

Is Your Pool Financially Solid?

NLC-RISC Staff Conference

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- ▶ Main Categories of Risk
- ▶ Approaches to Measuring Pool's Solvency
- ▶ Case Study #1: Risk-based Capital
- ▶ Case Study #2: Analyzing Financial Ratios
- ▶ Case Study #3: Capital Model

Agenda

Major Risk Categories for Insurance Organizations

- ▶ Asset Risk
 - ▶ Fixed Income
 - ▶ Equity
 - ▶ Credit Risk
- ▶ Underwriting Risk - Reserves
- ▶ Underwriting Risk - Written Premium
- ▶ Operational Risk

What approaches can you utilize to measure your pool's financial strength?

Less Sophisticated

More Sophisticated



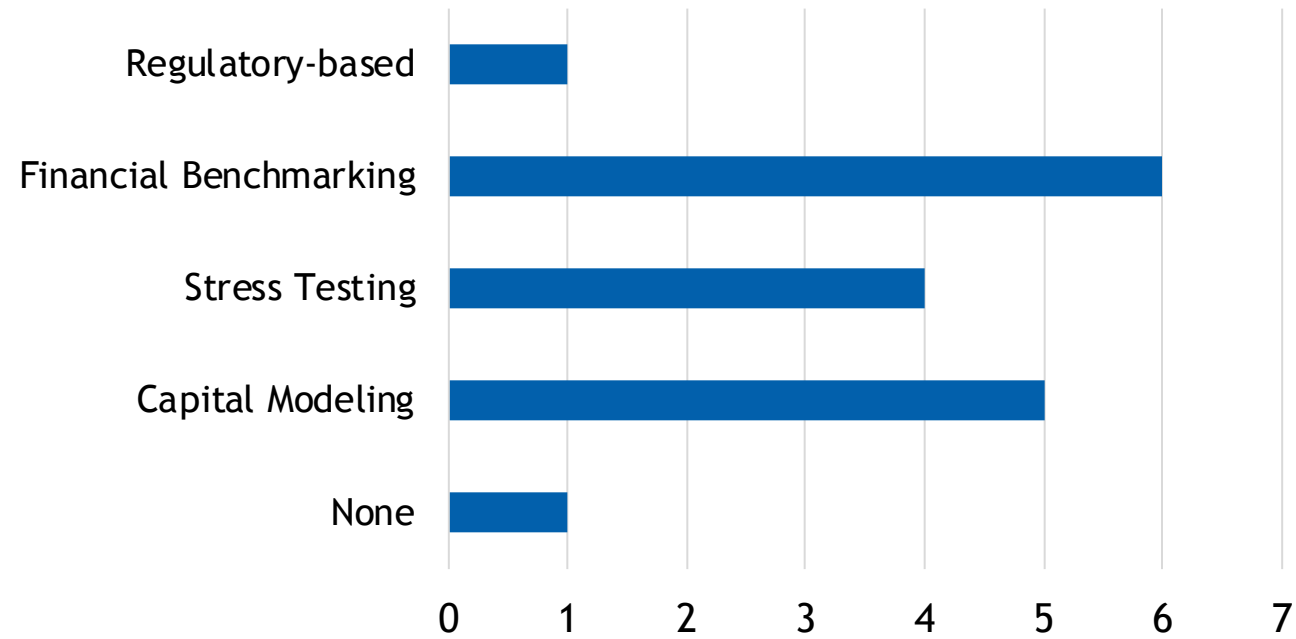
Regulatory-Based
Approaches

Financial
Benchmarking

Stress Testing

Capital Model

Survey question: Which of these tools does your pool use in determining “Target Equity” (10 respondents)?



RBC: Strengths and Weaknesses

- ▶ Strengths
 - ▶ Readily available
 - ▶ Objective
 - ▶ Already recognized by regulators
- ▶ Weaknesses
 - ▶ Not intended for determining “optimal capital position,” was developed for determining “minimum level” of capital to prevent insolvencies
 - ▶ One-size-fits-all (i.e., does not recognize important differences across companies’ overall portfolios)
 - ▶ Counter-intuitive (e.g., company’s capital requirement is partially dependent on business cycle and industry results)

Financial Benchmarking and Stress Testing: Strengths and Weaknesses

- ▶ Strengths
 - ▶ More relevant to company's portfolio than RBC
 - ▶ Identifies major risks and quantitative analysis
 - ▶ Financial benchmarking utilizes ratios based on financial statement
 - ▶ Stress testing quantifies severity for a handful of potential risk events
 - ▶ Less effort than building full-fledged capital model
 - ▶ Easily communicated to company stakeholders
- ▶ Weaknesses
 - ▶ May not be sufficient for regulatory agencies
 - ▶ Not as thorough as capital model

Capital Model: Strengths and Weaknesses

- ▶ Strengths
 - ▶ Most holistic approach, both in terms of incorporating company's entire operation and simulating wide potential range of economic / insurance scenarios
 - ▶ Allows quantification of capital needs to various percentiles (99th, 99.5th)
 - ▶ Links best practices in stochastic reserving to capital modeling
 - ▶ Provides independent review from industry expert
- ▶ Weaknesses
 - ▶ Time and cost
 - ▶ Appearance of “black box” by key stakeholders