Is Your Pool Financially Solid?

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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
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

Regulatory-Based Approaches
Financial Benchmarking

More Sophisticated

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

- Regulatory-based
- Financial Benchmarking
- Stress Testing
- Capital Modeling
- None

Bar chart showing the distribution of responses.
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