Capital Adequacy for Public Entity Insurance Pools
in Light of New Actuarial Standards and COVID-19 Pandemic

There have been two events over the past nine months that are changing the way that insurance organizations approach the assessment of their capital adequacy. While you are very familiar with one of these events (COVID, COVID, COVID!), the second is significant as well, the promulgation of *Actuarial Standard of Practice #55 – Capital Adequacy Assessment* by the Enterprise Risk Management Committee of the Actuarial Standards Board.

Arising from the financial crisis of 2008/2009 (which involved large global insurance companies in addition to the financial sector), ERM increasingly became a focus of the insurance industry over the past decade.

Starting in 2012, insurance regulators began implementing the 'own risk and solvency assessment' (ORSA) process. A key feature of ORSA is that it requires a formal assessment of capital adequacy to be part of an insurer's ERM program." (*Actuarial Standard of Practice #55 – Capital Adequacy Assessment,* Actuarial Standards Board, Appendix 1).

In 2015, the National Association of Insurance Commissioners (NAIC) formally adopted the ORSA process, making it a requirement of its accreditation standards. While Risk-Based Capital (RBC) "would continue to form the backstop function for insurer solvency… state insurance regulators decided that additional capital assessments evaluating prospective solvency should be added to the system." (*Own Risk Solvency Assessment*, NAIC's Center for Insurance Policy and Research). As you recall, this has been a topic at NLC-RISC conferences and NLC Mutual board meetings the past couple of years.

Having established that "a formal assessment of capital adequacy" is now an essential requirement for insurance organizations, both world-wide and specifically by U.S. regulators, the last question to establish best practice is "what constitutes a formal assessment of capital?"

In June of 2019, the Actuarial Standards Board's ERM Committee published *Actuarial Standard of Practice #55 – Capital Adequacy Assessment (ASOP #55)* to provide guidance on this very question, including specifically calling out "rules of thumb (e.g., premium to surplus ratios)," "regulatory rules (RBC ratios)" and "deterministic stress tests" (*ASOP #55*, Appendix 1) as not satisfying the "formal assessment of capital adequacy" requirement.

If there was still any doubt prior to the COVID-19 pandemic as to whether or not your pool should undergo a periodic formal capital adequacy assessment while still relying on antiquated benchmark leverage ratios, this crisis should remove any of those lingering doubts. With its likely double hit on underwriting and investment results in 2020, and its unique impact on public entity pools, the need for a wholistic approach that is tailored to the unique risks and characteristics of each individual insurance organization has never been greater.

What should be your insurance pool's next step to ensure it is adequately capitalized? Tune in June 4 to my webinar presentation on this topic hosted by NLC-RISC, to find out! Please reach out to me to discuss this or any other topic. I can be reached at cmckenna@nlcmutual.com or 202-626-3177.