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Supervisory Colleges: Considerations for the Financial Examiner and Adding Value

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Overview of the Supervisory College Process

The current insurance marketplace crosses multiple borders which has fueled the creation of multinational insurance holding companies. As a result, the increased utilization of Supervisory Colleges for group supervision has become more critical.

The International Association of Insurance Supervisors (IAIS) defines a supervisory college as "A forum for cooperation and communication between the involved supervisors established for the fundamental purpose of facilitating the effectiveness of supervision of entities which belong to an insurance group; facilitating both the supervision of the group as a whole on a group-wide basis and improving the legal entity supervision of the entities within the insurance group. (Source: http://www.iaisweb.org)

The NAIC supports the increased use of Supervisory Colleges and has developed a web-based request form that allows for international regulators to be able to request the participation of domestic insurance departments. Additionally, the NAIC has created a Supervisory Tracking document to monitor the activity of Supervisory Colleges. (Source: http://www.naic.org)

One of the challenges that domestic insurance departments face today is the coordination of activities with other insurance departments within the U.S. for domestic insurance holding companies. Add in foreign regulators, and now the issue is further magnified. The supervision of large multinational insurance groups requires more than just local supervision of the domestic entities within the group. Supervisory Colleges are an avenue in which information can be shared with multiple parties on a coordinated basis.

For anyone who is new to Supervisory Colleges, a great reference that covers multiple aspects of the Supervisory Colleges is the IAIS Insurance Core Principles (ICP) 25, "Supervisory Cooperation and Coordination." Throughout ICP 25, you will notice two key terms referenced the majority of the time—cooperate and coordinate. Simply put, without either one, Supervisory Colleges will not be nearly as effective.

According to ICP 25.1.13, the primary purpose of a Supervisory College is to discuss supervisory issues and exchange information that is relevant to a group focusing on the following:

- Agree on the cooperation and coordination process including the planning and setting of procedures for supervisory cooperation during emergency situations;
- Produce an overview of the group, setting out its formal and operational structure;

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- Carry out a risk analysis on a group-wide basis, identifying the most relevant entities and the most important relationships in the group;
- Discuss issues supervisors have found within the entities they supervise that they believe could be systemic throughout the group;
- Where practicable, agree on areas of supervisory work to avoid unnecessary duplication; possible joint inspections could also be decided;
- Agree on the information supervisors should gather from the group and exchange with other members of the supervisory college, including the form and the frequency with which this happens; and
- Agree on whether the Supervisory College should set out any arrangements in respect of group-wide supervision in written form (bilateral or multilateral agreements).

Effective communication among regulators is the key to a successful Supervisory College because without this level of communication, the focus items mentioned above may result in ineffective supervision. The chairman of the Supervisory College has a major role to play in the Supervisory College since he/she is responsible for proposing the agenda for the meetings (ICP 25.4.11) that incorporates the views and opinions of other members. In order to achieve this task, the chairman needs to communicate with the other members to find out what their concerns are in relation to the group. ICP 25.4.12 indicates that "Supervisory College meetings should be planned with clarity of the outcomes that are being sought and, based on this, should clearly record the outcomes that are achieved". Without adequate and effective planning and communication, the outcome may be more heaving weighted toward that of the organizer.

Supervisory College meetings should function to allow members of the Supervisory College to fully understand the major risks to which the group is subject (ICP 25.5.1). According to ICP 25.6.15, the key functions of a Supervisory College includes a supervisory review of the group's own risk and solvency assessment (ORSA), transparency of the group structure and suitability of the group's senior management and its independent board of directors. The review may also cover capital adequacy, large intra-group transactions and exposures, corporate governance (including risk management and internal controls), group crisis management arrangements and review of the effectiveness of these functions. It is also important to have a group-wide understanding of how key management decisions are vetted and agreed upon and how enterprise risk management (ERM) frameworks and internal models are established and operated to complement legal entity level supervision of the entities within the group (ICP 25.6.20). Domestic insurance

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regulators can provide a significant amount of subject matter as a result of the output from risk focused examinations. Prospective and financial reporting risk summaries (e.g., "dashboard" reports) and corporate governance assessments are some materials that can have been shared prior to or during the Supervisory College meeting to provide foreign regulators greater insight into the group's management and operations. Going forward, Company ORSA and Form F (ERM) filings, or excerpts thereof, will also be an excellent resource for Supervisory College discussions.

Trust is another critical aspect of a successful Supervisory College. According to ICP 25.5.18, each member is expected to make every reasonable effort to cooperate and coordinate in a spirit of mutual trust to ensure the protection of confidential information shared and to avoid unwarranted supervisory duplication and unnecessary supervisory burden for both the insurers and members involved. If proper communication occurs, there should be no trust issues as any areas of concern should be vetted prior to the meetings. As information is shared and exchanged in a secure and controlled environment, it both requires and encourages mutual trust (ICP 25.6.17).

Insurance company management is invited to the open sessions of the Supervisory College meetings which provide the Supervisory College members an opportunity to discuss any group level concerns with management directly (ICP 25.6.24). This forum allows management to speak directly about the company's business strategy, changes in senior officers, ERM, etc., at a group-wide level. It is up to the members of the Supervisory College to make the most of each meeting which means asking the companies to provide specific details regarding the areas that are critical to the concerns of the members. In some Supervisory College meetings, the companies have come in and presented the same (or similar) information that is shared with the rating agencies or provided to the SEC regarding financial information. Although this type of information can be great information to obtain, Supervisory Colleges should be utilized to get the critical information directly from the companies, including information about significant and emerging prospective risks, the company's corporate governance environment, and its "tone at the top." The agendas should be structured to allow for the proper information (both the right material and the right level of detail) to be shared by the company's senior management. Domestic regulators can play a key role in developing the agenda for the companies considering the key reports/documents that are vetted during the risk-focused examinations. Communication with the chairman of the Supervisory College is important to provide for the knowledge transfer to allow for the company's management to be adequately prepared for the meetings.

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As an example, an insurer that is the subject of the meeting could present its most significant or "top risk" listing, which is a consolidated view of risk derived from various risk assessments and other assurance activities. This is great high level information to receive; however, in some cases a deeper dive is necessary to fully understand the information contained in the risk report. The domestic regulator, as a result of a recent risk-focused examination, would know the names of the key reports to provide for a deeper dive into each of the areas referenced in the risk listing. As a result, this insider knowledge could foster deeper conversations with management regarding issues or risk areas within the group. A domestic regulator also would have an indication as to which risks on the top risk listing may not be as critical to regulators, allowing for the majority of the time with the company's management to be more focused solely on the risks or areas of concern identified by the members of the Supervisory College. Simply put, this type of knowledge and planning will help steer the meeting toward the highest areas of interest for the regulators.

Preparing for a Supervisory College—How the Examiner Can Assist

If a Supervisory College is occurring during or shortly after the examination, examiners may be called upon to assist in the preparation of documents for the Supervisory College. As mentioned above, prospective risk summaries/ dashboards and corporate governance assessments are a great place to start. If you have significant findings or exam adjustments, these are something the participants might be interested in. Other key documents that may be helpful would be key reports that management uses to manage/ monitor prospective and/or key financial risks, the Company's strategic plan, a listing of what the Company considers to be its key risks, etc. As Form F (ERM) and ORSA become commonly used regulatory tools it is expected that they will play a key role in Supervisory College discussions as well.

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When preparing these documents, it is important to understand who the audience will be and the stature of the company as part of the group as a whole, and then prepare materials accordingly. If the company you have examined is one of the lead companies in the group, you may want to prepare significant amounts of information and supporting documentation; however, if the company is immaterial to the group as a whole you may want to contain your documentation to high level critical information.

Another thing you may be asked to do to prepare for a Supervisory College is to host an examiner from one of the countries involved in the group supervision. This occurred on one of the exams that we were working on shortly before the Supervisory College. The examiner joined us on the exam, and we walked him through the prospective and financial reporting risk matrices, the corporate governance assessment, the Company's ERM results, our exam approach, etc. This helped him better understand the risks facing the Company under examination, and allowed him to better understand the risk-focused examination methodology.

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Utilizing Information Obtained from a Supervisory College in the Exam

Perhaps the Supervisory College will occur either shortly before, or during, your examination. If that is the case, even if you do not attend the Supervisory College personally, you should obtain information that was distributed in the Supervisory College for consideration in your exam. This information should be reviewed, along with the rest of the documents considered in Phase 1 to identify significant risks facing the Company, including key risks at the holding company level which may present risk to the Company under examination. If the Supervisory College occurs in the middle of the exam, the examiner should consider risks identified, and modify examination planning as necessary.

Conclusion

Preparing for the Supervisory College is just as important as conducting the meeting itself. Without proper preparation for the Supervisory College, the risk exists that it may become “just another meeting” (similar to when companies visit the insurance department periodically). In this were to occur, there may be a significant missed opportunity to truly accomplish the objectives of a Supervisory College. Instead, if all of the members of a Supervisory College take to heart the two key terms mentioned throughout ICP 25—cooperate and coordinate—then the Supervisory College meetings will be beneficial to all of the parties involved and will contribute in a much more meaningful capacity to effective group supervision and an effective risk surveillance process.

About the Authors

Shawn Towchik is a Director at Risk & Regulatory Consulting, LLC (RRC) and holds the CFE designation. He is a member of the SOFE Board of Governors and has been a member of the SOFE Professional Standards Committee for the past two years. Shawn has over 13 years of experience in insurance regulation of which 7.5 years was spent as a Financial Examiner for the Texas Department of Insurance.

Jan Moenck, a Partner in Risk & Regulatory Consulting’s (RRC) Minneapolis, Minnesota office has over 25 years of experience providing examination and internal audit services to clients in the financial services industry. For over 15 years, Jan served as the lead engagement manager working with the Minnesota office has over 25 years of experience providing examination and internal audit services to clients in the financial services industry. For over 15 years, Jan served as the lead engagement manager working with the Minnesota Department of Commerce, Insurance Division (Minnesota) by providing co-sourced financial examination services.

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Jan assisted Minnesota in the development and deployment of its risk-focused examination process and has served as the Examiner in Charge on risk-focused financial examinations for over twelve years. Jan has also provided hands-on and classroom training on risk-based examination techniques to several states, the Society of Financial Examiners (SOFE), and RRC employees.

LeeAnne Creevy, a Partner in Risk & Regulatory Consulting's (RRC) Hartford, Connecticut office, has over 18 years of professional experience. LeeAnne has participated in leadership roles on a number of risk-focused financial and information technology (IT) examinations as well as operational/internal controls reviews. This experience includes serving as a subject matter resource on several large insurance company risk-focused examinations related to the assessment of corporate governance, enterprise risk management (ERM) and internal audit functions, and risks and controls documentation. LeeAnne has also helped to lead the RRC team's development and enhancement of risk-focused examination methodology, including developing a "toolkit" with practical "hands on" guidance and resources. In addition, LeeAnne leads RRC's team of IT resources dedicated to insurance regulatory examinations and has led the team in developing methodology and approaches on IT risk-focused examinations.