

Update

New York Circular Letter No. 14 (2011) Insurer Heal Thy Self – Risk Management But It's Enterprise Risk This Time

The New York Insurance Department of the Department of Financial Services (“DFS”) issued Circular Letter No. 14 (2011) on December 19, 2011. The Circular Letter encourages every domestic insurer and health maintenance organization¹ to adopt a formal enterprise risk management program (“ERM”) and to implement processes to “identify, measure, aggregate and manage risk exposures within predetermined tolerance levels, across all activities of the enterprise of which the insurer is a part, or at the company level when the insurer is a stand alone entity.”² The Circular Letter states that ERM is a “key component” of a company’s overall risk management responsibilities and expressed the DFS’s intention to perform evaluations of insurers’ ERM during statutory examinations and/ or standalone examinations by the DFS.

Focus

The Circular Letter does not provide focused guidelines or a clear and objective path to delineate compliant ERM. Instead, the Circular Letter broadly defines the term “enterprise risk” as “any activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurer holding company system as a whole.” That broad definition, without further direction, affords the DFS great latitude in assessing a company’s compliance with the ERM guidelines.

Minimum Guidelines

Other than the prescription that a company need have an ERM program, at a minimum the DFS expects insurers to have:

- An experienced individual with the requisite authority and access to the board of directors and senior management;
- An ERM unit that is adequately resourced and has competent personnel who are able to provide the insurer’s board of directors and management with ongoing assessments of the insurer’s risk profile;
- A written risk policy that delineates the insurer’s risk/reward framework, risk tolerance levels, and risk limits; and,
- A process of risk identification and quantification supported by documentation providing appropriately detailed descriptions and explanations of risks identified, the measurement approaches used, key assumptions made, and outcomes of any plausible adverse scenarios that were run.

Insurers also must

- Consider a risk and capital management process to monitor the level of its financial resources relative to its economic capital and the regulatory capital requirements, incorporating its investment policy, asset-liability management policy, effective controls on internal models, and other analysis;
- Assess “all reasonably foreseeable and relevant material risks,” including, insurance; underwriting; asset-liability matching; credit; market; operational; reputational; liquidity;
- Integrate, where appropriate, an insurer’s board of directors and senior management’s so-called ORSA assessments, taking into account the insurer’s own risk and solvency assessment; and,
- Take into account holding company, consolidated enterprise, conglomerate, or other group and common control or management risks, including any risks that may result in direct financial loss to the insurer through transactional or common control ties and reputational and other risks where the loss of confidence in one member of the group may cause distress to the insurance company.

Further information

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Other Highlights

The insurer is expected to continuously revisit each of the above-mentioned risks in connection with its ongoing ERM assessments and to stay current as to requirements and market conditions that may affect or influence its ERM profile.

Since some or all of the data needed to support a company’s ERM function may be proprietary, the Circular Letter provides that an insurer may request confidential treatment from the DFS for any submissions made in connection with an ERM examination to the extent that such materials contain trade secrets or are otherwise competitively sensitive within the meaning of New York’s Freedom of Information Law.

The Circular Letter recognizes that a dedicated ERM program may be impractical or too costly for small insurers but it is not clear what the DFS means by a “small insurer.”

Conclusions

Finally, we point out that although the DFS did not issue a formal regulation, and courts have held that Circular Letters are merely advisory, lacking the force of law, this Circular Letter makes clear DFS intends to evaluate an insurer’s ERM as part of statutory examinations. It appears clear that ERM examinations will be coming for all New York insurers. So, word to the wise, the best approach is for companies to begin the preparation process now by assessing their ERM functions, memorialize those assessments and processes in a company policy manual with sufficient back-up and enforcement “teeth” to ensure compliance.

The New York Office of Clyde & Co has in-depth experience working with insurers and brokers to ensure compliance with insurance regulatory matters, including the requirements mandated by the DFS and other US insurance regulators, privacy, data safekeeping, security and breach protocols, market conduct issues, investment matters, solvency standards, ecommerce and other operational and governance issues affecting the insurance markets.

We provide strategic advice guiding our clients through emerging issues implicating life, non-life companies as well as intermediaries.

¹ As yet, the DFS has not extended ERM compliance under the Circular Letter to non-domestic insurers.

² This definition is similar to the version adopted by the National Association of Insurance Commissioners in December 2010 as part of the model Insurance Holding Company Systems Act.