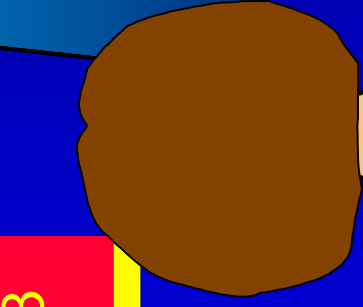


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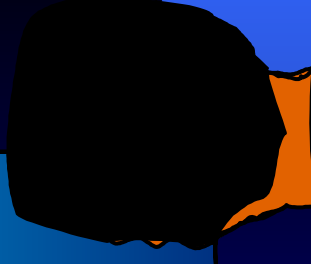
Supervisory Ladder – Overview



Lawrie



Savage & Associates Inc.



Inc.

Supervisory Ladder

Matrix approach to quantify levels of risk (i.e. Risk Profile) for companies, based on the various sources of information available to the supervisor. It is a way of developing a Risk Profile in an objective and consistent manner, incorporating the supervisor's benchmarks as to different levels of risk.

Consumer Complaint A

Ratio D

Fin'l Stmts D

Consumer Complaint C

Fin'l Stmts B

Ratio B

Inspect. Report B

Fin'l Stmts C

Inspect. Report C

2
7

Consumer Complaint B

Inspect. Report A

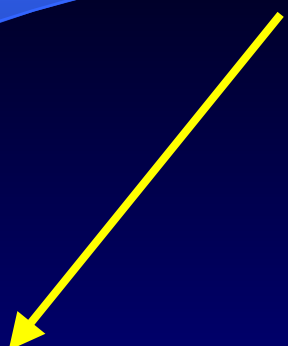
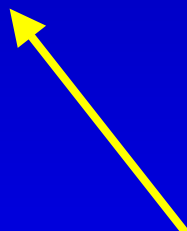
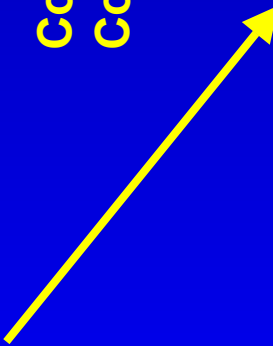
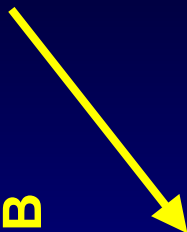
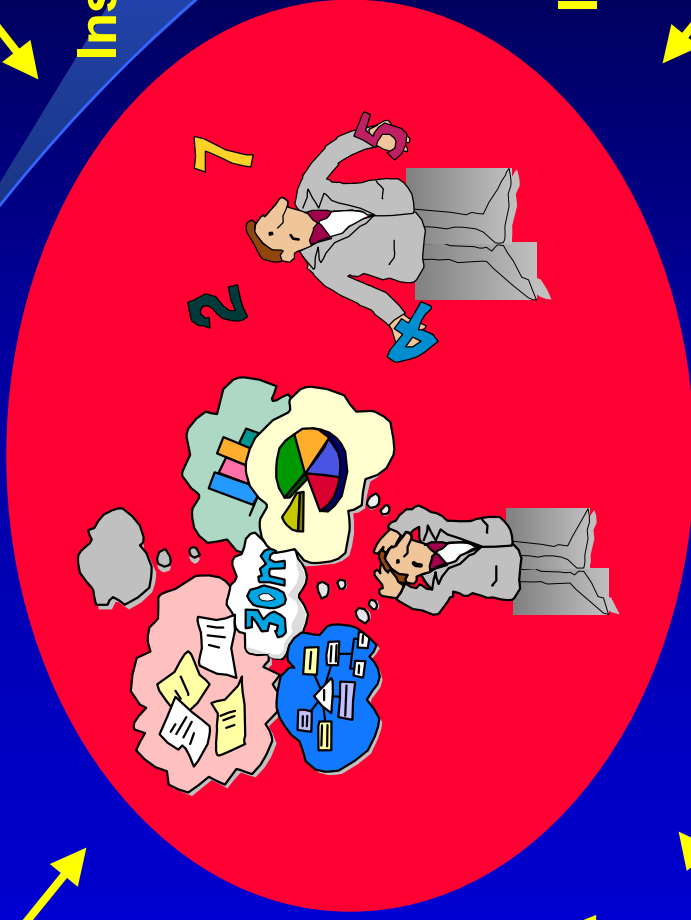
Consumer Complaint D

Fin'l Stmts A

Ratio C

Inspect. Report D

LS&A

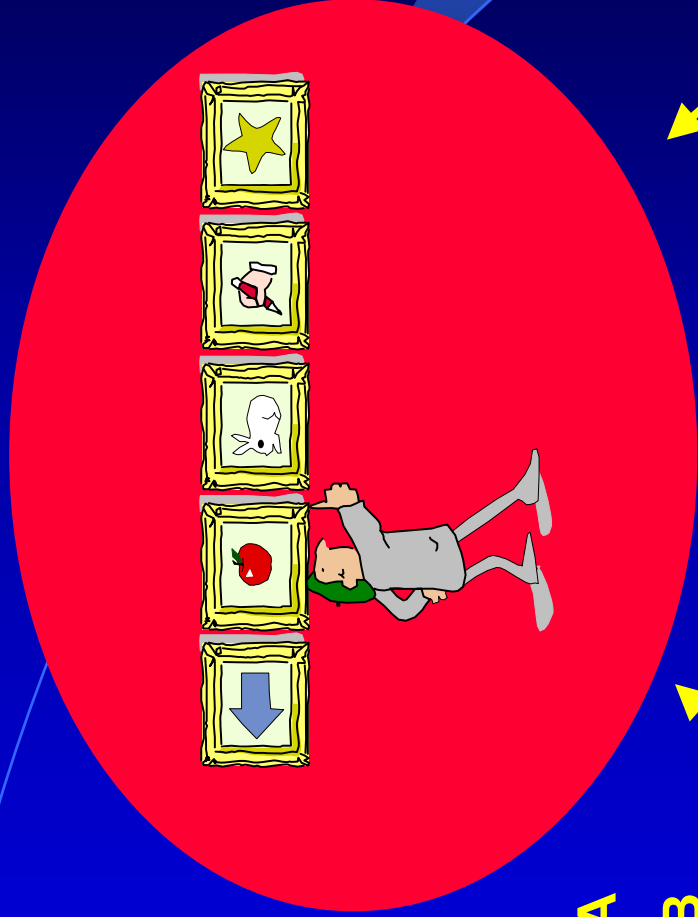


Consumer Complaint A
Consumer Complaint B
Consumer Complaint C
Consumer Complaint D

Inspect. Report A
Inspect. Report B
Inspect. Report C
Inspect. Report D

Ratio A
Ratio B
Ratio C
Ratio D

Fin'l Stmts A
Fin'l Stmts B
Fin'l Stmts C
Fin'l Stmts D



We use the Supervisory Ladder to assess the risk implications of all this information in a consistent manner.

Supervisory Ladder

Various categories of risks to be assessed

	Risk X	Risk Y	Risk Z
5.			
4.			
3.			
2.			
1.			

↑
Higher Risk

Prescribed Regulatory Responses

↑
Stronger Response

- Matrix rows represent levels of risk
- Matrix columns represent categories of risk to be assessed
- We develop a risk template by putting benchmark risks in each cell of the matrix

Possibilities for Risk Categories

Functional areas of supervision, i.e. financial analysis, on-site inspections, market intelligence . . .

In other words, we look at risks according to the same frame of reference that we use when we do our work.

So when we are doing an on-site inspection we look at risks of the type that would be apparent to use during the on-site work, such as quality of internal controls, ability to manage the business, etc.

We would also use financial analysis as a separate risk assessment area. So we would give risk assessments in this area based on performance on various financial ratio tests and so on.

Possibilities for Risk Categories

- CARMELS

CARAMELS

- Capital adequacy
- Asset quality
- Reinsurance
- Adequacy of Claims/Actuarial
- Management
- Earnings
- Liquidity
- Subsidiaries

Financial
Analysis

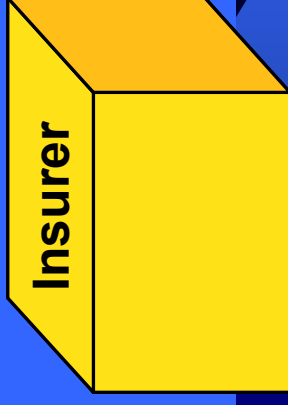
On-site
Inspections

Possibilities for Risk Categories

• Risk Areas

Framework
of Policies
Covering
Key
Risk
Areas

Board of
Directors



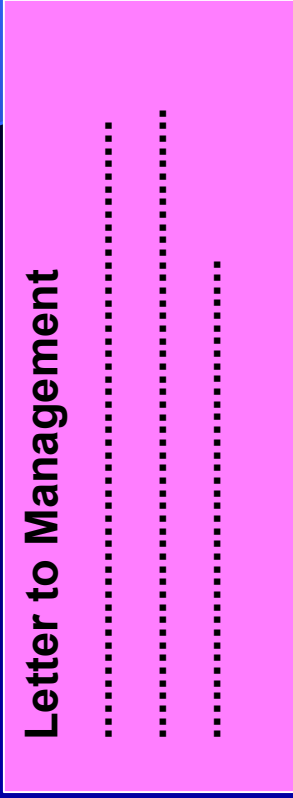
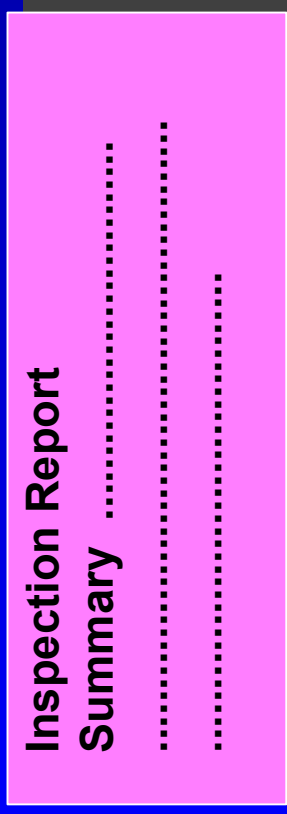
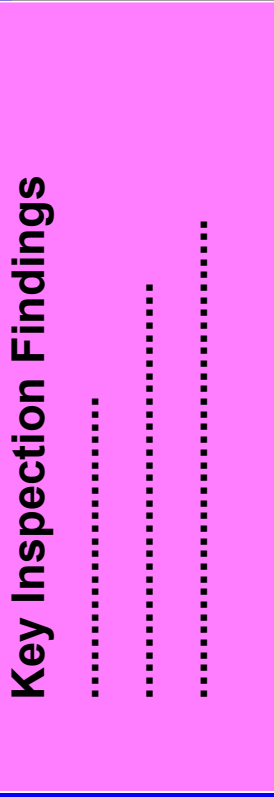
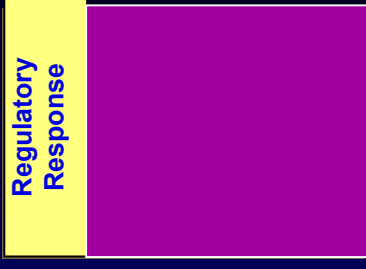
1. product design and pricing
2. underwriting management
3. claims liability management
4. reinsurance management
5. security portfolio management

6. credit risk management
7. foreign exchange risk management
8. real estate appraisals
9. liquidity management
10. capital management
11. internal controls

Supervisory Ladder

Risk Category	Financial Analysis	On-Site Examination	Actuarial Analysis
5.			
4.			
3.			
2.			
1.			

Highest risk level determines regulatory response.



Examples of Financial Analysis benchmarks that might typically be found in a company at this risk level:

Level 3

- Company outside normal ranges on 6 or more Early Warning Ratios.
- Risk ratio is in excess of 3.5 to 1.
- Highly unprofitable underwriting.
- Significant understatement of claims liabilities
- Speculative investments have harmed overall performance.
- Negative return on equity.
- Considerable reliance on reinsurance and reinsurers may be experiencing financial problems
- Management has not demonstrated ability to bring problems under control.
- Capital is close to being impaired.

Typical Steps in the Preparation and Use of the Supervisory Ladder

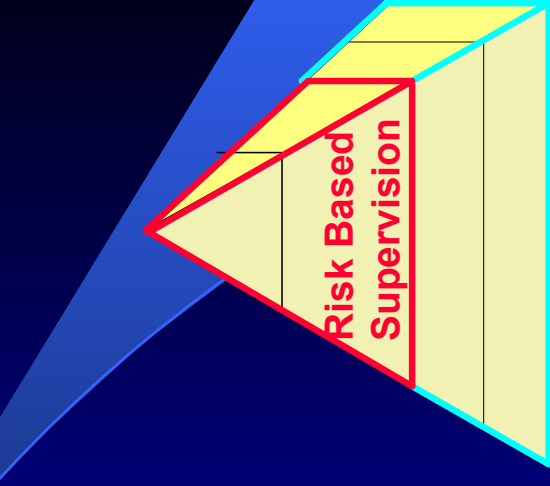
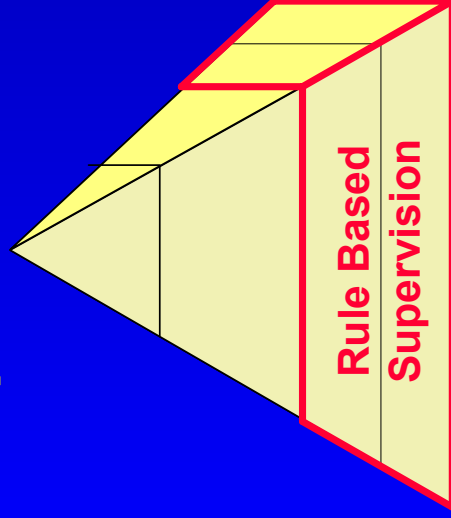
- 1. Prepare in “benchmark” format for both risk cells and supervisory response cells.**
- 2. Benchmarking requires considerable discussion to get consensus as to risk levels of various items.**
- 3. Discuss result with Minister and other government officials to get “buy in” before circulating to the industry.**
- 4. Circulate in draft form, probably simplified, to the industry for input and feedback.**
- 5. Begin using to classify the risk levels of companies and provide insurers with your risk assessments.**

Key Advantages of Risk Profile/Supervisory Ladder Approach

- 1. Consistency in evaluation of companies**
- 2. Consistency in regulatory response**
- 3. Institutions know what activities and conditions will be considered as higher risk, lower risk**
- 4. Formalization of approach so all institutions know what supervisory responses may be expected as risk level increases**
- 5. Government at political level can understand what will happen in given circumstances and provide general policy approval.**

Key Advantages of Risk Profile/Supervisory Ladder Approach

6. Use of the Supervisory Ladder helps all supervisory personnel to think in risk based terms:



Various categories of risks to be assessed

	Risk X	Risk Y	Risk Z
5.			
4.			
3.			
2.			
1.			

Use of the Risk Profile

However the Risk Profile is derived, it is the key by which the supervisor will prioritize the use supervisory resources.

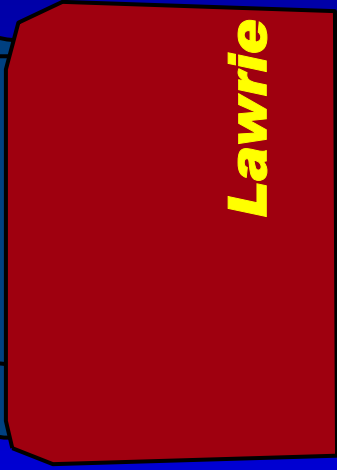
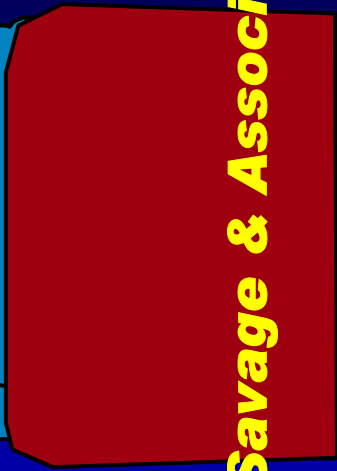
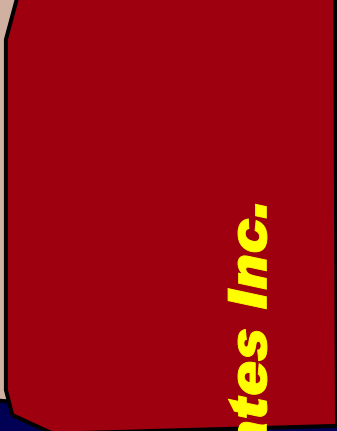
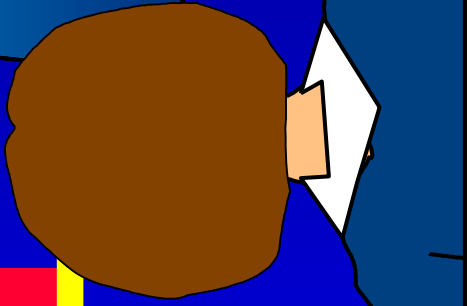
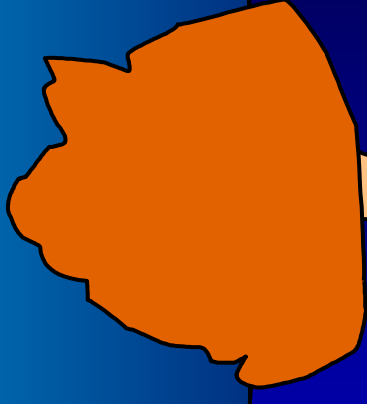
High risk companies should receive much closer attention than low risk companies.

As the degree of risk increases, so does the amount of general supervisory monitoring, frequency of visits and financial reporting, special reports by auditors and actuaries, and other focused supervisory activities.

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End of Presentation



Lawrie Savage & Associates Inc.