresses all reasonably foreseeable and relevant material risks, including, as applicable, insurance, underwriting, asset-liability matching, credit, market, operational, reputational, liquidity and other significant risks;
- includes an assessment that identifies the relationship between risk management and the level and quality of financial resources necessary as determined with both quantitative and qualitative matrixes; and
- identifies, quantifies and manages any risks to which the insurer may be exposed by transactions or affiliations with any member of its holding company, Article 16 or Article 17 system of which the insurer is a member.

The Summary Report

Like the NAIC's Model ORSA Act, the entity is required to file electronically an ERM Report with the Superintendent of the Division of Financial Services by April 30th of each year which identifies material risks within the holding company system. The Report must be executed by the domestic insurer's chief risk officer or other executive having responsibility for oversight of ERM functions, attesting to the best of his or her knowledge and belief that the Report identifies material risks within the domestic insurer that could pose enterprise risk to its domestic insurer(s). A domestic insurer that is not a member of a holding company, Article 16 or Article 17 system and has direct written premium and unaffiliated assumed premium, including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and the Federal Flood Program, equal to or greater than \$500 Million, shall also file electronically an ERM Report with the Superintendent by April 30th.

The assessment called for by the regulations must be consistent with the process set forth in the NAIC's ORSA Guidance Manual, and a domestic insurer must conduct an ORSA any time there is significant change to its risk profile, but no less than annually.

Exemptions

Domestic insurers individually are exempt from ORSA if they have:

- Annual direct written and unaffiliated assumed premium, including international direct and assumed premium, but excluding

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premiums reinsured with the Federal Crop Insurance and Federal Flood Insurance Program of less than \$500 Million; and

- A domestic insurer who is a member of a holding company, Article 16 or Article 17 system and has annual direct written and unaffiliated assumed premium, including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and the Federal Flood Insurance Program of less than \$1 Billion.

Importantly, if a domestic insurer qualifies for an exemption but the holding company, Article 16 or Article 17 system of which the domestic insurer is a member does not so qualify, then the ORSA Summary Report for the holding company system shall include every insurer within the holding company, Article 16 or Article 17 system. The domestic insurer may satisfy this requirement by submitting more than one ORSA Summary Report for any combination of insurers, provided that any combination of Reports includes every insurer within the holding company, Article 16 or Article 17 system. On the other hand, if the domestic insurer does not qualify for an exemption, but the holding company, Article 16 or Article 17 system of which the domestic insurer is a member does qualify, then the ORSA Summary Report shall include only that domestic insurer.

Waivers

A domestic insurer that does not qualify for an exemption may nonetheless apply to the Superintendent for a waiver from the filing requirements based upon unique circumstances. The Superintendent has discretion to grant such a waiver request based upon such considerations as the type and volume of business written, ownership and organizational structure, and any other factor the Superintendent considers relevant to the domestic insurer or holding company, Article 16 or Article 17 system of which the domestic insurer is a member. If the domestic insurer is a part of a holding company, Article 16 or Article 17 system with insurers domiciled in more than one jurisdiction, the Superintendent may consult with the head insurance regulators of the other states in considering whether or not to grant the domestic insurer's request for waiver. All exemption requests must be made at least 30 days before the insurer or entity is required to submit a report to the Superintendent. The contents of the exemption request are quite detailed and are set forth in the proposed regulations at §82.4(b). ■

For more information about any of the topics covered in this issue of the Insurance Law Alert, please contact:

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